

Does Foreign Ownership Affect Firm Performance? The Moderating Role of Indonesia's Omnibus Law

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ABSTRACT

This study investigated the complex relationship between foreign ownership (FO) and firm performance, focusing on the moderating role of institutional reform in the context of Indonesia's Omnibus Law (Job Creation Law). While prior literature suggests that foreign investors enhance performance, the impact may be conditional upon the host country's institutional quality. This research addressed this gap by analyzing different types of foreign investors (corporate and institutional) and their interaction with large-scale regulatory changes. Using a panel dataset of 147 Indonesian manufacturing firms listed on the IDX from 2018 to 2023, resulting in 882 firm-year observations, the study employed a two-way fixed effects regression model with clustered standard errors. The results indicated that overall FO, Foreign Corporate Ownership (FCO), and Foreign Institutional Ownership (FIO) did not have a significant direct impact on firm performance (ROA, ROE, and Tobin's Q). Crucially, the Omnibus Law generally failed to strengthen the FO-performance relationship. However, a significant specific finding emerged: the interaction between FIO and the Omnibus Law negatively and significantly affects Tobin's Q. This suggests that during the implementation and transition phase of major institutional reform, highly mobile foreign institutional investors became more cautious, leading the market to assign a lower valuation to FIO-held firms. The findings support Institutional Theory, emphasizing that the effectiveness of FO in enhancing corporate performance is critically dependent on the stability and maturity of the supporting institutional

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INTRODUCTION

Foreign ownership (FO) remains a critical topic in corporate governance, particularly in emerging markets like Indonesia. The Indonesian Stock Exchange (IDX) sees foreign investors holding nearly 48.5% of the total share ownership value as of 2024, emphasizing their strategic role as market movers. This research focuses on the Indonesian manufacturing sector—a backbone of the national economy, contributing 18.98% to the GDP and being the largest recipient of Foreign Direct Investment (FDI).

The theoretical debate surrounding FO is rooted in two competing perspectives: the Agency Theory (Jensen & Meckling, 1976), which suggests FO enhances performance through superior monitoring, and the Resource-Based View (RBV), which posits that foreign capital brings valuable resources and governance practices. However, empirical evidence on the FO-performance link is highly inconsistent, with studies in various economies showing mixed results (Gupta & Mer, 2023; Hasegawa & Kuroki, 2022). This inconsistency highlights that the impact of FO is not direct but is likely conditional upon the host country's institutional environment.

Drawing on Institutional Theory (North, 1990), this study argues that the effectiveness of FO is contingent upon the stability and quality of formal institutions. Indonesia's landmark effort to streamline its investment climate through the Omnibus Law on Job Creation (Law No. 11/2020) represents a significant institutional shock. This reform aimed to simplify bureaucracy and enhance competitiveness, expecting to amplify the positive impact of foreign capital. However, the subsequent market response, including a decline in FDI during the transition phase, suggests the success of this large-scale policy is complex and its implications on corporate governance remain under-explored. This study addresses this gap and offers two main contributions:

1. It is the first to empirically test the moderating role of the Omnibus Law implementation on the relationship between FO and firm performance in Indonesian manufacturing.
2. It differentiates the analysis by separately examining Foreign Corporate Ownership (FCO) and Foreign Institutional Ownership (FIO). FIO, known for its high mobility and sensitivity to information (Douma, George, & Kabir, 2006), is expected to react distinctively to regulatory changes compared to the stable, long-term FCO.

The scope of this research is publicly listed manufacturing firms on the IDX between 2018 and 2023. The objectives are: (1) to examine the direct influence of overall FO, FCO, and FIO on firm performance; and (2) to test the moderating effect of the Omnibus Law implementation on these relationships. The methodology employs a two-way fixed effects regression model with clustered standard errors, utilizing a robust panel dataset of 147 firms resulting in 882 firm-year observations. Performance is measured using both accounting metrics (ROA and ROE) and market valuation (Tobin's Q).

The empirical results suggest that overall FO and its disaggregated components (FCO and FIO) did not exhibit a significant direct impact on firm performance metrics. Moreover, the *Omnibus Law* generally failed to strengthen the FO-performance relationship. Crucially, the analysis revealed a highly significant finding: the interaction between FIO and the *Omnibus Law* negatively and significantly affects Tobin's Q. This indicates that the market viewed highly mobile foreign institutional investors as facing increased uncertainty or risk during the post-Omnibus Law regulatory transition, leading to a lower market valuation for FIO-held firms. These findings strongly support the Institutional Theory, stressing that the effectiveness of foreign capital in enhancing firm value is critically dependent on the stability and maturity of the institutional environment.

LITERATURE REVIEW

Agency Theory and Resource-Based View (RBV)

Agency Theory (Jensen & Meckling, 1976) posits a conflict of interest between firm managers and shareholders. Foreign ownership (FO) is viewed as an effective corporate governance mechanism that

mitigates this conflict through superior monitoring. Foreign investors often possess greater expertise and incentives to enforce good corporate practices, thereby improving managerial efficiency. Complementing this, the Resource-Based View (RBV) (Barney, 1991) treats foreign shareholders as strategic assets. Their involvement facilitates the transfer of inimitable resources, such as advanced technology, global market access, and modern managerial know-how, which is crucial for competitive advantage, particularly in the manufacturing sector.

Signalling Theory

Signalling Theory (Spence, 1973) explains the market perception of FO. In markets characterized by information asymmetry, the presence of foreign investors—especially reputable international financial institutions—is perceived as a strong positive signal of the firm's quality, credibility, and growth potential (Nguyen & Rugman, 2015). This positive signal is expected to reduce market uncertainty and result in higher market valuations (e.g., higher Tobin's Q).

Institutional Theory

(North, 1990; DiMaggio & Powell, 1983) is crucial for providing the context of this study. It asserts that economic outcomes are contingent upon the quality and structure of the formal institutional environment (regulations, rule of law). The effectiveness of foreign capital in enhancing firm performance is thus maximized when the institutional framework is robust and stable. Large-scale regulatory changes, such as the Omnibus Law, are considered institutional shocks that modify the incentives and constraints faced by foreign investors.

Foreign Ownership and Firm Performance

Recent evidence from other emerging markets further highlights the conditional nature of foreign ownership benefits. For instance, studies in Vietnam and India show that foreign investors may enhance firm efficiency only when regulatory enforcement and market transparency improve, while in Brazil and other Latin American markets, foreign capital often faces institutional constraints that limit its governance impact. These cross-country findings reinforce the argument that foreign ownership effects are context-dependent

and shaped by institutional maturity, supporting the relevance of Institutional Theory in emerging market settings.

The empirical literature on the direct effect of FO on performance remains inconclusive. While numerous studies support a positive link due to improved governance and resource transfer (consistent with Agency Theory and RBV), others report an insignificant effect, often attributed to the complexity of the host country environment, political risks, or the "cherry-picking" phenomenon (where foreign investors select already high-performing firms). Given the theoretical support for a positive influence, we hypothesize that FO impacts firm performance significantly:

H_{A1}: Overall foreign ownership (FO) significantly affects the performance of manufacturing firms in Indonesia.

The Influence of Differentiated Foreign Ownership

Foreign investors are not monolithic; their objectives and engagement levels vary, leading to differentiated impacts on firm performance (Douma et al., 2006). This study separates FO into two distinct categories:

1. Foreign Corporate Ownership (FCO): These are strategic, long-term investors (multinational corporations) typically focused on vertical integration and market positioning. Their concentrated ownership provides strong incentives for active monitoring and the transfer of core technical and managerial expertise (RBV and Agency Theory).
2. Foreign Institutional Ownership (FIO): These are financial investors (pension funds, mutual funds) often characterized by high mobility and short-to-medium-term investment horizons. While they are crucial for providing positive market signals, their monitoring role is generally more passive, focusing instead on financial returns and portfolio efficiency (Shrivastav & Kalsie, 2017).

The distinct roles played by these investor types lead to the following combined hypothesis:

H_{A2}: The type of foreign investor (corporate and institutional) significantly affects the performance of manufacturing firms in Indonesia.

The Moderating Role of the Omnibus Law

The Omnibus Law on Job Creation (2020) represents a comprehensive institutional reform designed to simplify regulations, ease licensing, and create a more transparent investment climate. In the Institutional Theory framework, effective pro-investment reform is expected to reduce institutional uncertainty and transaction costs, thereby reinforcing the positive contribution of foreign ownership (Boubakri et al., 2013). By providing a more favorable regulatory landscape, the Omnibus Law should strengthen foreign investors' incentives to engage productively (e.g., risk-taking, technology investment).

However, the efficacy of this moderation is contingent on the quality of implementation. If the reform's transitional phase introduces new uncertainties or implementation inconsistencies, the expected positive synergistic effect may be negated, or even turn negative—particularly for highly sensitive investors like FIO.

Therefore, the final hypothesis tests the crucial role of this institutional reform:

H_{A3}: The implementation of the Omnibus Law significantly moderates the influence of foreign ownership on the performance of manufacturing firms in Indonesia. (This hypothesis is tested on both overall FO, FCO, and FIO.).

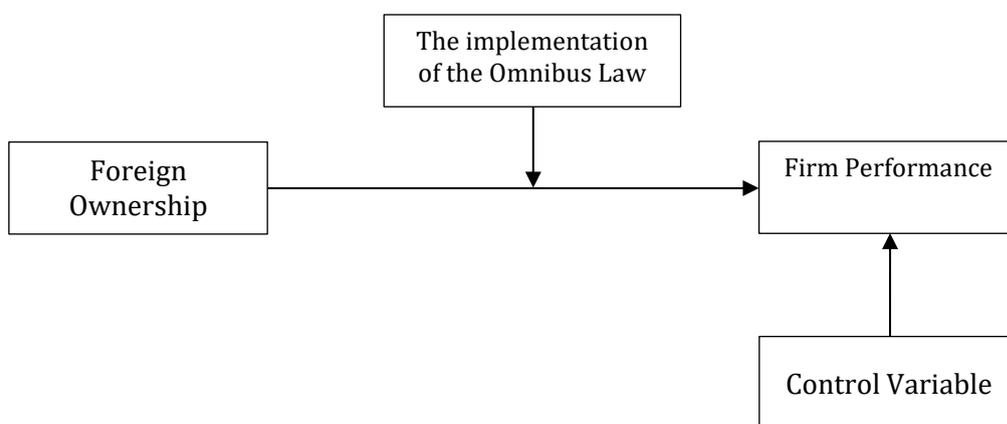


Figure 1. Research Framework

RESEARCH METHOD

The research adopted a quantitative approach using a panel dataset of manufacturing firms listed on the Indonesia Stock Exchange (IDX) spanning the period from 2018 to 2023. This period was deliberately chosen to encompass both the pre- and post-implementation phases of the Omnibus Law on Job Creation (Law No. 11/2020). Using purposive sampling, the final sample consisted of 147 firms, resulting in 882 firm-year observations. Firm performance, the dependent variable, was proxied by both accounting metrics (Return on Assets/ROA = Net Income / Total Assets; Return on Equity/ROE = Net Income / Total Equity) and market valuation (Tobin's Q = (Market Value of Equity + Market Value of Liabilities) / Book Value of Assets). The main independent variable, Foreign Ownership (FO), was measured as the percentage of shares held by foreign entities (Total Foreign

Shares / Total Shares Outstanding). FO was further disaggregated into Foreign Corporate Ownership (FCO) and Foreign Institutional Ownership (FIO) based on the type of foreign investor. The institutional shock, the Omnibus Law, was modeled as a dummy variable (OL), taking the value of 1 for the post-reform years (2021–2023) and 0 for the pre-reform period (2018–2020), based on the assumption that policy impact began significantly after 2020. Control variables included Firm Size (Ln Total Assets), Firm Age (Ln Years Listed), Leverage (LEV), and Gross Domestic Product (GDP) as a macroeconomic control. The hypotheses were tested using a Two-Way Fixed Effects Regression Model to control for unobserved firm-specific heterogeneity and time-specific effects. The moderating influence of the Omnibus Law was assessed via the interaction term (FO x OL). Finally, clustered standard errors at the firm level were

employed throughout the analysis to ensure robust statistical inferences.

It is important to note that the institutional reform effect may not be immediate. Although the Omnibus Law was enacted in late 2020 and operationalized in this study as a post-reform dummy starting in 2021, its economic and governance impact may exhibit lagged effects due to gradual implementation of derivative regulations, adjustment costs, and varying enforcement across regions and industries.

Therefore, the dummy approach captures the initial transition phase rather than the full long-term institutional outcomes.

RESULT AND DISCUSSION

Descriptive Statistics

A descriptive statistical analysis was performed to provide an initial overview of the 882 firm-year observations from Indonesian manufacturing firms over the 2018–2023 period, as summarized in Table 1.

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	882	0.040859	0.059834	-0.133750	0.249610
ROE	882	0.072630	0.243135	-0.863910	1.301330
TBQ	882	1.325819	1.359314	0.220508	8.356593
FO	882	0.297459	0.297388	0.000014	0.996631
FCO	882	0.124008	0.233296	0.000000	0.963182
FIO	882	0.103659	0.143000	0.000000	0.655146
SIZE	882	12.21964	1.538873	9.106535	16.27620
AGE	882	3.748985	0.405434	2.079442	4.691348
LEV	882	0.690928	1.198450	-2.210000	7.869300
GDP	882	0.036978	0.026332	-0.020655	0.053074
OMNIBUS	882	0.500000	0.500284	0	1
LFO	735	0.298544	0.293339	0.000014	0.996631
LFCO	735	0.122106	0.232239	0.000000	0.963182
LFIO	735	0.106858	0.145440	0.000000	0.655146

Table 1. Descriptive Statistics

Table 1 highlights several key characteristics of the sample. The average Overall Foreign Ownership (FO) is approximately 29.75%, confirming that foreign shareholders hold a significant and strategic portion of ownership in Indonesian manufacturing firms. This value exhibits a high degree of dispersion, with a standard deviation of 0.2974, suggesting considerable variation in foreign participation across firms. Disaggregating the ownership, the mean Foreign Corporate Ownership (FCO) (12.40%) is slightly higher than Foreign Institutional Ownership (FIO) (10.37%).

Regarding performance, the average Return on Assets (ROA) (4.09%) and Return on Equity (ROE) (7.26%) are modest, but the wide range between the minimum and maximum values indicates significant performance heterogeneity in the sector. Notably, Tobin's Q (TBQ) has a mean of 1.3258 but a high standard deviation (1.3593) and a wide range (0.2205 to 8.3566), suggesting that the market assigns highly volatile and

heterogeneous valuations to these firms, reflecting potential uncertainty or specific growth expectations. The mean of the Omnibus Law (D_OL) dummy is exactly 0.50, which confirms the balanced panel design covering equal periods before (2018–2020) and after (2021–2023) the reform implementation.

To provide a clearer illustration of the moderating effect, an interaction plot is introduced to visualize how Foreign Institutional Ownership (FIO) relates to Tobin's Q before and after the Omnibus Law implementation. The plot indicates that in the post-reform period (2021–2023), firms with higher FIO levels tend to exhibit a lower Tobin's Q compared to the pre-reform period, supporting the regression evidence that institutional investors react negatively to regulatory transition uncertainty.

Interaction Plot for Moderating Effect of Omnibus Law

Diagnostic Tests and Model Selection

Preliminary diagnostic tests were performed to determine the appropriate panel data estimation model. The Breusch-Pagan LM Test results confirmed that all models rejected the null hypothesis of the Common Effect Model (p-value < 0.05), validating the use of the panel data approach. Subsequently, the Hausman Test consistently indicated that the Fixed Effects (FE) model was the most suitable and consistent estimator across all models, particularly those involving the interaction terms. This decision was reinforced by theoretical considerations, recognizing the importance of controlling for time-invariant, unobserved firm-specific heterogeneity (e.g., corporate culture or founder effects) that may correlate with the foreign

ownership structure. Furthermore, the Multicollinearity Test showed no serious issue, as all VIF values were well below the threshold of 10. Given the confirmed presence of heteroskedasticity and autocorrelation across several models, all regressions utilized the Two-Way Fixed Effects Model with cluster-robust standard errors at the firm level, ensuring the reliability and efficiency of the coefficients.

Panel Regression Estimation and Discussion

The main analysis focuses on Model 4, which tests the differentiated moderating effect of the Omnibus Law on LFCO and LFIO on firm performance. The results are summarized in Table 2.

Table 2. Summary of Panel Regression Results (Fixed Effects Model)

Variable	ROA (β)	ROE (β)	Tobin's Q (β)
LFCO	0.008	0.064	0.327
LFIO	0.011	-0.063	0.230
Omnibus	-0.034**	-0.007	0.006
LFCO X Omnibus	0.009	-0.010	0.268
LFIO X Omnibus	0.013	-0.006	-0.974***
Control Variables			
Size	0.025	0.119*	-0.226
Leverage	-0.003	-0.121***	-0.006
GDP	4.342	3.567	10.074
Age	0.249	0.061	-0.313
R-Squared (Within)	0.20	0.18	0.31

Note: Significance levels: *** p<0.01; ** p<0.05; * p<0.10. Coefficients are rounded

Discussion of Findings

1. Direct Effect on Performance

The direct coefficients of both LFCO and LFIO are statistically insignificant across ROA, ROE, and Tobin's Q models. This non-finding suggests that the theoretical benefits of foreign ownership—such as superior monitoring and resource transfer as per Agency Theory and the Resource-Based View—are not directly translated into measurable firm performance gains in the Indonesian manufacturing sector during this period. In terms of accounting performance, Leverage (LEV) consistently showed a negative and highly significant relationship with ROE ($\beta = -0.121$, $p < 0.001$), emphasizing that financial structure is the primary determinant of returns to equity holders, regardless of foreign ownership concentration.

2. The Moderating Effect and Novelty (H_{A3})

The Omnibus Law reform itself showed a negative and significant direct impact on ROA ($\beta = -0.034$, $p = 0.016$), indicating that firms experienced an initial decline in operating profitability, likely due to transitional regulatory adjustment costs. The reform, however, showed no moderating effect on the profitability measures (ROA and ROE).

The study's most critical and novel finding emerged from the market valuation model (Tobin's Q):

The interaction term LFIO x OMNIBUS is highly negative and statistically significant on Tobin's Q ($\beta = -0.974$, $p < 0.001$).

This result leads to the acceptance of H_{A3}

concerning the moderated effect of Foreign Institutional Ownership on market valuation.

3. Institutional Uncertainty and Investor Sensitivity

The significant negative moderation effect contradicts the expectations based on institutional reforms, which predict that policy liberalization should strengthen the relationship between foreign ownership and firm performance. Instead, the finding is interpreted through the lens of Institutional Uncertainty:

1. Sensitivity of Institutional Investors: Foreign Institutional Investors FIO are typically short-term oriented, highly liquid, and hyper-sensitive to changes in regulatory risk and market stability.
2. Regulatory Ambiguity: The initial implementation phase of the *Omnibus Law* likely generated a signal of institutional ambiguity or complexity regarding derivative regulations. The market viewed firms with higher FIO concentrations as being more exposed to this regulatory uncertainty.
3. Market Discount: The large negative coefficient ($\beta = -0.974$) suggests that the market significantly discounted the future value (Tobin's Q) of firms with high LFIO in the post-reform period. This reflects investor caution, assuming that FIOs are more likely to divest quickly or perceive increased political/execution risk during the transition.

In contrast, the insignificance of the LFCO x OMNIBUS interaction confirms that Foreign Corporate Investors (strategic, long-term partners) are more resilient to short-term regulatory shocks.

The overall results affirm that in emerging markets, the influence of foreign capital is more distinctly felt in market valuation rather than in immediate accounting profitability, and that major institutional changes must be managed carefully to avoid triggering negative signals from highly mobile foreign institutional investors.

CONCLUSION

This study analyzed the impact of differentiated foreign ownership (FO, FCO, and FIO) on the

performance (ROA, ROE, and Tobin's Q) of Indonesian manufacturing firms from 2018–2023, and examined the moderating role of the *Omnibus Law* as a proxy for improved formal institutional quality. Utilizing a two-way fixed effects approach with clustered standard errors, the findings lead to the following conclusions:

1. Insignificant Direct Effect: Foreign ownership (total FO, FCO, and FIO) showed a positive but statistically insignificant influence on ROA, ROE, and Tobin's Q. This suggests that the presence of foreign investors has not yet resulted in a significant increase in profitability or market value throughout the study period. This is consistent with the view that foreign investors often engage in cherry-picking—selecting already well-performing firms—thereby limiting their marginal value creation.
2. Weak General Moderation: The implementation of the *Omnibus Law*, as a whole, has generally not succeeded in strengthening the relationship between foreign ownership and firm performance. The interaction terms were largely insignificant for ROA and ROE, indicating that the regulatory reform, being in its early stages, has not yet fully matured the institutional environment to maximize the productive contribution of foreign capital.
3. Negative Moderation on Market Valuation (Novelty): A critical finding is that the interaction between Foreign Institutional Ownership (FIO) and the *Omnibus Law* had a significantly negative effect on Tobin's Q. This result confirms that foreign institutional investors are the most sensitive group to regulatory uncertainty and transition risks. During the initial phase of the reform, the market responded cautiously to firms with high FIO, leading to a lower valuation, which is a classic symptom of regulatory uncertainty.
4. Dominant Internal Factor: Among control variables, Leverage (LEV) consistently showed a significant negative influence on ROE, confirming that funding structure is the primary internal factor affecting equity returns.

In essence, the research concludes that while the *Omnibus Law* did not enhance the governance or efficiency role of foreign ownership, it amplified the sensitivity of the market towards companies backed by highly mobile Foreign Institutional Investors during a period of institutional uncertainty.

Since the *Omnibus Law* was designed to stimulate job creation and economic growth, this study provides an early evaluation of whether such reforms translate into firm-level improvements. The results imply that the expected welfare benefits may not be immediately realized, especially during transitional phases, highlighting the need for sustained institutional strengthening to ensure that reforms ultimately support broader economic development.

Societal Implications

For policymakers, the findings suggest that the *Omnibus Law* alone is not a sufficient instrument to immediately attract productive foreign investment and enhance firm performance. Credible implementation, regulatory consistency, and legal certainty are crucial to avoid market skepticism. For firms, foreign ownership should be strategically leveraged through governance improvements, technology transfer, and managerial capability enhancement rather than treated as passive financial participation.

Practical Implications

This study reinforces Institutional Theory by showing that institutional reform does not automatically strengthen the governance role of foreign ownership. The findings indicate that large-scale regulatory shocks may generate transitional uncertainty, which can offset the expected benefits of foreign capital, particularly in emerging markets where institutional enforcement is still evolving.

Theoretical Implications

IMPLICATIONS

Recommendations for future research include:

1. **Institutional Theory Validation:** The findings strongly support Institutional Theory, affirming that the effectiveness of foreign ownership is contingent upon the quality and stability of the supporting institutional environment. The non-linear impact during the transition phase of the *Omnibus Law* underscores the principle that FO benefits become optimal only when institutions are mature and regulation implementation is stable.
2. **Behavioral Confirmation:** The results lend credence to the cherry-picking argument, suggesting that the lack of value creation is partly due to foreign investors targeting firms that already possess strong fundamentals, limiting the room for additional value creation.
3. **For Regulators (Government):** The negative market reaction to the FIO interaction highlights the necessity of ensuring consistency, credible implementation, and legal certainty for major regulatory reforms. The government must reinforce the consistency of implementation at the execution level to create a stable and credible business environment for foreign investors.
4. **For Firms:** The research signals that foreign ownership does not automatically improve performance. Firms must proactively leverage foreign capital by structuring better technology transfer, knowledge spillover, and implementing higher quality corporate governance practices, rather than treating FO as passive capital.
5. **For Investors:** The findings advise investors to conduct a deeper fundamental analysis that incorporates institutional conditions and regulatory risk, especially during periods of policy transition. This is particularly crucial for foreign institutional investors, who were found to be the most sensitive to regulatory fluctuations.

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