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East meets west—Corporate governance in Asian emerging markets: A literature review and research agenda

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ABSTRACT

This review examines how corporate governance mechanisms in the Asian emerging markets (AEMs) context affect firm-level outcomes. Literature about characteristics of the main corporate governance actors (boards and owners), their effects on firm-level outcomes, and contingency factors in AEMs offers interesting first insights. I synthetize these results and develop a research agenda that proposes how AEM corporate governance research should extend (but not ignore) agency theory, how AEM research about firm effects of corporate governance could take a stakeholder-oriented perspective, and how research could utilize the AEM institutional context to model contingency factors and extend our theoretical understanding of corporate governance.

1. Introduction

Recent corporate scandals in Asian emerging markets (AEMs) such as the expropriation of minority shareholders in Chinese companies like Meierya or Snjiu (Bai, Liu, Lu, Song, & Zhang, 2004) or the Satyam scandal, one of the largest fraud cases in India (Chen, Li, & Shapiro, 2010), indicate the need for effective control mechanisms in AEMs' business systems. These scandals cost shareholders a lot of money, employees their jobs, and states large amounts of tax revenues. In today's global world, these scandals do not only matter to the Asian economies but also frighten Western regulators and corporations who increasingly invest in AEMs (Globerman, Peng, & Shapiro, 2011). Researchers agree that improvements in firm-level corporate governance can help to avoid such scandals (e.g., Aguilera, Florackis, & Kim, 2016; Kang, Cheng, & Gray, 2007). Nevertheless, international corporate governance research has shown that the efficacy of corporate governance mechanisms significantly depends on the institutional environment (Aguilera & Jackson, 2010; Filatotchev, Jackson, & Nakajima, 2013; Oehmichen, Schrapp, & Wolff, 2017). As the institutional environment in AEMs is unique (institutions are weaker, more dynamic and more diverse than in Western countries), research might be able to learn unique things about corporate governance when looking at the AEM context.

The goal of this review is to systemize our current knowledge in this emerging field of research. This review analyses and synthesizes the extant knowledge about characteristics of the two major firm-internal corporate governance actors, namely owners and board members (Denis & McConnell, 2003), their consequential effects on firm-level outcomes, and potential contingency factors shaping these mechanisms in the AEM context. Specifically, this study will answer the following questions: What do we know about characteristics of internal corporate governance actors in AEMs, their impact on firm-level outcomes, and contingency factors? Which questions do researchers have to answer to extend our knowledge about these characteristics and their underlying mechanisms, outcomes, and contingency factors, specifically in AEMs as well as globally? Thereby, AEMs represent a relevant research object because of their economic weight. For instance, Asia is the world's most populated region (Barkema, Chen, George, Luo, & Tsui, 2015), and China is the second largest economy in GDP attracting most foreign direct investment (Witt & Redding, 2014).

AEMs exhibit a unique institutional setting of weak formal institutions, diverse institutions, and an institutional dynamism. This unique setting is the result of pairing the focus on emerging markets, defined as "low-income, rapid-growth countries using economic liberalization as their primary engine of growth" (Hoskisson, Eden, Lau, & Wright, 2000, p. 249) and the focus on the Asian region that is characterized by a great diversity in cultural, philosophic, and religious traditions (Barkema et al., 2015). These institutional particularities of AEMs allow researchers to advance the theoretical understanding of corporate governance in three dimensions. First, the institutional void context of AEMs with failing market mechanisms reveals tasks of corporate governance actors beyond agency cost reduction. Hence, this study proposes how to extend principles of agency theory in corporate governance research.

Second, this study uncovers a disconnect between firm-level outcomes used in the majority of empirical studies and outcomes of

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relevance that appropriately consider the institutional context. As failing market mechanisms and regulatory dynamics make me question the dominance of shareholder value, I am proposing how a stakeholder-oriented perspective adds to firm-level effects of corporate governance in AEMs.

Third, the institutional diversity of AEMs offers the possibility to shed more light into unclear mechanisms of corporate governance characteristics. I outline how sociological concepts such as country-level elite structures help identify relevant contingency factors and understand ambiguous results.

In summary, this review contributes to corporate governance research by extending knowledge gained from prior corporate governance reviews that either only focus on an U.S./U.K. context (e.g. Gillan, 2006) or have a global focus (Aguilera & Jackson, 2010; Denis & McConnell,2003) and thus miss to explore institutional particularities of a specific region. My focus on corporate governance systems in AEMs represents a middle ground between generating specialized knowledge about country-specific particularities and generalized knowledge about universal mechanisms and their interdependencies with institutional contingency factors.

2. Corporate governance in AEMs – a literature review

Corporate governance literature on Western countries identified boards and shareholders as the key internal corporate governance actors (Denis & McConnell, 2003). They own the company, bear the risk and responsibility of all major corporate decisions, and serve as link between the firm and all its stakeholders. Researchers have shown how these owners and boards affect firm-level decisions and outcomes such as executive compensation (e.g., Devers, McNamara, Wiseman, & Arrfelt, 2008; Hüttenbrink, Oehmichen, Rapp, & Wolff, 2014), organizational learning (e.g., Heyden, Oehmichen, Nichting, & Volberda, 2015; Kim, Kim, & Lee, 2008; Oehmichen, Heyden, Georgakakis, & Volberda, 2017), strategic decisions (e.g., Kavadis & Castaner, 2014; Oehmichen, Schrapp et al., 2017), and firm performance (e.g., Chaganti & Damanpour, 1991; Oehmichen, Braun, Wolff, & Yoshikawa, 2017). Nevertheless, the efficacy of specific board and owner characteristics in an AEM context is still an emerging field of research. The following section reviews, what we know about these two corporate governance actors in the AEM context. After briefly introducing the institutional context, I systemize recent research about characteristics of boards and owners in AEMs, their effects on firm-level outcomes, and the current knowledge about contingency factors that shape the effectiveness of AEMs corporate governance mechanisms.[1] The review covers the AEM countries China, India, Indonesia, Malaysia, Thailand, and the Philippines.

2.1. Institutional context of AEMs

By definition, emerging markets are countries with *weak formal institutions* due to their reduced market effectiveness (Khanna & Palepu, 1997) and *dynamic institutions* due to ongoing development of regulations (Hoskisson, Wright, Filatotchev, & Peng, 2013) and rapid growth-rates (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). Additionally, Asia exhibits a great *diversity in informal institutions* such as cultural, philosophic and religious traditions (Barkema et al., 2015).

[1] I included studies published in journals listed in the Social Sciences Citation Index (SSCI). However, to avoid an unbalanced sample of studies, I only considered the most prestigious journals for studies of the Chinese context. Prestige of the journal was assessed based on impact factors; nevertheless all articles with a Chinese context were checked for new insights and added to the review when they provide new insights, disregarding the impact factor of their journal. On the other hand, I allowed journals that are not listed in the SSCI for the Philippines.

2.1.1. Weak formal institutions

AEMs are characterized by (1) weak law enforcement, (2) restricted managerial labor markets, and (3) limited capital markets. Weak formal institutions do not imply an absence of law but rather weakly enforced rules and people distrusting their efficacy (Young et al., 2008). Despite high quality accounting standards (e.g. in China, Witt & Redding, 2014), corporate governance codes (e.g. in the Philippines, Kondo, 2014), and awards for good governance (e.g. in Thailand, Suehiro & Wailerdsak Yabushity, 2014) AMEs lack institutionalized trust and law enforcement (Rajagopalan & Zhang, 2008) with courts having backlogs of thousands of cases (Saez, 2014) and corrupt judges (Kondo, 2014). Additionally, firms in AEMs face managerial labor market constraints because a lack of trust in externally hired professionals hinders filling executive positions. Most executive teams consist of family members and friends rather than professional managers (Kondo, 2014; Rosser, 2014; Suehiro & Wailerdsak Yabushity, 2014). Finally, weak institutions limit capital market access. Although all AEMs offer hypothetical access to equity via national stock exchanges, most capital has to be raised from banks instead of stock markets (Saez, 2014).

2.1.2. Dynamic institutions

AEMs are characterized by superior growth rates (Young et al., 2008) and severe economic shocks such as the Asian financial crisis (see e.g., Mitton, 2002). This economic volatility is accompanied by (1) political developments and (2) the ongoing globalization:

The *political development* in AEMs is characterized by privatization (Young et al., 2008) and political instability. China for instance recognized privatization as an instrument to increase effectiveness and competitiveness of state-owned companies (Mar & Young, 2001). Additionally, the entire region exhibits strong political instability as for instance the latest political developments in Thailand (Hoskisson et al., 2013) indicate. Continuously changing politico-economic agendas reduce firms' trust in institution, lead to short-term business orientation, and thus undermine economic impact of regulatory improvements. Furthermore, due to the ongoing *globalization,* global capital meets local tradition in AEMs (Ahmadjian, 2014). Foreign investors might hence force local governments to adapt the regulatory environment and for instance introduce corporate governance or stewardship codes.

2.1.3. Diverse informal institutions

AEMs are characterized by a great institutional variety primarily grounded in the variety of religious and philosophic traditions such as Confucianism, Buddhism, Catholicism, the Islam, legalism, and militarism (Barkema et al., 2015). Affiliations to castes (Chen, Chittoor, & Vissa, 2015), Catholicism-based importance of families (Kondo, 2014), or the special role of Bumiputra (indigenous Malays) in Malaysia (Johnson & Mitton, 2003) are significant drivers for differences in social identity.

Furthermore, the identity and role of societal elites differ between AEM countries. In China, they primarily consist of government officials and their children (Witt & Redding, 2014). In India and Indonesia, the elite consists of politically well-connected family firm members. Their influence is largely based on strong ties to politics (Rosser, 2014; Saez, 2014), but not on inter-firm connections which could create a countervailing economic power. In Malaysia, owner-entrepreneurs form an elite whose success also primarily relies on good relationships to politicians (Carney & Andriesse, 2014). Thailand's economy is controlled by an elite of militaries, business people of Chinese origin and bureaucrats (Suehiro & Wailerdsak Yabushity, 2014). In the Philippines, business families form a factionalized elite that avoids taxation and thereby causes severe budget deficits (Kondo, 2014). These families mostly own industry-leading firms that suppress competitors and therewith form a fragmented elite structure through quasi-monopolies rather than elite networks (Kondo, 2014).

In summary, AEMs are characterized by a particular context of