International Journal of Business and Society, Vol. 27 No. 1 2026, 269-289

FOREIGN OWNERS' PSYCHIC DISTANCE AND CORPORATE RISK-TAKING IN EMERGING MARKET FIRMS

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ABSTRACT

This study aims to investigate the relationship between certain attributes of the psychic distance (i.e., cultural, geographical, linguistic, political, economic, and governance quality distance) through two principal components (competitiveness and location distance) between the foreign owner's home country and host country, with a firm's risk-taking behavior. By using fixed-effect panel regression on a data set of 251 Indonesian non-financial listed firms over 2010-2019 period, includes foreign investors from 25 countries, and by employing sub-sampling regressions based on environmental and social risks according to the ESG Risk Atlas, this study finds that competitiveness distance between a foreign owner's home country and the host country negatively affects a firm's risk-taking behavior. This result remains robust, particularly for firms clustered within the high social risk group. We recommend that the Indonesian government prioritize promoting investment opportunities to foreign institutional investors from countries with a smaller competitiveness distance. Thus, Indonesian firms' risk-taking behavior will increase, signifying a willingness to pursue new investment projects that ultimately contribute to economic growth. This study extends prior research in international distance and agency theories by demonstrating the importance of incorporating foreign owners' competitiveness distance to reduce agency conflicts between foreign investors and a firm's managers, thereby increasing the firm's risk-taking behavior.

Keywords: Foreign ownership, Psychic distance, Risk-taking behavior

Submission: 20th May 2025
Accepted: 23rd January 2026
https://doi.org/10.33736/ijbs.12824.2026

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1. INTRODUCTION

As an emerging economy, Indonesia has been actively opening its markets to foreign investment as part of its broader strategy to accelerate economic growth. Foreign investment is expected to serve as a substitute for limited domestic capital and enhance corporate liquidity when domestic sources are constrained (Genthner & Kis-Katos, 2022). This effort has been supported by the 2020 omnibus law, which allows foreign investors to own 100% of shares in Indonesian firms, except in certain regulated sectors. By 2024, Indonesia had emerged as the largest economy in ASEAN and ranked fifth in Asia—after China, Japan, India, and South Korea—reflecting improvements in corporate competitiveness (Liu et al., 2026). With increased access for foreign investors, understanding the impact of their presence from an agency-theory perspective is essential, especially on corporate investment behaviors that support Indonesia's economic growth.

Research within the agency theory framework has extensively examined how foreign ownership influences corporate investment decisions, often reflected in risk-taking behavior. Foreign ownership is generally believed to enhance corporate governance, as foreign owners tend to closely monitor the firm (Ghazali, 2010; Gu et al., 2019). However, this has been shown to produce contrasting outcomes. Foreign ownership may lead firms to be more cautious (Naufa et al., 2019), resulting in reduced investment as foreign owners encourage more conservative decision-making (Vo, 2016). On the other hand, foreign ownership can increase a firm's confidence to engage in riskier investment projects due to improved governance structures (Boubakri et al., 2013; Đặng et al., 2022). This inconsistency in findings suggests that additional factors may shape the influence of foreign ownership on firm behavior.

One such factor is the concept of psychic distance, which arises from differences between the home country of foreign owners and the host country, impacting their perceptions of business operations abroad (Håkanson & Ambos, 2010). Psychic distance, defined by dimensions such as cultural, geographic, linguistic, political, economic, and governance quality, introduces a layer of complexity into the relationship between foreign ownership and corporate behavior. These differences can influence the ease with which foreign owners can monitor and control their investments, thereby impacting the firm's risk-taking behavior (Ambos & Håkanson, 2014; Malca et al., 2023; Nebus & Chai, 2014; Zhou et al., 2020).

This study aims to investigate whether the distance between the foreign owner's home country and Indonesia affects the risk-taking behavior of Indonesian listed firms. Adopting an international business perspective, this research views foreign ownership not merely as a type of shareholder ownership but as a mode of engagement by foreign investors in other countries (Doh & Luthans, 2018). As companies often have multiple foreign investors from diverse countries, each with different psychic distances, this study aggregates each foreign owner's distance based on their ownership share. This aggregated measure of psychic distance accounts for the combined influence of all foreign owners based on their control over the firm.

Through this research, we aim to contribute to agency theories by explaining inconsistencies in previous studies on foreign ownership and corporate risk-taking behavior, drawing on insights from international business on international distance. Using all publicly available data on

Indonesian companies listed on the stock exchange—excluding financial firms—this study covers the period from the post-2008 economic crisis to 2019 (prior to the COVID-19 pandemic) to avoid distortions caused by major economic shocks. Within this timeframe (2010-2019), we identify 2,065 foreign-owner observations across 251 listed firms from 25 countries that are considered to exercise control over the firm (with ownership of more than 5%). This research enriches the literature with insights from an emerging economy with large observations, a context often underrepresented in international business studies. Given that corporate decisions are often influenced by the actions of other companies within the same industry (Bustamante, 2015), we perform subsampling based on environmental and social risks using the ESG Risk Atlas to enhance robustness. Therefore, we add methodological rigor and offer a multi-level approach to understanding corporate risk-taking. Finally, this study offers policy recommendations for policymakers to promote or provide incentives to selected foreign investor countries to encourage investment in domestic firms. Finally, the study provides policy implications for how policymakers can promote investment from selected foreign investor countries to strengthen domestic firms. From the perspective of firms and foreign investors, the findings also help clarify the concerns of foreign shareholders with diverse characteristics, thereby reducing information asymmetry and improving alignment between ownership and managerial decisions.

The results indicate that, among the two principal components representing the six dimensions of psychic distance, *competitiveness*, rather than *location*, negatively affects corporate risk-taking behavior. The greater the competitiveness differences between Indonesia and the foreign investor's home country, the lower the firm's risk-taking inclination. Due to perceived differences, which increase monitoring costs and complicated communication, foreign shareholders often restrict corporate investment activities. Consequently, we recommend that the Indonesian government prioritize attracting investors from countries with closer competitiveness ties, as this alignment can enhance investment and drive economic growth.

The paper proceeds as follows. In the literature review section, we review prior literature on foreign ownership and psychic distance, followed by a research framework that explains the hypothesis we propose. Then, in the method section, we describe our sample, the analytical procedure, and the variables we used. In the results section, we show the findings and interpret them to test our hypotheses. Finally, the discussion section explores the theoretical and managerial implications.

2. LITERATURE REVIEW

2.1. Related Theories

The relationship between foreign ownership and corporate risk-taking has been widely examined in corporate finance and international business literature, primarily through the lens of agency theory. Agency theory highlights conflicts arising from the separation of ownership and control, where managers may pursue personal interests rather than shareholder value due to goal misalignment and information asymmetry (Jensen & Meckling, 1976). Foreign ownership can influence these agency problems by strengthening monitoring and governance mechanisms.

This perspective is complemented by resource dependency theory (Pfeffer & Salancik, 1978), which emphasizes firms' reliance on external stakeholders for critical resources. As key capital providers, foreign investors gain bargaining power, enabling them to influence corporate decision-making. Institutional theory further enriches this view by arguing that firms are embedded within institutional environments (DiMaggio & Powell, 1983). Differences between home- and host-country institutions may create perceptual gaps, prompting foreign owners to intervene in managerial decisions to align practices with their expectations.

Empirical evidence on the impact of foreign ownership on risk-taking remains mixed. Some studies show that foreign investors enhance monitoring and governance, leading to more conservative risk behavior (Đặng et al., 2022; Ghazali, 2010; Gu et al., 2019; Naufa et al., 2019; Vo, 2016). Conversely, other research suggests that improved governance may enable firms to engage in higher, value-enhancing risk-taking through innovation and strategic expansion (Boubakri et al., 2013; Đặng et al., 2022).

These contradictory findings suggest strong context dependence. Yen et al. (2024) argue that heterogeneity among foreign owners—stemming from differences in institutional and cultural backgrounds—explains these variations. Such differences, captured by the concept of psychic distance (Håkanson & Ambos, 2010), increase informational uncertainty and monitoring costs (Malca et al., 2023), often leading to more cautious risk-taking behavior (Ambos & Håkanson, 2014; Nebus & Chai, 2014; Zhou et al., 2020).

2.2. Psychic Distance Dimensions and the Firm's Risk Taking

Among the dimensions of psychic distance, cultural distance plays a pivotal role in shaping monitoring and control challenges in foreign investments. Cultural differences between home and host countries increase information asymmetry by complicating the identification and interpretation of information (Eriksson et al., 2000). Prior studies show that greater cultural distance raises monitoring difficulties for headquarters, increases the risk of misaligned subsidiary decisions, and often leads to reduced subsidiary autonomy (de Jong et al., 2015). In international joint ventures, higher cultural distance heightens foreign owners' vulnerability due to monitoring challenges, resulting in more cautious investment decisions, lower risk-taking, and diminished firm value (Antia et al., 2007; Karolyi, 2016; Yamin & Golesorkhi, 2010).

Geographic and linguistic distances represent more physical barriers but similarly exacerbate information asymmetry and transaction costs. Geographic distance increases monitoring difficulty by separating investors from operational activities, as demonstrated by Li et al. (2025), who find that the performance benefits of government ownership in Chinese SOEs decline with increasing distance from central authorities. Such distance intensifies information gaps (Ly et al., 2018), raises equity capital costs, and encourages investors to reduce ownership stakes to limit oversight challenges (Boubakri et al., 2016). To mitigate these constraints, foreign investors—particularly venture capitalists—often syndicate with local partners to access local knowledge and reduce information and transaction costs (Tykvová & Schertler, 2014).

Linguistic distance further constrains effective monitoring by impeding communication and amplifying information asymmetry. Language barriers hinder information exchange, opportunity

identification, and negotiation in cross-border investments (Ly et al., 2018). These barriers complicate strategic alignment between the multinational headquarters and local (Gaur et al., 2022). Firms frequently respond by partnering with local entities, prioritizing language similarity, or appointing board members from diverse linguistic backgrounds to establish a common communication medium, such as English (de Jong et al., 2015; El Moujahid et al., 2025).

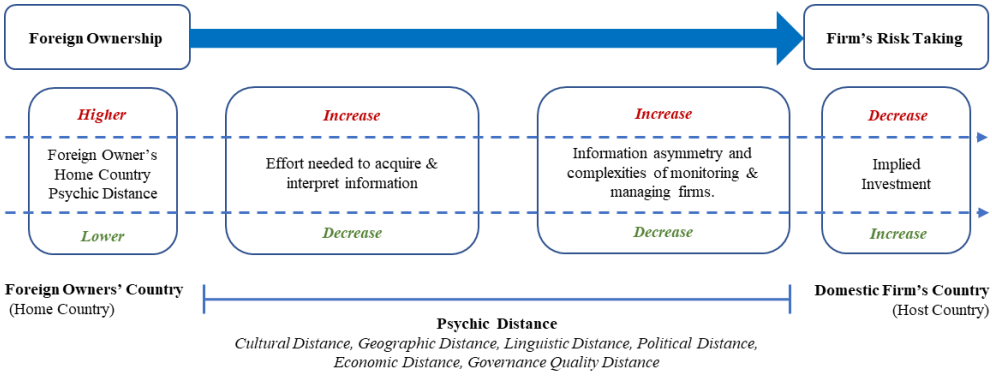
Political distance reflects psychological separation shaped by historical political, military, and colonial ties. Shared political histories—such as wartime alliances or common colonial backgrounds—often generate similar regulatory systems and institutional characteristics, facilitating communication and coordination (El Moujahid et al., 2025; Håkanson & Ambos, 2010). Conversely, greater political distance hampers effective communication and increases managerial complexity (Ambos & Håkanson, 2014).

Economic and governance quality distances further condition foreign investors' perceptions and behaviors. Differences in institutional quality, often reflected in levels of economic development, complicate decision-making as investors navigate unfamiliar regulatory and administrative environments (de Jong et al., 2015; Ghemawat, 2001). Evidence from China shows that investors hold less favorable views of joint ventures originating from institutionally distant countries (Zhang et al., 2024). Governance quality distance—measured through indicators such as Control of Corruption, Government Effectiveness, Political Stability, Regulatory Quality, Rule of Law, and Voice and Accountability—also increases perceived risk and complicates alignment between foreign investors and host-country firms (Aggarwal et al., 2012; Kaufmann et al., 2010).

Based on the above arguments, as illustrated in the theoretical framework, taken together, these dimensions of psychic distance collectively shape how foreign investors evaluate, monitor, and influence host-country firms. Cultural differences between the home and host countries can make interpreting information difficult. Likewise, geographical distance and language differences between the two countries continue to increase the effort required to obtain accurate and timely information. A similar effect arises from political distance: shared political backgrounds often result in similar institutional characteristics, whereas differing backgrounds tend to produce divergent institutional systems. Institutional differences may also stem from variations in economic development and governance quality, as countries with greater economic development and stronger governance tend to have more robust economic institutions. As illustrated in the theoretical framework (Figure 1), these differences collectively increase the difficulty of interpreting information and increase the effort required for effective monitoring. Consequently, information asymmetry, monitoring complexity, and managerial challenges rise, influencing how principals direct the investment behavior of agents within host-country firms—potentially leading to less risk-averse corporate behavior. Thus, we expect:

H1. Foreign owners' home country distance is negatively related to the firm's risk-taking.

Figure 1: Theoretical Framework



3. METHODOLOGY

3.1. The Sample

We collected the sample data of Indonesian non-financial services public firms owned by foreign investors from 2010 to 2019. The exclusion of periods before 2010 and after 2019 is intended to avoid the effects of the 2007-2009 financial crisis and the 2020-2022 COVID-19 Pandemic, which might have influenced the firm's performance and foreign investors' behavior. The firm-level information (Chen et al., 2017; Lindemanis et al., 2022) was extracted from the Thomson Reuters Eikon – Datastream Database, while the country-level information on psychic distance was obtained from Hofstede's National Culture, the Centre d'études prospectives et d'informations internationales (CEPII) Database, the World Bank Database, and the Worldwide Governance Indicators by the World Bank.

Table 1 presents 567 non-financial services public firms owned by foreign owners in the 2010-2019 period, with 102,739 firm-owner observations from 64 countries worldwide. After cleaning the raw data from local owners and foreign shareholding with less than 5% ownership, following Ng et al. (2016) Based on the rule for determining strategic investors considered to have control over the firm, the final sample comprises 251 non-financial services public firms owned by foreign investors, with 2,065 firm-owner observations from 25 countries.

Table 1: Indonesian Non-Financial Services Public Firms in the 2010-2019 Period

	Number of Firms	Number of Firm Owner Observations	Number of Foreign Owner Countries
Non-Financial Services Public Firms	567	102,739	61
Non-Financial Services Public Firms with more than 5% foreign owners' holding	251	2,065	25

3.2. Measures

Dependent variables. Firm's Risk-taking. Following Boubakri et al. (2013), Đặng et al. (2022), Likitwongkajon & Vithessonthi (2022), Ooi & Hooy (2022), and Vo (2016), Return on Assets Volatility (*RISKROAV*) is employed to measure earnings volatility by observing the standard deviation of a firm's return on assets for overlapping periods of three years. Following Đặng et al. (2022), for robustness, we also test the hypothesis by using the variation between the minimum and maximum Return on Assets (*RISKROAD*) in three overlapping years.

Independent variables: Competitiveness Distance and Location Distance. From the six dimensions of psychic distance suggested by Håkanson & Ambos (2010), cultural, geographic, linguistic, and political distances are constant over time, while the economic and governance quality distances might change from time to time.

Cultural distance ($CULT_i$) is calculated using the Kogut and Singh (1988) index based on Hofstede's six national culture dimensions—Power Distance, Individualism, Masculinity, Uncertainty Avoidance, Long-Term Orientation, and Indulgence—following prior studies (de Jong et al., 2015; Li et al., 2022; Tykvová & Schertler, 2014; Zhou et al., 2019):

$$CULT_i = \sum_{j=1}^{6} \frac{\left(\frac{(I_{j,u} - I_{j,i})^2}{V_j}\right)}{6} \qquad \text{Eq (1)}$$

where $CULT_i$ represents the cultural distance between Indonesia (u) and foreign owner's home country (i), $I_{j,u}$ represents the index for the j^{th} cultural dimension for the host country (Indonesia), $I_{j,i}$ represents the index for the j^{th} cultural dimension for the foreign owner's home country, and V_j represents the variance of the index for the j^{th} cultural dimension. Greater cultural distance is expected to increase information asymmetry and monitoring difficulties, thereby reducing firms' risk-taking behavior(de Jong et al., 2015; Eriksson et al., 2000).

Geographical distance ($GEOG_i$) is measured as the natural logarithm of the physical distance (in kilometers) between Indonesia and the foreign owner's home-country capital city (Boubakri et al., 2016; Gaur et al., 2022). Larger distances raise transportation and communication costs, increasing information asymmetry and reducing firms' willingness to take risks (Ghemawat, 2001; Ly et al., 2018; Tykvová and Schertler, 2014). Linguistic distance ($LANG_i$) captures whether Indonesia and the foreign owner's home country share a common mother tongue (equals one if there is no commonality in the language, 0 otherwise); lack of commonality is expected to hinder communication and negatively affect risk-taking (Gaur et al., 2022; de Jong et al., 2015; Ly et al., 2018). Political distance ($POLI_i$) is proxied by the absence of a historical colonial relationship between Indonesia and the foreign owner's home country (equals one if there is no historical colonial relationship, 0 otherwise), reflecting lower perceived political and institutional commonality (de Jong et al., 2015; Håkanson & Ambos, 2010). Economic distance ($ECON_{i,t}$) is measured as the absolute difference in constant GDP per capita, representing disparities in institutional quality that complicate coordination and information flow (de Jong et al., 2015; Evans & Mavondo, 2002; Håkanson & Ambos, 2010).

Finally, governance quality distance ($GOVQ_{i,t}$) is calculated using the Kogut and Singh approach (Dikova, 2009; Gaur et al., 2022) applied to the World Bank's Worldwide Governance Indicators (Kaufmann et al., 2010), capturing differences in governance standards that increase perceived risk and misalignment in business practices (Aggarwal et al., 2012):

$$GOVQ_{i,t} = \sum_{j=1}^{6} \frac{\left(\frac{\left(I_{j,u,t} - I_{j,i,t}\right)^2}{V_j}\right)}{6} \qquad \text{Eq (2)}$$

where $GOVQ_{i,t}$ represents the governance quality distance between Indonesia (u) and foreign owner's home country (i) at time t, $I_{j,u,t}$ represents the index for the j^{th} governance quality for the host country (Indonesia), $I_{j,i}$ represents the index for the j^{th} governance quality for the foreign owner's home country, and V_j represents the variance of the index for the j^{th} governance quality dimension.

Using the six distinct dimensions of psychic distance enables a detailed examination of how each influences corporate risk-taking. Across all dimensions, greater psychic distance is hypothesized to reduce firms' risk-taking behavior. However, treating these dimensions individually complicates the development of cohesive policy and investment recommendations, as different dimensions may point to different priority source countries for foreign investment. To overcome this limitation, the study applies Principal Component Analysis (PCA) to aggregate the six dimensions into broader constructs.

The PCA results yield a two-component solution with eigenvalues greater than one and an acceptable sampling adequacy (Kaiser–Meyer–Olkin = 0.6450). The first component, labelled *competitiveness distance* (*COMP*), loads strongly on cultural, economic, and governance quality distances. This component reflects institutional theory, emphasizing how differences in cultural and institutional environments—embedded in both foreign owners and host firms—shape firm behavior through variations in economic development and governance quality. Consistent with prior hypotheses, greater competitiveness distance is expected to reduce firms' risk-taking behavior. The second component, termed *location distance* (*LOC*), loads on geographical and linguistic distances. These dimensions capture physical and communication barriers highlighted in international business theory, which increase transaction and coordination costs and hinder effective monitoring and information exchange. Accordingly, a higher location distance between foreign owners and firms is also predicted to reduce corporate risk-taking. Table 2 presents the two components and their loadings.

Table 2: Distance Components Identified by PCA Data Reduction Techniques

Variables	Component 1	Component 2
Competitiveness Distance (*COMP*)		
Cultural Distance (*CULT*)	0.5330 *	
Geographical Distance (*GEOG*)	0.1339	
Linguistic Distance (*LANG*)	-0.0155	
Political Distance (*POLI*)	0.1985 *	
Economic Distance (*ECON*)	0.5711 *	
Governance Quality Distance (*GOVQ*)	0.5765	
Location Distance (*LOC*)		
Cultural Distance (*CULT*)		-0.2084
Geographical Distance (*GEOG*)		-0.6703 *
Linguistic Distance (*LANG*)		0.6632 *
Political Distance (*POLI*)		-0.0053
Economic Distance (*ECON*)		0.1640
Governance Quality Distance (*GOVQ*)		0.2010

Notes: Kaiser-Meyer-Olkin measure of sampling adequacy 0.6450. Cumulative explained variance 66.63%. *Absolute loading more than 0.3.

Foreign Owner Psychic Distance. In previous studies on foreign ownership, two methods are commonly used as proxies for it. The first approach is by using a dummy variable that applies to a specific ownership percentage threshold determined based on the assumed level of control held by foreign owners (e.g. Chen et al., 2017; Kwon & Park, 2018; Moin et al., 2020). The second approach directly represents foreign ownership by the actual percentage of foreign ownership in a firm (Do et al., 2020; Gantyowati et al., 2022; Jeon et al., 2011; Lam et al., 2012; Naufa et al., 2019; Vo, 2015). This method enables a clearer observation of the effects associated with the magnitude of foreign ownership.

Since each firm may have a different combination of foreign owner types and multiple foreign owners from different countries within each type, the country's psychic distance should be aggregated. To come up with that measure, first, we determine the percentage of ownership of each foreign owner, institutional ($FINST_{i,t}$) and corporation ($FCORP_{i,t}$), coming from the same country at the same firm (i) year (t) observation. Then, we calculate the sum product of the ownership percentage of each foreign owner from each different country with the two components of psychic distance ($COMP_{i,t}$ and $LOC_{i,t}$).

Control Variables. In line with extant literature (Boubakri et al., 2013; Đặng et al., 2022; Likitwongkajon & Vithessonthi, 2022; Naufa et al., 2019; Ooi & Hooy, 2022; Vo, 2016), we include several firm-level factors that might affect firms' risk-taking. We measure firm size (*CONTSIZE*) by calculating the natural logarithm of the firm's book value of total assets at the end of the year, firm age (*CONTAGE*) by calculating the natural log of the number of years since the firm was incorporated, firm marketability (*CONTMBR*) by calculating the firm's market value of equity divided by the book value of equity at the end of the year, firm sales growth (*CONTSGR*) by calculating the percentage change in sales versus the year t-1, firm sales to total assets (*CONTSTA*) to represent the firm's productivity, firm profitability by using the firm's return on assets (*CONTROA*), firm leverage by calculating the firm's total debt to total assets (*CONTTDTA*), and firm domestic ownership (*CONTDOM*) by summing up all domestic owner's shareholdings percentage.

3.3. Regression Model

To test the hypothesis on whether the foreign owner's home country distance affects Indonesian listed firms' risk-taking, we adopt the model developed by Boubakri et al. (2013), Vo (2016), and Đặng et al. (2022) related to foreign ownership and corporate risk-taking behavior, and adjust for different types of psychic distance:

$$RISK_{i,t} = \alpha + \beta_1 FINSTDIST_{i,t-1} + \beta_2 FCORPDIST_{i,t-1} + \beta_3 CONT_{i,t} + \delta\ Industry\ Dummies + \gamma\ Year\ Dummies + \varepsilon_{it} \quad \text{Eq (3)}$$

where $FINSTDIST_{i,t-1}$ and $FCORPDIST_{i,t-1}$ are the lagged values of foreign owner psychic distance for foreign institutional owners and foreign corporate owners, respectively. Table 3 shows a list of the key variables, including dependent, independent, and control variables.

Table 3: Key Variables and Proxies

Variables	Measurement	Supporting References	Expected Sign
Dependent Variable			
Firm's Risk-taking			
Return on Assets Volatility (*RISKROAV*)	The standard deviation of a firm's return on assets (ROA) for overlapping periods of three years.	Boubakri et al. (2013), Đặng et al. (2022), Likitwongkajon & Vithessonthi (2022), Ooi & Hooy (2022), Vo (2016)	
Variation between the minimum and maximum Return on Assets (*RISKROAD*)	The variation between the minimum and maximum firm's return on assets (ROA) for overlapping periods of three years.	Đặng et al. (2022)	
Independent Variables			
Foreign Institutional Owner's Home Country Distance (FINSTDIST)			
Foreign Institutional Owners Competitiveness Distance (*COMPINST*)	$COMPINST_{i,t} = \sum_{i,t=1}^{n}(FINST_{i,t}\ x\ COMP_{i,t})$	de Jong et al. (2015), Li et al. (2022), Tykvová & Schertler (2014), Zhou et al. (2019), Gaur et al. (2022), Dikova (2009)	(-)
Foreign Institutional Owners Location Distance (*LOCINST*)	$LOCINST_{i,t} = \sum_{i,t=1}^{n}(FINST_{i,t}\ x\ LOC_{i,t})$	Boubakri et al. (2016), de Jong et al. (2015), Gaur et al. (2022), Ly et al. (2018)	(-)
Foreign Corporate Owner's Home Country Distance (FCORPDIST)			

Variables	Measurement	Supporting References	Expected Sign
Foreign Institutional Owners Competitiveness Distance (*COMPCORP*)	$COMPCORP_{i,t} = \sum_{i,t=1}^{n}(FCORP_{i,t}\ x\ COMP_{i,t})$	de Jong et al. (2015), Li et al. (2022), Tykvová & Schertler (2014), Zhou et al. (2019), Gaur et al. (2022), Dikova (2009)	(-)
Foreign Institutional Owners Location Distance (*LOCCORP*)	$PHYSICCORP_{i,t} = \sum_{i,t=1}^{n}(FCORP_{i,t}\ x\ LOC_{i,t})$	Boubakri et al. (2016), de Jong et al. (2015), Gaur et al. (2022), Ly et al. (2018)	(-)
Control Variables			
Firm's Size (*CONTSIZE*)	The natural logarithm of the firm's book value of total assets at the end of the year.	Boubakri et al. (2013), Đặng et al. (2022), Likitwongkajon & Vithessonthi (2022), Ooi & Hooy (2022), Vo (2016)	(+)
Firm's Age (*CONTAGE*)	The natural log of the number of (1 + years since the firm was incorporated).	Đặng et al. (2022), Ooi & Hooy (2022)	(+)
Firm's Marketability (*CONTMBR*)	The market value of equity divided by the book value of equity at the end of the year.	Likitwongkajon & Vithessonthi (2022)	(+)
Firm's Growth (*CONTSGR*)	The percentage change in sales versus the year t-1.	Boubakri et al. (2013), Đặng et al. (2022), Ooi & Hooy (2022)	(+)
Firm's Productivity (*CONTSTA*)	The ratio of total sales divided by total assets at the end of the year.	Naufa et al. (2019)	(-)
Firm's Profitability (*CONTROA*)	The ratio of EBIT divided by total assets at the end of the year.	Boubakri et al. (2013); Đặng et al. (2022); Likitwongkajon & Vithessonthi (2022)	(+)
Firm's Leverage (*CONTTDTA*)	The ratio of total debt to total assets at the end of the year.	Boubakri et al. (2013); Đặng et al. (2022); Likitwongkajon & Vithessonthi (2022); Ooi & Hooy (2022); Vo (2016)	(-)
Firm's Domestic Ownership (*CONTDOM*)	The percentage of domestic owners' shareholdings at the end of the year.	Boubakri et al. (2013); Đặng et al. (2022); Naufa et al. (2019); Vo, (2016)	(+)

4. RESULTS AND DISCUSSION

This section provides an overview of findings related to how the foreign owner's home country's distance affects firms' risk-taking. The descriptive statistics for the variables used in the regression analysis are provided in Table 4. The average volatility in return on assets (*RISKROAV*) and the variation between the minimum and maximum return on assets (RISKROAD) across the sample are 0.7302 and 1.3886, respectively, with large standard deviations of 13.0555 and 24.9479, indicating significant variability in firm risk-taking. Regarding distance measures, there is a

noticeable difference between institutional and corporate owners' distances, with corporate owner distances (COMPCORP and LOCCORP) generally showing greater variability than institutional owner distances (*COMPINST and LOCINST*). For the control variable, it is worth noting that three variables have large standard deviations (exceeding the average): firm marketability (*CONTMBR*), profitability (*CONTROA*), and leverage (*CONTTDTA*), indicating high variability across firms.

Before conducting the regressions, we examine correlations among the independent variables and find generally low correlations (Table 5). We further assess multicollinearity by calculating the average variance inflation factor (VIF) for each regression model. All average VIF values are below 1.3, well under the commonly accepted threshold of 5.6 (de Jong et al., 2015), indicating no multicollinearity concerns.

Table 4: Descriptive Statistics

	Observation	Mean	Std. Dev.	Min	Max
RISKROAV	1,002	0.7302	13.0555	0.0001	288.6216
RISKROAD	1,002	1.3886	24.9479	0.0002	552.8492
COMPINST	1,004	0.0338	0.1089	0.0000	1.3515
COMPCORP	1,004	0.4973	0.9671	-1.7397	5.1422
LOCINST	1,004	0.0578	0.2160	-0.0638	2.0002
LOCCORP	1,004	1.8617	2.3247	-0.7004	8.4961
CONTSIZE	1,003	5.2518	1.6254	0.2416	9.9900
CONTAGE	973	3.2907	0.5404	1.0986	4.6151
CONTMBR	1,004	4.1384	59.7386	0.0000	1858.5060
CONTSGR	984	0.5253	4.1593	0.0001	96.8957
CONTSTA	1,003	0.9302	0.9084	0.0000	8.4293
CONTROA	1,004	0.8297	18.0421	0.0000	555.1753
CONTTDTA	1,003	0.2639	0.7749	0.0000	14.7780
CONTDOM	1,004	54.7112	29.1949	0.9100	95.0000

Table 5: Correlation Matrix

		1	2	3	4	5	6	7	8	9	10	11	12
1	***COMPINST***	1.00											
2	***COMPCORP***	-0.08	1.00										
3	***LOCINST***	0.38	-0.01	1.00									
4	***LOCCORP***	-0.15	-0.07	-0.08	1.00								
5	***CONTSIZE***	0.13	0.14	0.04	-0.06	1.00							
6	***CONTAGE***	-0.02	0.24	0.09	0.09	0.03	1.00						
7	***CONTMBR***	-0.01	0.06	-0.01	0.07	0.00	0.02	1.00					
8	***CONTSGR***	-0.01	0.00	-0.02	0.05	-0.05	-0.08	0.00	1.00				
9	***CONTSTA***	-0.09	0.12	0.00	0.04	-0.21	0.17	0.09	-0.05	1.00			
10	***CONTROA***	-0.02	0.08	-0.07	0.01	-0.05	-0.03	0.01	0.09	0.15	1.00		
11	***CONTTDTA***	-0.03	0.08	-0.04	-0.01	0.00	-0.03	-0.01	-0.01	0.24	0.36	1.00	
12	***CONTDOM***	0.17	-0.35	0.06	-0.44	0.02	-0.19	-0.06	-0.07	-0.13	-0.03	0.04	1.00

A fixed-effect panel regression analysis is conducted using the robust approach to test the hypothesis. Results of this analysis (Table 6) are derived from a dataset comprising 951 firm-year observations spanning 201 firms over 7 years. Model 1 shows that the institutional competitiveness distance (*COMPINST*) has a negative and significant effect on firms' risk-taking. Specifically, the coefficient for *COMPINST* is -0.03176 with moderate significance ($p < 0.05$) for RISKROAV and -0.05389 with low significance ($p < 0.1$) for RISKROAD, even though the competitiveness

distances for corporate owners (COMPCORP) are not statistically significant for either RISKROAV or *RISKROAD*. On the other hand, location distances for both institutional (*LOCINST*) and corporate (*LOCCORP*) are not found to show a significant effect on a firm's risk-taking (Model 2) for both *RISKROAV* and *RISKROAD*.

On control variables, Firm's Marketability (*CONTMBR*), Firm's Growth (*CONTSGR*), and Firm's Profitability (*CONTROA*) are significant in all models, positively contributing to firms' risk-taking. The firm's marketability shows a significant relationship with firm risk-taking in all models ($p < 0.01$), with coefficients of 0.00003 for *RISKROAV* and 0.00006 for *RISKROAD*. The firm's growth also shows a significant relationship with firm risk-taking across all models, with $p < 0.1$ for Model 1 on RISKROAV and $p < 0.05$ for the remaining models, and coefficients ranging from 0.00101 to 0.00207. The firm's profitability shows a significant relationship with the firm's risk-taking in all models ($p < 0.01$), with coefficients ranging from 0.29252 to 0.53762. On the other hand, Firm's Leverage (*CONTTDTA*) is negatively associated with a firm's risk-taking with a coefficient ranging from -0.06649 to -0.03345, consistently showing significance in all models ($p < 0.01$).

To account for industry-specific influences on corporate decision-making, we conduct sub-sample regressions based on industry characteristics. Firms' investment and risk-taking decisions are shaped not only by firm-level factors but also by the behavior and risk profiles of other firms within the same industry (Bustamante, 2015). To examine whether the effect of foreign owners' home-country distance on risk-taking varies across industries, we classify industries using the ESG Risk Atlas developed by S&P Global, which assesses sectors' exposure to environmental and social risks (S&P Global, 2019).

The ESG Risk Atlas evaluates environmental risk based on factors such as land and water use, manufacturing footprint, and packaging, and social risk based on human capital and safety management. Governance risk is excluded from the sectoral classification, as it reflects country-level governance quality rather than industry characteristics. The Atlas assigns sector risk scores on a scale of 1–6, where lower values indicate lower exposure. We map S&P Global's 34 sectors to 11 Indonesian sectors and compute average environmental and social risk scores for each. Industries with average scores below 3 are considered low risk, while those with scores of 3 or higher are considered high risk. Based on this approach, four industries are identified as high environmental risk and eight as high social risk, with substantial firm-year observations across multiple firms and years.

Table 6: Relationship of Foreign Owners' Home Country Distance and Firm's Risk-taking

	RISKROAV		***RISKROAD***	
	Model 1	**Model 2**	**Model 1**	**Model 2**
Constant	-0.22516	-0.22088	-0.41356	-0.40556
	(0.214)	(0.235)	(0.208)	(0.229)
COMPINST	-0.03176 **		-0.05389 *	
	(0.043)		(0.076)	
COMPCORP	-0.00080		-0.00080	
	(0.941)		(0.968)	
LOCINST		-0.00246		-0.00632
		(0.777)		(0.697)
LOCCORP		-0.00087		-0.00151
		(0.782)		(0.796)
CONTSIZE	0.01601	0.01638	0.02726	0.02787
	(0.366)	(0.354)	(0.403)	(0.392)
CONTAGE	0.05611	0.05443	0.10955	0.10668
	(0.176)	(0.217)	(0.158)	(0.196)
CONTMBR	0.00003 ***	0.00003 ***	0.00006 ***	0.00006 ***
	(0.000)	(0.000)	(0.000)	(0.000)
CONTSGR	0.00101 *	0.00106 **	0.00199 **	0.00207 **
	(0.058)	(0.042)	(0.041)	(0.03)
CONTSTA	-0.01951	-0.01921	-0.04034	-0.03984
	(0.167)	(0.171)	(0.142)	(0.144)
CONTROA	0.29328 ***	0.29252 ***	0.53762 ***	0.53631 ***
	(0.000)	(0.000)	(0.000)	(0.000)
CONTTDTA	-0.03359 ***	-0.03345 ***	-0.06649 ***	-0.06623 ***
	(0.000)	(0.000)	(0.000)	(0.000)
CONTDOM	0.00004	0.00004	0.00003	0.00002
	(0.903)	(0.908)	(0.963)	(0.971)
Industry Effect	Y	Y	Y	Y
Year Effect	Y	Y	Y	Y
Observation	951	951	951	951
R-Squared	0.2468	0.2457	0.2481	0.2472
Mean VIF	1.14	1.14	1.14	1.14

Notes: Robust standard errors in parentheses, ***p < 0.01; **p < 0.05; *p < 0.1. Each model tests the effect of a single Psychic Distance component, both for Foreign Institutional Owners (*INST*) and Foreign Corporate Owners (*CORP*), on a firm's Risk-taking (*RISKROAV* and *RISKROAD*), where Industry Effect and Year Effect were both controlled. Model 1 provides fixed-effect panel regression results for Competitiveness Distance (*COMP*), and Model 2 provides fixed-effect panel regression results for Location Distance (*LOC*). The definitions of the variables are shown in **Table 3**.

The sub-sample analysis reveals that the effects of the distance to foreign owners' home countries on firms' risk-taking vary across risk contexts (Table 7). In the high social risk sub-sample, competitiveness distance for institutional owners (*COMPINST*) is significant. With a coefficient of -0.02763 (p = 0.012), *COMPINST* has a negative and statistically significant effect on *RISKROAV*. For the *RISKROAD*, *COMPINST* also shows a significant negative effect with a coefficient of -0.04614 (p = 0.030). On the other hand, competitiveness distance for corporate owners (*COMPCORP*) is statistically insignificant in affecting a firm's risk-taking in the high social risk

sub-sample, both for *RISKROAV* and *RISKROAD*. These results are consistent with those in the overall sample. In the high environmental risk sub-sample, competitiveness distance for neither institutional nor corporate owners appears to matter.

Table 7: Relationship of Foreign Owners' Home Country Distance and Firm's Risk-taking for High Environmental and Social Risk Firm Group

	HIGH ENVIRONMENTAL RISK		**HIGH SOCIAL RISK**	
	RISKROAV	***RISKROAD***	***RISKROAV***	***RISKROAD***
Constant	-0.28979	-0.55615	-0.16998	-0.31803
	(0.213)	(0.228)	(0.196)	(0.212)
COMPINST	-0.01082	-0.01445	-0.02763 **	-0.04614 **
	(0.323)	(0.465)	(0.012)	(0.030)
COMPCORP	0.00396	0.00695	-0.00274	-0.00453
	(0.831)	(0.844)	(0.799)	(0.819)
CONTSIZE	0.03222 *	0.06167 *	0.02170	0.03876
	(0.066)	(0.067)	(0.160)	(0.194)
CONTAGE	0.05433	0.10640	0.03699	0.07539
	(0.438)	(0.447)	(0.299)	(0.274)
CONTMBR	0.00010	0.00020	0.00003 ***	0.00006 ***
	(0.522)	(0.515)	(0.001)	(0.001)
CONTSGR	0.00153 ***	0.00308 ***	0.00109 **	0.00216 **
	(0.007)	(0.004)	(0.029)	(0.024)
CONTSTA	-0.01294	-0.02672	-0.01973	-0.04058
	(0.382)	(0.355)	(0.159)	(0.149)
CONTROA	0.24834 ***	0.44067 ***	0.30437 ***	0.55619 ***
	(0.000)	(0.000)	(0.000)	(0.000)
CONTTDTA	-0.03370 ***	-0.06664 ***	-0.03202 ***	-0.06320 ***
	(0.000)	(0.000)	(0.000)	(0.000)
CONTDOM	-0.00014	-0.00029	-0.00027	-0.00057
	(0.748)	(0.715)	(0.418)	(0.357)
Industry Effect	Y	Y	Y	Y
Year Effect	Y	Y	Y	Y
Observation	434	434	730	730
R-Squared	0.3625	0.3629	0.2743	0.2742
Mean VIF	1.18	1.18	1.16	1.16

Notes: Robust standard errors in parentheses, ***p < 0.01; **p < 0.05; *p < 0.1. Each model tests the effect of Competitiveness Distance (*COMP*), both for Foreign Institutional Owners (*INST*) and Foreign Corporate Owners (*CORP*), on a firm's Risk-taking (*RISKROAV* and *RISKROAD*), where Industry Effect and Year Effect were both controlled. The definitions of the variables are shown in **Table 3**.

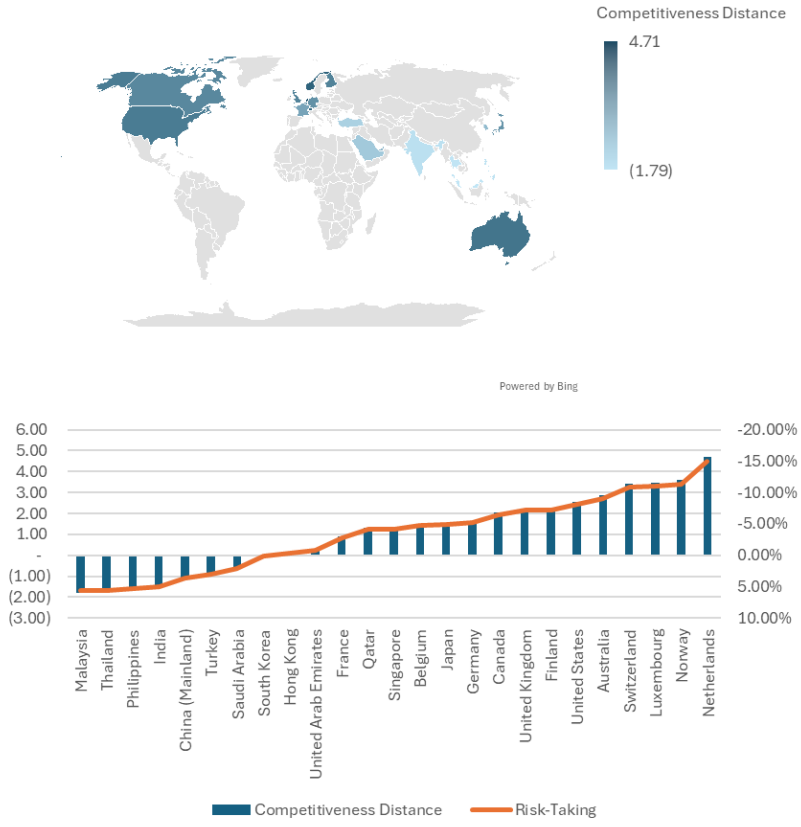
This study examines the relationship between foreign ownership and firms' risk-taking behavior, addressing the inconsistent findings in prior research that report both negative and positive effects. It argues that these inconsistencies can be better explained by considering the distance between foreign owners' home countries and firms' host countries, rather than treating foreign ownership as a homogeneous factor.

The results show that competitiveness distance—a composite measure capturing cultural, economic, and governance quality distance—has a significant negative effect on firms' risk-taking behavior. As the distance to competitiveness increases, firms become less inclined to take risks. Empirically, a one-point increase in competitiveness distance is associated with a reduction in earnings volatility (measured as the standard deviation of ROA over overlapping three-year periods) of more than 0.03% (Table 6, *RISKROAV*, Model 1). This finding supports the hypothesis that greater home–host country distance discourages corporate risk-taking. This effect is driven by challenges faced by foreign owners in interpreting information and monitoring firms in culturally and institutionally distant environments (de Jong et al., 2015; Eriksson et al., 2000; Yamin & Golesorkhi, 2010). Cultural distance increases information asymmetry, leading shareholders to constrain firms' engagement in high-risk investments (Antia et al., 2007; Karolyi, 2016). Similarly, economic distance reflects differences in institutional quality that hinder coordination and decision-making, thereby reducing firms' risk appetite (de Jong et al., 2015; Ghemawat, 2001; Håkanson & Ambos, 2010; Toh & Jia, 2021). Governance quality distance further amplifies these difficulties by increasing perceived investment risk and misalignment of business practices (Aggarwal et al., 2012). Collectively, these findings align with institutional theory, which emphasizes the role of institutional environments in shaping organizational behavior (DiMaggio & Powell, 1983).

In contrast, location distance—comprising geographical and linguistic distance—does not significantly affect firms' risk-taking behavior. Unlike earlier studies (e.g., Ly et al., 2018), the results suggest that advances in transportation, communication technologies, and the globalization of business practices have reduced the relevance of physical and language barriers in influencing corporate risk decisions. Industry-level analysis reveals that competitiveness distance consistently affects firms operating in industries with high social risk but not those facing high environmental risk. Firms in high-social-risk industries tend to exhibit more aggressive risk-taking when foreign ownership comes from countries with lower competitiveness distance.

This study contributes to agency theory by demonstrating that differences in foreign owners' home-country characteristics help explain mixed evidence in prior research on foreign ownership and risk-taking (Boubakri et al., 2013; Đặng et al., 2022; Ghazali, 2010; Naufa et al., 2019; Vo, 2016). It recommends that future research explicitly incorporate the concept of competitiveness distance. From a policy perspective, the study advises governments—particularly Indonesia—to prioritize foreign institutional investors from countries with a smaller competitiveness distance to reduce information asymmetry, enhance monitoring, and promote productive risk-taking that supports economic growth. Figure *2* illustrates the home countries of foreign investors and the expected impact of their investments on firm risk-taking behavior. The closer the competitiveness distance between the foreign investor's country and Indonesia, the higher the expected risk-taking behavior of Indonesian firms, thereby creating higher shareholder value.

Figure 2: Foreign Institutional Owner's Home Country Competitiveness Distance to Firm's Risk-taking Behavior Relationships



5. CONCLUSION

This study addresses inconsistencies in agency theory–based research on the relationship between foreign ownership and firms' risk-taking behavior by incorporating country-level characteristic distances—cultural, geographical, linguistic, political, economic, and governance quality—captured through competitiveness and location distance. Using an objective measure of psychic distance and aggregating foreign ownership by investment shares, the study distinguishes between foreign institutional and corporate owners to assess how these distances shape corporate investment decisions.

The findings indicate that competitiveness distance, particularly for foreign institutional owners, negatively affects firms' risk-taking behavior, with this effect being more pronounced in industries facing high social risk, as identified by the ESG Risk Atlas. These results offer important insights

for policymakers in designing targeted strategies to attract foreign investors who can foster economic growth through more effective investment, in line with SDG 8: Decent Work and Economic Growth. From a managerial perspective, reducing differences in cultural, economic, and governance quality dimensions can mitigate information asymmetry and communication costs, thereby enhancing coordination and strategic alignment between foreign owners and local firms.

The study contributes to agency theory by offering a clearer framework for understanding how psychic distance conditions the effects of foreign ownership on risk-taking behavior. While the analysis focuses on Indonesian firms with 25 foreign owners from 25 countries, future research could expand to other emerging economies to enhance the generalizability of the findings.

ACKNOWLEDGEMENT

This research was funded by the 2024 PPMI scheme through SBM ITB (Decree No. 061/IT1.C09/SK-TA/2024).

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