Corporate Governance in Emerging Markets

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Editor's Note: Ruth V. Aguilera is Professor at the D'Amore-McKim School of Business at Northeastern University; and Ilir Haxhi is Assistant Professor of Strategy and Corporate Governance at the University of Amsterdam. This post is based on their recent article, forthcoming as a chapter in the *Oxford Handbook on Management in Emerging Markets* (Eds.) R. Grosse & K. Meyer, Oxford University Press.

Related research from the Program on Corporate Governance includes The Elusive Quest for Global Governance Standards by Lucian Bebchuk and Assaf Hamdani.

This essay belongs to an edited book dedicated to management in emerging markets. In our chapter, we adopt a systematic cross-national comparative approach to provide an overview of corporate governance (CG) in emerging markets (EMs). Our focus is mostly on the BRIC countries (Brazil, Russia, India, and China). We begin by highlighting the importance of better understanding CG in EMs, and identifying some of the key challenges these countries face as they seek to enhance their CG. Second, we review managerial research conducted after the year 2000 on CG in EMs in the following four categories: ownership, boards of directors, top management teams (TMTs), and CG practices and reform. We discuss the main research questions and findings from this collective body of work, which tends to be "siloed" in terms of drawing few cross-national comparisons. Third, we offer an overview of the main CG features of each of the BRIC countries relative to one another, taking on the OECD Guidelines of CG as its benchmark framework. To do so, we address core governance areas related to the overall model of CG, ownership types and ownership rights, information disclosure and reporting, and stakeholder management and corporate social responsibility. Finally, we conclude by highlighting common themes for CG in emerging markets and suggesting fruitful areas for future research.

In this chapter, we take stock of what we know about CG in EMs and what research questions scholars should focus on moving forward. We adopt a systematic cross-national comparative approach in examining the national cases of the BRIC (Brazil, Russia, India, and China) countries. These are the four major EMs that constitute about 40% of the world population (or 3.6 billion people), representing about 21% of the gross world product (nominal GDP of US$16.6 trillion). In addition to their large share of the world's economy in terms of trade and access to natural resources, BRICs share similar features of both centralized and pro-market economies, recording a high economic growth and degree of foreign direct investment (FDI) attractiveness. However, in most other dimensions, particularly referring to political regimes and strength of institutions, they differ substantially, which has critical repercussions to the patterns of CG and makes their cross-national comparison interesting.

Extensive conceptual and empirical research exists on the CG of developed markets (DMs), particularly in the US and the UK, as well as Continental European countries, a context in which the main theoretical contributions have been tested and established. This research has mainly focused on the two dichotomous (shareholder- versus stakeholder-oriented) CG models (Aguilera & Jackson, 2003, 2010; Haxhi, 2015); however, recent work has refined how different CG dimensions align with each other into different governance configurations or types (Aguilera, Desender, Bednar, & Lee, 2015; Haxhi & Aguilera, 2017). Due to the institutional challenges to improve CG in EMs and their dearth of available and reliable data, CG research in EMs is less extended and started later, although, this trend is changing rapidly.

CG in EMs firms is important from the investors' point of view because effective CG might make up for country weakness in the overall national governance system—for example, in terms of enforcement of minority shareholder protection rights (Khanna & Zyla, 2017). It is critical to highlight at the outset that governance practices that might be considered key and effective in DMs, such as independent boards, might likely not apply or be less of a priority for EM firms, which are typically controlled by either the state or families. Firms in EMs face greater concerns associated with minority expropriation than firms in more DMs, and as a consequence, EM investors need to equip themselves with self-protection measures given the weaker legal enforcement and institutional structures. Self-protection strategies might include greater due diligence, third-party arbitration, larger discounts on price, or greater focus on firm-level governance attributes.

Law and finance scholars have explored the connection between good CG, interpreted as strong legal systems, and dispersion of ownership structures—the direct causality between the strength of a country's the law and its economic development has also been disputed (Aguilera & Williams, 2009). In the context of EMs, reducing tunneling schemes within business groups seems to be one of the most effective ways to improve governance and in turn enhance firm performance. Management and finance scholars mostly agree that effective CG in EMs might be a form of investor protection, particularly given the absence of strong institutions and presence of key institutional voids.

We emphasize that country's path-dependent socioeconomic development is critical in understanding its national CG framework. Embedded in the country's legal system and capital, product, and labor markets, the CG framework is part of a broader macro-economic and societal context. The four BRIC countries share several comparable historical paths regarding their economic transformation, state intervention, and governance structures. All of them followed similar paths of structural change from centralized economies to more open market economies, where the state continues to have an interventionist role but modified from prior to the opening of the economy. As a result, these countries have experienced an ownership shift from strong state ownership control to differing waves of privatizations, leading to an increase in private and foreign ownership, and to indirect ways of state intervention in the economy. These changes have paved the way to the adoption of more effective forms of CG practices, the implementation of which varies substantially across the four BRICs. For this purpose and in an effort to facilitate a systematic comparison, we discuss each country's overall CG dimensions following the OECD Principles—this is summarized in Table 2 in the chapter.

In short, overall BRIC countries face corporate challenges derived from weak institutional environments, which could partly be tackled by improving CG practices. There also exist macro-level challenges characteristic of rapidly growing economies such as social and economic inequality, political risk, environmental spillovers, corruption, etc., all of which make the institutional environment uncertain. It is fascinating to observe that these countries tend to operate in a two speed economies, one in which large firms navigate versus the informal economy of SMEs. The former is fully integrated into the global economy, while the latter is embedded in the local constraints and flows more informally. Some of the traditional governance practices widely adopted in advanced industrialized countries will not be effective in these environments; they might in fact have unintended outcomes, and therefore often governance solutions might need to be implemented at the firm level or at the sectorial level in order to have a competitive plain field. It seems that a core difficulty in these markets has been the principal–principal agency problem between majority shareholders and minority shareholders, and the risk of expropriation. A firm-level governance solution to attract investment and build confidence is to improve the levels of corporate transparency and disclosure quality in EMs.

We conclude that more research is necessary to properly understand CG in EMs. We urge scholars to move away from applying Western-centric models of CG to the EM reality and seek to apply context-dependent concepts such as trust, informal norms, process, political power, rule of man, etc., that can help capture the important nuances of these countries that have changed so dramatically so quickly, and how they compete in their integration into the global markets.

The complete chapter is available for download here.

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