2

Taking Stock of the Principal–Principal Agency Perspective: A Review and the Way Ahead

Kshitij Awasthi

Introduction

Governance has been one of the major issues faced by corporations ever since the industrial revolution. In his book, *The Wealth of Nations*, Adam Smith (1776) provided the first recognized instance of governance-related discussion by expressing concern about examining the organizational and public policy consequences of the separation of ownership and control in large firms. However, it was the groundbreaking work of Berle and Means (1932), addressing the concerns of Smith (1776) almost 150 years later, which led to a theory of governance in modern enterprises that have both widely dispersed ownership and separation of ownership and control. They conceptualized that owners of modern corporations are different from controllers (managers); this idea became the basis for a rich stream

K. Awasthi (✉)
Indian Institute of Management Bangalore, Bangalore, India
e-mail: kshitijawasthi@yahoo.co.in

© The Author(s) 2017

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_2

of research. Jensen and Meckling (1976: 311) proposed that the firm is "a nexus of contracts" and that there is the divergence of interest between principals (owners) and agents (managers). This divergence of interest leads to what is known as "agency cost". One of the principal objectives of corporate governance is to minimize these agency costs, by creating incentive systems to align the interests of agents (who are assumed to be opportunistic and self-interested) with those of principals and/or by providing proper monitoring mechanisms.

Principal–agent relations have been studied widely in a developed-economy context in the corporate governance literature. Agency theory has become one of the major theoretical perspectives used to understand corporate governance, in general, and board structure, board functions, and CEO compensation, in particular. However, in several other economic contexts, particularly emerging economies, the institutional structure leads to concentrated ownership, and a different kind of agency conflicts—between majority (controlling) and minority shareholders (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008), usually termed as principal–principal relations (Dharwadkar, George, & Brandes, 2000). The past two decades of research on institutional theory have led to better understanding of the impact of institutional environments, and the emergence of the principal–principal governance model in studies set in emerging and transition economies. Young et al. (2008) provided the first major conceptual overview of principal–principal research. However, the field has witnessed considerable scholarship since then, and progress has been made, particularly with respect to empirical testing of the previously laid theoretical groundwork. This chapter builds on the conceptual overview of Young et al. (2008), synthesizing significant developments in this subfield of corporate governance on both the theoretical and empirical fronts. Another major focus area of the chapter is to provide directions for future research, in order to continue to develop our understanding of corporate governance in general, and the principal–principal issue in particular.

The remainder of the chapter is structured as follows. A comparison of the traditional agency and principal–principal perspectives is followed by an overview of institutional aspects of corporate governance in the context of emerging economies and exposition of a conceptual stream of research pertaining to the principal–principal model. The remaining

section reviews recent developments in the empirical testing agency theory in emerging markets, and the chapter concludes with discussion and directions for future research.

Principal–Agent and Principal–Principal Conflicts

Traditional agency relations involve the principal, the agent, and the contractual relationship between them. The agency problem occurs because of differences in the interests and risk-appetites of the principal and the agent, and the difficulty associated with the monitoring of the agent's behavior by the principal (Eisenhardt, 1989). Agency theory is based on the assumption that people are self-interested, risk-averse, and driven by bounded rationality. This agency model has been applied widely both in descriptive and normative studies of corporate governance. However, researchers have recognized that this agency model, alone, does not capture the corporate governance practices across all institutional (La Porta, Lopez-de-Silanes, & Shleifer, 1997, La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998) and national contexts (Aguilera & Jackson, 2003). The traditional model of agency theory, or the principal–agent problem, is applicable to developed economies, particularly in Anglo-American contexts that are characterized by relatively better enforcement of property rights (Peng, 2003). Given that ownership and control are largely separated in these legal environments, principal–agent conflicts are the primary focus of practice and research.

This model, however, does not necessarily reflect the agency relations and corporate governance practice in other institutional contexts, as those of emerging economies. The emerging-market institutional context makes the enforcement of agency contracts difficult, due to weak formal and informal institutions (North, 1990). To reduce agency costs in such contexts, corporations tend to have more concentrated ownership (Dharwadkar et al., 2000). This, to some extent, solves the traditional agency issue. However, concentrated ownership, combined with an absence of effective external governance mechanisms, is expected to result

in more frequent conflicts between controlling shareholders and minority shareholders (Morck, Wolfenzon, & Yeung, 2005). Consideration of the effect of institutional context on corporate governance led to the principal–principal model, which focuses on the conflicts between different sets of principals within the firm (Young et al., 2008), particularly on conflicts between controlling and minority shareholders (Dharwadkar et al., 2000). Thus, principal–principal conflicts can be viewed as resulting from concentrated ownership, extensive family ownership and control, business group structures, and weak legal protection of minority shareholders (Young et al., 2008).

Table 2.1 Comparison of traditional principal-agent model and principal-principal models

	Principal-agent agency model	Principal-principal agency model
Agency cost	Due to divergence of interests between shareholders (principal) and managers (agent)	Due to possibility of expropriation of minority shareholders by the controlling shareholder group
Institutional context	Majorly developed countries	Majorly emerging/transition economies
Assumptions	Bounded rationality, opportunism, self-interest, maximizing agents	Controlling shareholders maximizing wealth even at the cost of minority shareholders, managers follow majority owners' objectives
Reasons for conflict	Opportunism and self-interest behavior by managers in dispersed ownership	Expropriation of minority shareholders by large shareholders and their appointed managers due to weak minority shareholder protection
Concept of shareholders	Homogeneous group	Heterogeneous (controlling and minority)
Largest shareholders	Hardly visible, not too strong	State-owned enterprises, family ownership, pyramid ownership
Role of boards	Monitoring agents	Negligible, facilitating majority shareholder's interest
Forms of expropriation	Managerial entrenchment, empire building, private benefits to managers	Below market value asset transfers to controlling owner, personal/private benefits of large controlling shareholders
Liquidity of stocks	Usually high	Generally low

Thus, it can be asserted that the principal–agent and principal–principal agency models have different antecedent institutional environments and distinguishing between them should, therefore, be useful in analyzing corporate governance issues in the applicable institutional contexts. It is pertinent, then, to understand the fundamental differences in assumptions and application between these models, so as to have a clearer picture of corporate governance practices in developed and emerging economies. Table 2.1 provides a comparison between the two agency models on some key dimensions of corporate governance.

Corporate Governance in Emerging Economies

The major difference between the two types of agency models (principal–agent and principal–principal) comes from the underlying institutions in which they are applicable. Institutions have two crucial constituents—environment and arrangements (Davis & North, 1971). The institutional environment refers to the background constraints or "rules of the game" that guide individuals' behaviors (North, 1990). These rules can be both formal and explicit (e.g., constitutions, laws, property rights) and informal and often implicit (e.g., social conventions, norms). The institutional environment forms the framework in which human action takes place. North (1990: 4) asserts that institutions "define and limit the set of choices of individuals". Institutional arrangements, on the other hand, are specific guidelines that are also referred to as "governance structures". Coase (1937, 1960) made the crucial connection among institutions, transaction costs, and neoclassical theory. The neoclassical result of efficient markets only eventuates when it is costless to transact; however "when it is costly to transact, institutions matter" (North, 2006: 2). The institutional context in general, and property rights in particular, are crucial determinants of the efficiency of markets and of corporate governance practices which differ substantially between emerging/transition economies and developed economies.

Emerging economies can be defined as "low-income, rapid-growth countries using economic liberalization as their primary engine of growth" (Hoskisson, Eden, Lau, & Wright, 2000: 249). These economies

are further characterized by their attempt to transition toward market-based mechanisms, rather than the traditional relation-based system, due to internal need or external pressure (Peng, 2003). In other words, the transition signifies the state when an emerging economy is in the process of moving from a "relation-based" to a "rule-based" system (Peng, Lee & Wang, 2005). However, this transition is generally not smooth; formal rules may change overnight, but informal rules take time to change (North, 1991), as a result of institutional stickiness that is also known as "institutional rigidity" or "path dependence" (North, 1994).

The institutional differences between developed and emerging economies come from formal rules (e.g., relatively weaker property rights/contract law, ambiguous role of boards, less protection for minority shareholders), as well as informal rules (e.g., prevalence of family-owned business, preferential pricing for group companies). Even more pressing is the weak enforcement of prevailing laws in emerging economies. This weak enforcement leads to different types of conflicts within emerging-economy organizations. The principal–agent conflict, as described by Jensen & Meckling (1976) and others, may not, thus, account for conflicts typical in emerging economies. Indeed, some researchers have noted that standard corporate governance mechanisms have relatively little institutional support in emerging economies (Peng, 2004; Peng, Buck, T. & Filatotchev, 2003).

Thus, the institutional context in emerging economies lends itself to a different type of agency issues, principal–principal conflicts, created by concentrated ownership and control and inadequate institutional protection of minority shareholders. Emerging-economy contexts include weak governance practices such as fewer publicly traded firms (La Porta et al., 1997), information asymmetry and abuse (Morck, Yeung, & Yu, 2000), and expropriation of minority shareholders (Claessens, Djankov, & Lang, 2000; Faccio, Lang, & Young, 2001). These arrangements lead to lower levels of dividend payouts (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000) and, ultimately, to lower firm valuations (Claessens, Djankov, Fan, & Lang, 2002; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2002).

When an economy grows and moves toward a market-based system, the transition may be in the best interest of the future prospects for "threshold firms", which are near the point of transition from a founder-

based system to a professionally managed firm (Daily & Dalton, 1992). However, due to ambiguity over the law, problems with implementation and the potential for short-term disadvantage often lead owners to retain control even during transition. Moreover, failure to make the transition may worsen principal–principal conflicts (Young et al., 2008). This situation results in the continuance of informal institutions such as relational ties, business groups, family business, and government contacts all playing greater roles in shaping corporate governance (Peng & Heath, 1996; Yeung, 2006).

In summary, it can be asserted that the corporate governance practices in emerging economies often differ substantially from those in developed economies (Backman, 1999; Peng, 2004). Hence, the corporate governance in emerging economies leads to a different set of agency issues, specifically principal–principal conflict, which is becoming a major area of interest among corporate governance scholars studying emerging economies.

The State of Research in Principal–Principal Conflicts

Research on the traditional agency model highlights several governance mechanisms aimed at reducing conflict. These governance mechanisms are both external (e.g., product market competition and the market for corporate control) and internal (e.g., concentrated ownership, CEO compensation, and the board of directors). The optimal combination of these interdependent mechanisms (Jensen, 1993) leads to effective corporate governance. However, the efficiency of such a mechanism varies across institutional contexts; different countries have different efficiencies pertaining to external and internal control mechanisms (La Porta et al., 1997, 1998, 2002). The institutional setting in emerging economies calls for a "different bundle of governance mechanisms since the corporate governance conflicts often occur between two categories of principals—controlling shareholders and minority shareholder" (Young et al., 2008; 199). Therefore, corporate governance research set in emerging economies needs to look at governance mechanisms that are different from those employed in developed-economy contexts.

The principal–principal conflict, though a relatively new topic of governance research, has evolved in several directions. Key areas of investigation have been about the primary drivers of conflict (Young et al., 2008), the effect of principal–principal problems on various life cycle stage of firms (Zahra & Filatotchev, 2004), means of expropriation by dominant shareholders (Faccio et al., 2001; Chang & Hong, 2000; Khanna & Rivkin, 2001), and comparisons of empirical evidence of the two agency models (Bruton, Filatotchev, Chahine, & Wright, 2010). These are discussed in more detail.

Primary Drivers of Conflict

Dominant Ownership

This aspect of principal–principal conflict has drawn considerable research attention. First, considering reasons for concentrated ownership, one stream of literature discusses that "threshold" firms—those in transition from founder to professional management—experience the need to provide some private information to outsiders (Daily & Dalton, 1992), something that had not been required under the previous governance regimes. This disclosure of information requires that the founding family place its trust (Zahra & Filatotchev, 2004) in a new set of professional managers. This trust may be particularly difficult to achieve in an emerging economic environment (North, 1990). Moreover, institutions that might facilitate such trust may be lacking in emerging economies, which make crossing the threshold from dominant to dispersed ownership more difficult (Young et al., 2008). The second issue cited commonly is the presence of both external and internal corporate governance mechanisms. As discussed above, developed economies are more likely to provide something close to an optimal bundle of mechanisms (Fama & Jensen, 1983) to facilitate smooth corporate governance. Key external governance mechanisms, such as product and labor markets, or markets for corporate control, are more mature in developed economies; in contrast, the governance mechanisms in emerging economies may not be efficient enough with respect to forcing managers to behave in the

interest of shareholders (Djankov & Murrell, 2002). Similarly, internal governance mechanisms (board structure and independence, monitoring and control rights) in emerging economies are also weaker (Fama & Jensen, 1983), meaning that firms are forced to rely on dominant ownership to keep potential managerial opportunism in check (Dharwadkar et al., 2000). The social antecedents of dominant ownership have also been studied; Young et al. (2008), for example, identified three sets of institutional antecedents of concentrated ownership: family businesses, business groups, and state-owned enterprises (SOEs).

Family Businesses In emerging economies, controlling ownership is often in the hands of a family (La Porta, Lopez-de-Silanes, & Shleifer, 1999). This has both costs and benefits. On one hand, it reduces agency costs by aligning ownership and control. Family ties assist firms in reducing monitoring costs, which may lead to enhanced performance (Young et al., 2008). On the other hand, family ownership and control may also increase the possibility of expropriation of other minority shareholders by family shareholders, negatively affecting the firm. Further, family owners may not allocate resources efficiently, and may give preference to social relations over efficiency. This inefficiency can be reflected in outcomes such as the appointment of under-qualified family members to key posts (Claessens et al., 2000), non-merit-based compensation, and inefficient strategic decisions.

The net advantage or disadvantage of family control depends upon a myriad of factors. Family firms tend to perform well in low-munificence and complex, but highly dynamic, environments, while struggling in converse scenario (Gedajlovic, Lubatkin, & Schulze, 2004; Young et al., 2008).

Business Groups A business group is "a collection of legally independent firms that are bound by economic (such as ownership, financial and commercial) and social (such as family, kinship and friendship) ties" (Yiu, Bruton, & Lu, 2005: 183). Usually, each of the member firms in a business group is a distinct business entity, in legal terms (Young et al., 2008). In many emerging economies, business groups and family businesses are

coalesced; that is, various group companies are owned by different family members. Though business groups are commonplace in many developed economies, they are relatively more widespread in emerging economies (Peng, Lee, & Wang, 2005; Yiu et al., 2005).

A business group structure may provide more advantage in emerging economies (Chakrabarti, Singh, & Mahmood, 2007; Khanna & Palepu, 2000). Internal resource allocations among constituent firms become particularly important in emerging economies, due to less developed markets for critical resources such as capital. Often, emerging economies lack a well-functioning external capital market. Even if the external capital market is fully functional, firms within a business group are sometimes denied external capital because they are not able to signal value creation from specific projects, especially if group resources are tied up with multiple ongoing projects (Myers & Majluf, 1984). The business group's internal capital market provides an alternative, and creates value by efficiently allocating resources among member firms (Stein, 1997); nonetheless, business groups also have to bear coordination and administration costs (Claessens et al., 2002).

The business group also escalates the opportunity for expropriating minority shareholders by inefficient and veiled resource transfers, thus affecting minority shareholder interests in some member firms. For example, to help a group firm, inputs from a sister firm may be bought at higher-than-market prices, or output can be sold to a sister firm below market price. Similarly, a group company can invest in projects of other group firms, even if this is not fully economically desirable. This is arguably more likely to happen when the control rights of the controlling shareholders are greater than their cash flow rights, which can lead to a practice known as "pyramiding" (Bertrand, Mehta, & Mullainathan, 2002; Claessens et al., 2002). For example, consider that Firm A has 50 % control over Firm B, which, in turn, has 50 % control over Firm C. In this case, Firm A has a 25 % cash flow right in Firm C, but more like 50 % control right, given its ability to also act through Firm B. Under such conditions, owners have the ability to divert resources from Firm C to Firm A, so as to enjoy better cash rights. The literature on internal capital markets suggests that business groups are prone to over-investment and lobbying costs (Rajan, Servaes, & Zingales, 2000), thereby reducing value.

In summary, principal–principal conflict is viewed as more likely to surface in emerging markets, where business groups are known to give preferential treatment to some member firms, over and above economic and efficiency considerations.

State-Owned Enterprises In emerging economies, for social, political, and historical reasons, many of the largest firms are controlled by the state. For example, Xu and Wang (1999) note that, in China, about two-thirds of the shares in publicly listed companies are owned by the state, either directly or through other SOEs. Dharwadkar et al. (2000) note the prevalence of SOEs in emerging economies, asserting that, even post-privatization, the structure of several SOEs resembles their previous structures, at least in practice, due to rigidities associated with the systematic involvement of insiders, including managers, employees, and the state. This insider dominance in privatized firms risks the creation of principal–principal agency issues (Dharwadkar et al., 2000).

Means of Expropriation by Controlling Shareholders

The mechanisms employed in the expropriation of minority shareholders represent another area that has drawn attention of scholars in this field. This stream of research looks at the methods or instruments by which controlling shareholders fulfill their objectives at the cost of minority shareholders. Faccio et al. (2001), for example, found that controlling owners may put less than fully qualified family members, friends, and associates in key positions, thereby reducing efficiency that could have been gained by selection of professional on an arm's length basis. Moreover, controlling shareholders may engage in the purchase of inputs at higher-than-market price and/or the supply of output at lower-than-market price, to firms that they own or with which they have some association (Chang & Hong, 2000; Khanna & Rivkin, 2001). Social and political objectives may mean that the benefits of such preferential treatment may accrue to firms owned by other family members, a sister concern in the business group, or other SOEs. Backman (1999) also looked at the possibility of engaging in suboptimal strategies that advance personal

or family agendas (political/social, in many cases) at the expense of firm performance, including excessive diversification and empire building.

Other Areas

Apart from those discussed above, some research has touched peripheral areas, such as the differential effect of principal–principal conflict on firms at different life cycle stages. In an empirical study, Zahra and Filatotchev (2004), for example, found that young entrepreneurial firms are more likely than mature firms to face principal–principal agency issues. Recently, researchers have also tried to disentangle the effects of both agency-related conflicts—principal–agent and principal–principal—suggesting a multi-agency perspective (e.g. Bruton et al., 2010).

Principal–Principal Agency Costs and Firm Performance

Young et al. (2008) discuss three reasons why these costs may be higher in emerging economies: (1) ambiguous institutional structures (North, 1990; Peng, 2003) that can lead to higher costs of measuring contract terms, (2) less effective boards of directors, due to the propensity of top managers to also be controlling shareholders (Dharwadkar et al., 2000), and (3) decreased liquidity due to ownership concentration (Morck et al., 2005). Additionally, as discussed at some length in the last section, some researchers have argued that principal–principal conflicts also affect organizational performance by “corrupting firm strategy” (Young et al., 2008: 209).

The issues mentioned above may affect the cost of capital and cause severe damage to firms’ sustainability. First, the cost of external capital increases because minority shareholders, understanding expropriation risks, may demand higher returns in the form of dividends (Gomes, 2000; Lins, 2003). Second, cost of equity can rise, due to the under-pricing of public offering resulting from the possibility of principal–principal agency conflict (Gomes, 2000). As external financing becomes difficult or costly, firms need to rely on internal financing, which may lower their market capitalization, especially in emerging economies (La Porta et al., 1998, 2002).

In most of the scenarios, as discussed previously, minority shareholders risk being expropriated, and may be incentivized to exit the market. A fundamental question here is why minority investors remain in the market, despite the higher possibility of expropriation. In other words, in principal–principal agency issues, how do controlling shareholders attract minority shareholder investors? Young et al. (2008: 208) argue that, in this case, the controlling shareholders may need to incur "bonding costs" as a type of implicit guarantee against expropriation. These bonding costs may take various forms, including developing "a reputation for treating minority shareholders well" (Gomes, 2000: 616).

To summarize, principal–principal conflicts may undermine the firm's competitiveness and discourage investor participation, which, in turn, increases the cost of capital through higher dividends and lower prices for equity offerings. To save themselves from this long-term disadvantage, firms facing this type of agency conflict probably need to either transform themselves into professionally run organizations or attempt to reduce agency costs by taking measures such as building a reputation for engaging in fair practices.

Overview of Recent Empirical Studies and Methodology

There seems to be broad consensus among corporate governance scholars that traditional agency models alone can neither describe nor prescribe corporate governance practices for firms in emerging economies. This is a primary factor behind the prominence that principal–principal agency models have gained for studying corporate governance practices in such contexts. The development of this subfield has been rather rapid. From a focus on theoretical development over the past two decades, it has started to produce a flurry of empirical studies in recent years; see Table 2.2. The areas addressed in the empirical research have been quite varied; some of these are discussed briefly in the following paragraphs.

Type of Ownership As noted in the section on conceptual developments, type of ownership has been a major area of empirical research in this subfield. Ownership types considered to date have included family firms

Table 2.2 Some recent empirical studies on principal-principal agency relations

Authors	Study	Method and sample	Data analysis	Results
Su, Xu and Phan (2008)	Principal–principal problem in boards of Chinese publicly listed companies	Six years panel data of listed Chinese firms in two stock exchanges	Feasible generalized least squares (FGLS) regression	Curvilinear (U-shape) relationship between ownership concentration and principal–principal agency cost
Chen and Young (2010)	Cross-border mergers and acquisitions by Chinese-listed companies	39 cross-border mergers and acquisitions by Chinese companies between 2000 and 2008	Event study, instrumental variable, multiple regression	Investors look unfavorably to state-dominant acquirers in overseas mergers and acquisitions
Bruton et al. (2010)	Multiple agency theory, impact of venture capitalist and business angels in determining IPO performance in UK and France	Hand-collected data of 224 IPOs (112 each from France and the UK), multi-method	Matched pair and two-stage least squares (2SLS) regression	Effect of ownership concentration on corporate governance varies with institutional context
Lu, Xu, and Liu (2009)	Impact of corporate governance and institutional environments on the export behavior of firms in emerging economies	779 Chinese-listed manufacturing firms for the period of 2002–2005	Random effect Tobit and GMM models	Principal–principal conflict affects (inverted U) the export-related decision in emerging economies.

Peng and Jiang (2010)	Family ownership and control in large firms and role of legal and regulatory institutions	Event study of 634 publicly listed large family firms in seven Asian countries around the Asian financial crisis	Ordinary least squares (OLS) regression	The net balance of the benefits and costs of family control in large firms depends on the legal and regulatory institutions governing investor protection.
Renders and Gaeremynck (2012)	Impact of principal–principal agency problems on the quality and effectiveness of corporate governance structures	1064 year-firm observations from 14 European countries	Factor analysis and simultaneous equation modeling	There is some cost of installing good governance, but it creates value in long run.
Ward and Filatotchev (2010)	Agency problems associated with mutual and joint stock organizational forms	Panel data set consisting of 42 UK life insurance companies over the period 1990–1997	Dynamic panel data estimation	Mutuals have higher principal–agent and principal–principal costs, compared with stocks; independent distribution mitigates both agency problems.

(*continued*)

Table 2.2 (continued)

Authors	Study	Method and sample	Data analysis	Results
Bhaumik et al. (2010)	Impact of ownership structures of emerging-market firms on the decision to undertake outward FDI	Panel data for 2000–2006, on 196 automotive and 581 pharmaceutical firms of Indian ownership	Panel data Tobit maximum likelihood estimation	Family firms and firms with concentrated ownerships are less likely to invest overseas.
Jiang and Peng (2010)	Principal–principal conflicts during crisis	877 publicly listed large corporations with concentrated ownership in seven Asian countries and regions	2SLS regression	Family firms tend to choose certain control structures associated with potential principal–principal conflicts.
Jiang and Peng (2011)	Effect of concentrated family ownership and control on firm performance	744 publicly listed large family firms in eight Asian countries	OLS regression	Concentration effect varies across countries, but is irrelevant at aggregate level.
Hu et al. (2009)	Effects of internal governance mechanisms in enhancing firms' value in China	3-year (2003–2005) panel data covering 304 Chinese publicly listed companies	Structural equation modeling	Ownership concentration has significant negative governance effect.
Chen et al. (2011)	Whether adopting OECD-prescribed corporate governance principles can solve the major corporate governance problems in an emerging economy	Panel data of over 1100 Chinese-listed firms between 2001 and 2003	Fixed-effect panel OLS regression	"Good governance practices" in OECD countries do not mitigate the principal- principal issue.

Filatotchev et al. (2011)	How family control affects private information abuses and firm performance in emerging economies	447 companies listed on Hong Kong Stock Exchange in 2006	2SLS regression	Family ownership and family board dominance increase private information abuse risk.
Banchit et al. (2011)	Impact of principal–principal conflicts on performance in Islamic banking	Panel data (2005–2010) of 37 banks that adopt Islamic banking in 10 countries	Feasible generalized least square (FGLS)	Principal–agent is the primary concern with inconclusive results for principal–principal conflicts.
Banchit and Locke (2011)	Principal–principal cost and conflict in large publicly listed companies in four ASEAN countries	193 listed companies from four ASEAN countries	OLS regression	Principal–principal cost is a major problem in ASEAN markets.
Shan (2014)	Impact of internal governance mechanisms on audit quality	Panel data (2001–2005) of 117 Chinese companies	Logistic regression	Foreign ownership and number of professional supervisors are positively related, and the size of the supervisory board is negatively related, to audit quality

(Peng & Jiang, 2010; Jiang & Peng 2011; Filatotchev, Zhang, & Piesse, 2011), business groups (Bhaumik, Driffeld, & Pal, 2010), and SOEs (Su, Xu, & Phan, 2008; Chen & Young, 2010).

Strategic Decisions and Industry Contexts Several studies link principal–principal conflict to strategic decisions, investigating its effect on cross-border mergers and acquisitions (Chen & Young, 2010), IPOs (Bruton et al., 2010), the internationalization process (Lu, et al., 2009), outward foreign direct investment (FDI) (Bhaumik et al., 2010), and performance during crisis (Jiang & Peng, 2010). However, this research has tended not to focus industry-specific contextualization; most studies have employed mixed-industry data, apart from exceptions pertaining to the automotive and pharmaceutical (Bhaumik et al., 2010) and insurance (Ward & Filatotchev, 2010) industries.

National Contexts The extant literature in this subfield has focused strongly on the Chinese context (Su et al., 2008; Chen & Young, 2010; Lu et al., 2009; Hu, Tam, & Tan, 2009; Chen, Li, & Shapiro, 2011; Filatotchev et al., 2011; Banchit, Locke, Abidin, & Wellalage, 2011; Shan, 2014) and Association of South East Nations (ASEAN) countries (Peng & Jiang, 2010; Jiang & Peng, 2010, 2011; Banchit & Locke, 2011). However, other national contexts have also been addressed, including India (Bhaumik et al., 2010) and the BRIC (Brazil, Russia, India, and China) countries (Estrin & Prevezer, 2011). Moreover, particularly interesting for the development of the subfield have been the studies testing principal–principal perspective in developed countries, including the UK (Ward & Filatotchev, 2010), France and the UK (Bruton et al., 2010), and 14 European countries (Renders & Gaeremynck, 2012); in addition, Banchit et al. (2011) considered this issue in the context of Islamic banking. Evidence of principal–principal conflict in developed economies (e.g., Ward & Filatotchev 2010) is particularly promising in terms of theory development.

Methodology

As evident from Table 2.2, most of the empirical research has concentrated on quantitative studies based on secondary financial market data.

Although there have been some cross-sectional studies (e.g., Banchit & Locke, 2011; Filatotchev et al., 2011), most of the studies have used a panel data approach. As far as data analysis is concerned, Table 2.2 reflects a wide variety in the techniques used, including ordinary least squares (e.g., Banchit & Locke, 2011; Peng & Jiang, 2010), two-stage least squares (Filatotchev et al., 2011), logistic regression (Shan, 2014), and simultaneous equation modeling (Hu et al., 2009).

Discussion and Future Research Direction

Based on the previous discussion, it can be seen that there has been a considerable amount of conceptual development in the field of principal–principal agency. The broad areas of enquiry have been those pertaining to institutional antecedents of principal–principal conflicts, the *modus-operandi* of expropriation of minority shareholders, and solutions to these problems. On the empirical front, the lack of consensus on constructs and measurement initially hindered hypothesis testing. However, over the years, there has been noticeable surge in the number of empirical studies involving use of different operationalizations of constructs. The empirical studies in this relatively nascent field have been quite varied, and these have shown enough evidence regarding the topic to give rise to the expectation of future developments in the field.

Implications and Future Research Direction

This chapter has attempted to provide a conceptual overview of the development of the subfield of principal–principal agency, with particular emphasis on the empirical front. Though there have been fast-paced developments in the subfield, there is still much more to understand, both conceptually and empirically. The evidence of principal–principal conflicts in developed economies has opened the floodgates for future research on corporate governance. This evidence provides not only an opportunity to compare institutional context in corporate governance studies but also shows a way forward for the multi-agency perspective to be used to develop stronger explanation of corporate governance practices.

While many studies addressing this perspective have focused either on China or on ASEAN countries, there remains a clear opportunity to extend our understanding of principal–principal conflicts in the context of other emerging markets, particularly India. Further, studies addressing specific industry contexts will enable researchers to control for industry-wide differences in corporate governance practices in particular institutional contexts, and allow for micro-understanding of the institutions prevailing in such economies. Pertinent cases for developing deeper insights might include more regulated industries, such as airlines and petroleum/mining, along with less regulated industries, such as retailing. More institutional-level classifications of economies, based on legal system or property rights, including comparisons of civil law and common law contexts, will add nuanced understanding and build on the developed versus emerging-economy dichotomization in the corporate governance context. As an example, Bruton et al. (2010) compare two developed countries—the UK and France—which have different legal systems, and identify significant variation in the corporate governance practices in these two countries.

On the other hand, it might be helpful to question even the micro-foundations of principal–principal conflicts. For example, until now, scholars have been considering "family" as a homogeneous unit in family-run business. However, differences in interest among family members within these firms are observed quite often in emerging economies; such differences may lead to within-family agency issues. In the same vein, studies that compare economies within more similar institutions (e.g., BRIC, which are considered emerging economies) on various dimensions of corporate governance (e.g., family businesses, business group characteristics, or the nature of SOEs) can further tease out distinctions and enhance our understanding.

Similarly, more work is needed regarding the social embeddedness of organizations, which may lead to institutional rigidity. For example, in many emerging economies, for a family member to assume the business leadership of the firm is a norm, and the appointment of a new leader from outside of the family does not elicit a positive response from investors. Such norms are social phenomena and characteristics of the under-

lying institution. Nonetheless, understanding and accounting for such norms is important for researchers and practitioners alike.

In broad conceptual terms, more multi-agency studies are required for theory development as well as for a better understanding of corporate governance practices. Development on this front can lead to a grand theory of agency, which can potentially be generalized to a higher degree. On the empirical front, longitudinal case studies of corporate governance practices and their evolution, in both developed- and emerging-economy contexts, will shed light on the evolutionary aspects of these issues.

Overall, apart from these potential areas of development, the principal–principal perspective also needs to address many questions moving further afield. Examples include the role of managers in the principal–principal setting, and the impact of basic tenets of decision-making related to corporate finance (e.g., capital structure, financing, diversification). Even more challenging will be distinguishing between deliberate and specifications related to minority shareholder expropriation from those that are based on strategic choice and that may cause harm to both minority and controlling shareholders. Extending this further, it will be interesting to understand more about whether preference for social objectives, over purely economic objectives, by SOEs should be considered as minority shareholder expropriation. Also, should banking/financial institutions be considered equivalent to "minority shareholders" that are vulnerable to expropriation by controlling shareholders in institutional settings characterized by weak property rights regimes?

In summary, by addressing these issues, contributions can be made to several fields, particularly institutional theory and corporate governance. Such research offers the potential to extend agency theory, to increase its predictive and explanatory power related to corporate governance across institutions, while providing clearer understanding of institutions per se. As institutions are central to both the principal–principal perspective and institutional theory, a better understanding of institutions can address, to some extent, the concern Williamson (2000: 595) expressed, noting that "we are still very ignorant about institutions".

References

Aguilera, R. V., & Jackson, G. (2003). The cross-national diversity of corporate governance: Dimensions and determinants. *Academy of Management Review, 38*, 447–465.

Backman, M. (1999). *Asian eclipse: Exposing the dark side of business in Asia*. Singapore: Wiley.

Banchit, A., & Locke, S. (2011). Principal-principal conflicts: Is it a big problem in ASEAN 4 markets? *International Review of Business Research Papers, 7*, 1–15.

Banchit, A., Locke, S., Abidin, S., & Wellalage, N. H. (2011). *Do principal-principal or principal-agent conflicts impact the performance of Islamic banking?* Working paper No. 1930105, SSRN. [Online] Available from: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1930105&download=yes

Berle, A. A., & Means, G. C. (1932). *The modern corporation and property*. New York: Harcourt.

Bertrand, M., Mehta, P., & Mullainathan, S. (2002). Ferreting out tunnelling: An application to Indian business groups. *Quarterly Journal of Economics, 117*, 121–148.

Bhaumik, S. K., Driffeld, N., & Pal, S. (2010). Does ownership structure of emerging-market firms affect their outward FDI? The case of the Indian automotive and pharmaceutical sectors. *Journal of International Business Studies, 41*, 437–450.

Bruton, G., Filatotchev, I., Chahine, S., & Wright, M. (2010). Governance, ownership structure and performance of IPO firms: The impact of different types of private equity investors and institutional environments. *Strategic Management Journal, 31*, 491–509.

Chakrabarti, A., Singh, K., & Mahmood, I. (2007). Diversification and performance: Evidence from East Asian firms. *Strategic Management Journal, 28*, 101–120.

Chang, S. J., & Hong, J. (2000). Economic performance of group-affiliated companies in Korea: Intragroup resource sharing and internal business transactions. *Academy of Management Journal, 43*, 429–488.

Chen, V. Z., Li, J., & Shapiro, D. M. (2011). Are OECD-prescribed "good corporate governance practices" really good in an emerging economy? *Asia Pacific Journal of Management, 28*, 115–138.

Chen, Y. Y., & Young, M. N. (2010). Cross-border mergers and acquisitions by Chinese listed companies: A principal–principal perspective. *Asia Pacific Journal of Management, 27*, 523–539.

Claessens, S., Djankov, S., Fan, J., & Lang, L. (2002). Disentangling the incentive and entrenchment effects of large shareholdings. *Journal of Finance, 57*, 2741–2771.

Claessens, S., Djankov, S., & Lang, L. (2000). The separation of ownership and control in East Asian corporations. *Journal of Financial Economics, 58*, 81–112.

Coase, R. H. (1937). The nature of the firm. *Economica, 4*(16), 386–405.

Coase, R.H. (1960), 'he problem of social cost, J*ournal of Law and Economics*, *3*, 1–44.

Daily, C. M., & Dalton, D. R. (1992). Financial performance of founder-managed versus professionally managed small corporations. *Journal of Small Business Management, 30*, 25–34.

Davis, L. E. & North, D. C. *Institutional change and American economic growth*. New York: Cambridge University Press.

Dharwadkar, R., George, G., & Brandes, P. (2000). Privatization in emerging economies: An agency theory perspective. *Academy of Management Review, 25*, 650–669.

Djankov, S., & Murrell, P. (2002). Enterprise restructuring in transition: A quantitative survey. *Journal of Economic Literature, 40*, 739–792.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *The Academy of Management Review, 14*, 57–74.

Estrin, S., & Prevezer, M. (2011). The role of informal institutions in corporate governance: Brazil, Russia, India, and China compared. *Asia Pacific Journal of Management, 28*, 41–67.

Faccio, M., Lang, L., & Young, L. (2001). Dividends and expropriation. *American Economic Review, 91*, 54–78.

Fama, E., & Jensen, M. (1983). Separation of ownership and control. *Journal of Law and Economics, 26*, 301–325.

Filatotchev, I., Zhang, X., & Piesse, J. (2011). Multiple agency perspective, family control, and private information abuse in an emerging economy. *Asia Pacific Journal of Management, 28*, 69–93.

Gedajlovic, E. R., Lubatkin, M. H., & Schulze, W. S. (2004). Crossing the threshold from founder management to professional management: A governance perspective. *Journal of Management Studies, 41*, 988–1012.

Gomes, A. (2000). Going public without governance: Managerial reputation effects. *Journal of Finance, 55*, 615–646.

Hoskisson, R. E., Eden, L., Lau, C. M., & Wright, M. (2000). Strategy in emerging economies. *Academy of Management Journal, 43*, 249–267.

Hu, H. W., Tam, O. K., & Tan, M. G. (2009). Internal governance mechanisms and firm performance in China. *Asia Pacific Journal of Management, 27*(4), 727–749.

Jensen, M. C. (1993). The modern industrial revolution, exit, and the failure of internal control systems. *Journal of Finance, 48*, 831–880.

Jensen, M. C., & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs, and ownership structure. *Journal of Financial Economics, 3*, 305–350.

Jiang, Y., & Peng, M. W. (2010). Principal-principal conflicts during crisis. *Asia Pacific Journal of Management, 28*(4), 683–695.

Jiang, Y., & Peng, M. W. (2011). Are family ownership and control in large firms good, bad, or irrelevant? *Asia Pacific Journal of Management, 28*, 15–39.

Khanna, T., & Palepu, K. (2000). The future of business groups in emerging markets: Long-run evidence from Chile. *Academy of Management Journal, 43*, 268–285.

Khanna, T., & Rivkin, J. (2001). Estimating the performance effects of business groups in emerging markets. *Strategic Management Journal, 22*, 45–74.

La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (1997). Legal determinants of external finance. *Journal of Finance, 52*, 1131–1150.

La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (1999). Corporate ownership around the world. *Journal of Finance, 54*, 471–517.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (1998). Law and finance. *Journal of Political Economy, 106*, 1113–1155.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (2000). Investor protection and corporate governance. *Journal of Financial Economics, 58*, 3–27.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (2002). Investor protection and corporate valuation. *Journal of Finance, 57*(3), 1147–1170.

Lins, K. V. (2003). Equity ownership and firm value in emerging markets. *Journal of Financial and Quantitative Analysis, 38*, 159–184.

Lu, J., Xu, B., & Liu, X. (2009). The effects of corporate governance and institutional environments on export behaviour in emerging economies: Evidence from China. *Management International Review, 49*, 455–478.

Morck, R., Wolfenzon, D., & Yeung, B. (2005). Corporate governance, economic entrenchment, and growth. *Journal of Economic Literature, 63*, 655–720.

Morck, R., Yeung, B., & Yu, B. W. (2000). The information content of stock markets: Why do emerging markets have synchronous stock price movements? *Journal of Financial Economics, 58*, 215–260.

Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. *Journal of Financial Economics, 13*(2), 187–221.

North, D. C. (1990). *Institutions, institutional change and economic performance*. New York: Norton.

North, D.C. (1991). Institutions. *Journal of Economic Perspectives*, *5*(1) 97–112.

North, D. C. (1994). Economic performance through time. *American Economic Review, 84*, 359–368.

North, D. C. (2006). *Understanding the process of economic change*. New Delhi: Academic Foundation.

Peng, M. W. (2003). Institutional transitions and strategic choices. *Academy of Management Review, 28*, 275–296.

Peng, M. W. (2004). Outside directors and firm performance during institutional transitions. *Strategic Management Journal, 25*, 453–471.

Peng, M. W., Buck, T., & Filatotchev, I. (2003). Do outside directors and new managers help improve firm performance? An exploratory study in Russian privatization. *Journal of World Business*, *38*(4), 348–360.

Peng, M. W., & Heath, P. (1996). The growth of the firm in planned economies in transition: Institutions, organizations and strategic choice. *Academy of Management Review, 21*, 492–528.

Peng, M. W., & Jiang, Y. (2010). Institutions behind family ownership and control in large firms. *Journal of Management Studies, 47*, 253–273.

Peng, M. W., Lee, S.-H., & Wang, D. (2005). What determines the scope of the firm over time? A focus on institutional relatedness. *Academy of Management Review, 30*, 622–633.

Rajan, R., Servaes, H., & Zingales, L. (2000). The cost of diversity: The diversification discount and inefficient investment. *The Journal of Finance, 55*, 35–80.

Renders, A., & Gaeremynck, A. (2012). Corporate governance, principal-principal agency conflicts, and firm value in European listed companies. *Corporate Governance: An International Review, 18*, 87–106.

Shan, Y. G. (2014). The impact of internal governance mechanisms on audit quality: A study of large listed companies in China. *International Journal of Accounting, Auditing and Performance Evaluation, 10*(1), 68–90.

Smith, A. (1776). *The wealth of nations*. New York: Modern Library.

Stein, J. C. (1997). Internal capital markets and the competition for corporate resources. *The Journal of Finance, 52*, 111–133.

Su, Y., Xu, D., & Phan, P. H. (2008). Principal-principal conflict in the governance of the Chinese public corporation. *Management and Organization Review, 4*, 17–38.

Ward, D., & Filatotchev, I. (2010). Principal–principal–agency relationships and the role of external governance. *Managerial and Decision Economics, 31*, 249–261.

Williamson, O. E. (2000). The new institutional economics: Taking stock, looking ahead. *Journal of Economic Literature, 38*, 595–613.

Xu, X., & Wang, Y. (1999). Ownership structure and corporate governance in Chinese stock companies. *China Economic Review, 10*, 75–98.

Yeung, H. (2006). Change and continuity in Southeast Asian Chinese business. *Asia Pacific Journal of Management, 23*, 229–254.

Yiu, D., Bruton, G. D., & Lu, Y. (2005). Understanding business group performance in an emerging economy: Acquiring resources and capabilities in order to prosper. *Journal of Management Studies, 42*, 183–206.

Young, M., Peng, M. W., Ahlstrom, D., Bruton, G., & Jiang, Y. (2008). Corporate governance in emerging economies: A review of the principal-principal perspective. *Journal of Management Studies, 45*, 196–220.

Zahra, S., & Filatotchev, I. (2004). Governance of the entrepreneurial threshold firm: A knowledge-based perspective. *Journal of Management Studies, 41*, 885–897.