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# Revisiting the Fundamental Theories of Corporate Governance: Do the Westernized Models Fit Emerging Economies?

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## Abstract

The study revisits the fundamental theories of corporate governance, such as agency theory, stakeholder theory, stewardship theory, and resource dependence theory. Each of the theories identifies the nature of the relationship between the owners and managers and proposes courses of action that could be implemented to foster organizational outcomes. Although there exist differences in views among the proponents of the governance philosophies, these theories are essentially developed for the countries in which diffused ownership pattern is the standard. Following the standardized theories, many developing countries have also adopted Westernised models. However, the outcome of incorporating the mechanisms is inconclusive. Therefore, this study suggests developing codes of governance that prioritizes the prevailing cultural, economic, and institutional dynamics of emerging economies.

**Keywords:** Agency Theory, Principal-Agent Problem, Principal-Principal Problem, Emerging Economy

## 1. Introduction

Corporate governance (CG) is a collection of guidelines, procedures, and controls designed to guarantee that the directors are subject to establishing checks and balances in protecting the interests of all stakeholders. CG has its root in the seminal research on the separation of ownership and control (Berle and Means, 1932) with an emphasis on the potential differences of opinions between shareowners and executives. Moreover, the complex nature of global business and escalating pressure from shareholders have been making the prominence of CG almost undeniable to the top-level management. However, it is a matter of inquiry whether the same set of CG mechanisms works evenly irrespective of country. Therefore, this study explores the fundamental theories of governance to examine if these philosophies yield the intended outcome for both developed and emerging countries.

It is worthwhile to mention that the connotation of CG varies depending on how an individual perceives it (Shahin and Zairi, 2007), and as such scholars from a diverse set of domains observe CG from different perspectives. For instance, the legal domain identifies CG as 'the framework of rules, relationships, systems and processes (Owen, 2003, xxxiii) which tries to rein in managers' tendency toward self-interest (Chhillar and Lellapalli, 2015) and to establish harmony and accountability among the parties involved; economists view CG as a means of earnings commitment from the company to the investors (Shleifer and Vishny, 1997), which certainly emphasises on a contractual relationship that binds managers with the companies to serve at owners interests; the domain of accounting views CG as a system to monitor activities of managers and to inform shareholders using standard reporting practices (Al-Malkawi and Pillai, 2012) that establishes accountability of individuals involved in decision making and execution of strategies and policies. CG, on one hand, identifies for whom the company operates, by whom and how the execution takes place; it also deals with the set of mechanisms that exert influence on the economic and social concerns of a company. In this connection, Mazumder (2013) identifies three core conceptual elements of CG: First, CG braces the ultimate intent and prioritises of a firm. Second, outline the responsibilities of shareholders, managers, and directors, and the way boards interact with diverse constituencies of the firms. Third, it focuses on the rules, regulations and the prevalent controlling mechanisms of the market that largely influence the existence and operations of a company.

CG cannot merely be viewed as a tool to manifest business growth, rather it is a set of guidelines or approaches that facilitate an organization to boost manifold performance indicators. The approaches of CG are not an assurance of the premium outcome of a company, and it does not recommend shielding against insolvency either (Toprak or Bayraktar, 2017). The impact of CG on several financial and non-financial companies in established and developing countries has been the subject of numerous research. Researchers have identified that quality CG is related to minimising the chances of pledging subterfuge (Chen et al., 2006; Toprak and Bayraktar, 2017); escalating liquidity of a firm (Berglund, 2020); upswing market valuations (Biswas, 2020); substantial effect on capital structure decisions (Vijayakumaran and Vijayakumaran, 2019); significant influence on the firm risk (Hatane et al., 2019) and better operating performance (Alodat et al., 2021). However, the empirical results have got mostly equivocal (Clarke, 2017). As each of the economies are unique depending on their varied cultural and political contexts, a company needs to consider the institutional (e.g. economic, legal, political, and social) settings which may have a profound effect on designing governance mechanisms (Aguilera et al., 2008) and are critical to attaining expected performance. Therefore, it is imperative to develop a CG structure that fosters consensus among shareholders and top-tier executives to ensure a balance of power and authority within the organisation. Following this, researchers have been trying to develop a set of standard good practices of governance in line with the existing theories and models that could well be fit for maximising firm value.

Given the backdrop, it is essential to demonstrate a comparative picture of the theories with a view to identifying if one size fits all. Scholars have reviewed and identified the theories of CG to explore the facets of the contrasting viewpoints. Turnbull (2019), for instance, examined the contextual and ethnic dimensions of CG views discussing the governance models. Yusoff and Alhaji (2012), in another study, reviewed the key theories of CG and claim that no single theory is sufficient to resolve internal governance issues. Identifying the roles of the corporate boards, Madhani (2017) claims that directors have varied duties and responsibilities, and different theories are needed to explain those board functions. However, no studies as of yet have tested, given the contrasting views of the CG theories, whether the already-developed philosophies are applicable in emerging economies. This void of research is fulfilled in this study. Therefore, the objectives of this study are twofold. First, it rigorously discusses the background, assumptions, key facets, and limitations of each of the governance theories. Second, it identifies the distinctive characteristics of developing economies and challenges the practice of existing theories exclusively in this context. Therefore, this research could be a template for the future development of CG theory for emerging economies.

## 2. Theories of Corporate Governance

The journey of the theories on CG began with the ground-breaking work, Agency Theory, proposed by Jensen and Meckling (1976). This theory of CG outlines how the costs emerge from the separation of management and ownership within a company. Later, several other philosophies like resource dependence theory in 1978, stakeholder theory in 1984, and stewardship theory in 1991 emerged to spell out the dynamics of the relationship that prevails in corporations and how the goals of an organisation are prioritised. According to Heugens et al (2009), CG theories try to exhibit the way directors and/or managers affect the behaviour of an organization and work as a safeguard for the shareholders to get a return on their investment. Moreover, the theories also propose a number of mechanisms to motivate the executives and control their actions to ensure the sustainability of an organisation.

### 2.1 Agency Theory

Agency theory holds the idea that the principal (shareholder) appoints an agent (manager) with the mandate to participate in specific decision-making activities on behalf of the shareholders of an organisation. Executives, in reciprocity, undertake imperative decisions and strategies to meet principals' expectations. Consequently, the owners and managers enter into a covenantal relationship (Shankman, 1999), whereby the latter work for the betterment of the former. Agency theory, on one hand, identifies the situations in which managers may work for their own benefit while sending off the interests of shareholders and develops mechanisms to deal with the possible conflicts on the other (Lasfer, 2006; Al-Najjar and Clark, 2017) that may arise due to managerial opportunism.

### 2.1.2. Assumptions of Agency Theory

Agency theory is developed on the economics framework, which believes that an organisation should devote itself to maximise the welfare of the shareholders i.e., owners only (Blair, 1995). The fundamental proposition of agency theory is, that both the owners and managers try to exert self-interested behaviour; while shareholders focus on return on their investment, executives intend to maximise their compensation and other benefits (Jensen and Meckling, 1976). Therefore, agents in absence of proper organisational policies may try to exercise their self-interested behaviour at the expense of principals (Wright et al., 2001) leading to a tension of interest between the shareowners and the executives and thwarting organisational success.

Another fundamental tenet of agency theory is that the stockholders of a company are indifferent to the level of risk i.e., risk-neutral, while the executives are risk-averse (Jensen and Meckling, 1976; Wright et al., 2001). Economists (e.g., Child, 1974; Ross, 1973) brought the risk-sharing issue into consideration, which specifies different persons having distinctive preferences for risk. The theory is an augmentation of risk sharing view and it extends the discussions regarding the risk-taking behaviour of parties involved in a transaction when they have divergent objectives and division of labour (Jensen and Meckling, 1976; Ross, 1973). This mismatched nature of risk preference is a common phenomenon in organisations and leads to a suboptimal outcome for an organisation if risk-sharing is to outline an optimal mechanism for both the paving.

### 2.1.3. Agency Problem: Consequences and Panacea

Agency theory goes beyond just identifying the types of relationships and potential conflicts that exist inside an organisation; it also outlines the governance mechanisms to align the disparate goals of the parties involved in a corporate structure. Therefore, it has been named the most authoritative theory in CG literature (Chhillar and Lellapalli, 2015; Dalton et al., 1998).

Shleifer and Vishney (1997) claim that agency conflict may arise from a number of managerial expropriations such as engaging in cash out, choice of transfer pricing that troubles the firm, trading securities at a sub-optimal price, undertaking inferior initiatives in shareholder wealth maximisation and selecting projects with less potential, and putting themselves in a position to influence a company in prioritising managerial interests over shareholders (entrenchment). In this vein, scholars (Al-Najjar and Clark, 2017; Jensen and Meckling, 1976; Mishra and Kapil, 2017 among others) argue that agency conflict arises due to disparate goals and risk preferences between principal and agent, which have a root in disproportionateness of information. Therefore, agency conflict is the product of information asymmetry. Not to mention, whatever the dimension of information asymmetry is, it generates agency cost (Healy and Palepu, 2001).

However, agency theorists have suggested different governance mechanisms to control and monitor the self-interested behaviour of the managers (Dalton et al, 1998; Fama, 1980; Jensen and Meckling, 1976; Shleifer and Vishny, 1997). The key to solving this problem depends upon efficient contracting between principal and agent (Jensen and Meckling, 1976, Letza et al., 2004). Letza et al (2004) further emphasise relaxing control of the factor market, developing a code, designing the best reward structure, and recruiting non-executive directors. Moreover, mechanisms for minimising information asymmetry and appointing independent directors on the board can play a vital role in resolving agency conflict.

Following the agency perspective, appointing independent directors on the boards is viewed as an effective governance mechanism. Because, the independent directors may oversee the board decisions so that the actions taken by the supreme authority can well be devised to ensure the interests of stakeholders, which in turn include shareowners of a firm (Khan, 2010; Tauringana and Chithambo, 2015). Therefore, independent directors as a part of the board can work as a trustworthy and unbiased agent for the parties who depends on directorial and managerial actions. Moreover, these outside directors work as a dominant character to counsel external disclosure (Khan et al., 2011) and supervise the activities with a view to aligning initiatives to communal and ecological policies (Brammer and Pavelin, 2008; Khan et al., 2013).

Another alternative to governance mechanisms may be to design incentive plans such as offering shares (Agarwal and Mandelker, 1987) to the executives who are employed for a designated time even at a lower price than the market (Core et al. 1999; Jensen and Meckling 1976) to attain the pecuniary objectives of owners. This can also work as stimuli for the managers to concentrate on the financial interests of the principals. As soon as the managers will have more and more shares in the firm, this may defocus them from attaining their own interests; and hence can lessen the amount of agency cost and transform managers from being agents to stewards (Rashid, 2015).

If the above alternatives fail to ensure the interests of the shareholders, agency theory advocates using market control instruments like mergers, acquisitions and hostile takeovers to take action against underperforming executives and companies (Rwegasira, 2000). Moreover, Fama (1980) emphasises the utmost use of market forces in the labour market for executives; wherein the managers may find it competitive to avail a job and then to sustain for a longer tenure. These external governance measures can control the managers' actions if they fail to comply with a given standard of performance.

### 2.1.4. Criticisms and Further Developments

Although the assumptions and proposals to tackle agency problems have been followed in many of the developed countries that include the UK and the USA, it is not beyond contradictions. Agency theory advocates monitoring and controlling the activities of agents carefully because they are always presumed to concentrate on the individual goal of attaining self-benefit by expropriating the interest of the shareholders. Also, agency theorists assume that supervising managerial actions help to attain goal uniformity between principals and agents. This sort of skepticism undermines the behaviour of agents and gives birth to agency problems, which also intensifies agency costs to monitor and control their activities. However, it is contended that not all executives tend to exercise shirking behaviour (Donaldson and Davis, 1991;1994), and the role of managers can best be viewed as trustworthy rather than acquisitive (Daily et al., 2003). Besides, what happens if organisations set the governance mechanisms in a way that induces agents to prioritise the goals of the principals? Therefore, in a world of goal congruence, there will be no diversion of interest on the part of agents irrespective of monitoring initiatives (Eisenhardt, 1989).

Apart from the issues discussed above, agency theory is impugned largely for not considering the social responsibilities and the community at large (Smith, 2003). As shareholders are not the sole entity who influence or are influenced by the organisational actions, the other entities who have a connection with the success of a company need to be considered. Hence, in this era of neo-classical economics, agency theory needs a few adjustments (Lin and Chuang, 2011) to reflect market demand and outperform all the other theories of international CG.

### 2.2. Stakeholder Theory

Agency theory is arguably the dominant model in CG; in which only the welfare of the shareholders has been the case for a long (Lazonick and O'Sullivan, 2000), and all the remedies followed by agency conflict are prescribed to get hold of the owner's ascendancy. However, other theorists of CG have challenged the point in focus of the shareholder's model by specifying that an organization is not exclusively dependent on the shareholders but also there are some other parties whose participation has a direct or indirect contribution to the maximisation of the firm value. The simplest form of the definition of stakeholder thus follows, "any group or individual who can affect or is affected by the achievement of the organisation's objectives" (Freeman, 1984, 46). Thus, stakeholder includes a wider community comprising shareholders, managers, employees, lenders, suppliers, customers and the government.

The opposite camp of shareholders theory does not deny the contribution of owners as a financier, rather it incorporates the other individuals or elements that are connected and so efficiently contributing to the achievement of corporate goals. Aguilera et al (2006) also support this idea by emphasising the significance of considering the stakeholders' welfare to eliminate the insecurity of the shareholders that may arise at the time of implementing management decisions. Therefore, a company needs to consider the welfare of a wider community over and above the interests of shareholders which fosters achieving persistent firm value.

The stakeholder Model or German Model is a norm in countries where economic, cultural and legal contexts are different from those of the countries that follow agency theory (Chhillar and Lellapalli, 2015), and has widely been practised in Germany and the continental European nations. The journey of considering the interests of all the parties relevant to the operation of an organisation came into existence as Freeman (1984) theorises pinpointing the importance of stakeholders in the organisational success. According to Preston and Sapienza (1990), the word 'stakeholder' originated during the time of depression as the General Electric Company (GEC) recognised four groups of individuals as key stakeholders: shareholders, employees, customers, and the general public.

What distinguishes stakeholder models from shareholder models of CG, is exactly the focus of the former on linking organisational success towards meeting stakeholders' satisfaction, including the society. Moreover, companies are far more concerned about environmental and social issues than before due to the heightened interest of people around the globe that demands to encompass the welfare of a wider community. While agency theory puts managers at the locus of control, stakeholder theory opposes this point by emphasising coordination among all organs of a company. Rossouw (2008) extends this domain of governance and opines that both boards as well management of a company need to incorporate the interests of diverse parties whilst making decisions. Scholars clarify the idea of Freeman (1984) and Friedman (1970) by emphasising that the role of managers should be cautious about the individuals like customers, employees, stockholders, suppliers (Kotter and Heskett, 1992) as well as society (Rossouw, 2008) and thus organisations that follow such principles can be termed as the social institution (Evan and Freeman, 1993). The objective of this kind of social institution is to maintain and harmonise the diverse conflicting expectations (Collier and Roberts, 2001) that deters agency problems and establishes coherence within an organisation.

### 2.2.1. Approaches to Stakeholder Theory

Stakeholder theory is divided into three categories by Donaldson and Preston (1995): Descriptive, Instrumental, and Normative. The descriptive view is linked to 'how managers deal with stakeholders and how they represent their interests' (Kinyua et al., 2015). This view explains how stakeholders can characterize their interests and the effect on the achievement of firm objectives that may have at the time of considering stakeholder perspective. Therefore, the descriptive genre spells out how the managers act with the stakeholders with a view to taking care of the interests of diverse parties.

The normative genre, on the other hand, identifies the ethical understanding of how managers should interact with stakeholders of an organisation or how they should operate a firm (Hasnas, 1998). The Normative stream is related to an ethical and philosophical point of view in response to organizational behaviours (Fontain et al., 2006). Rossouw (2008) supports this view of stakeholder theory as this can create an asymmetry of individual and social goals with corporate objectives.

The instrumental view of the philosophy analyses the organisational outcome or consequences that may arise due to the behaviours of stakeholders who eventually affect firm performance. Jones (1995), being an instrumental theorist of stakeholders, claims that concentrating on stakeholders' aids to attain a competitive edge as it enables reliance and support as well as restrains the chances of opportunism. Although the stream is not enriched by huge contributions, many scholars have acclaimed this instrumental view of stakeholder theory (Logsdon and Yuthas, 1997).

### 2.2.2. Criticisms of Stakeholder Theory

The good thing about stakeholder theory is that it emphasises not merely the shareholders, but also the employees, suppliers, customers and others who are directly or indirectly involved in a business. In so doing, the theory is accused of a few major issues that may sometimes underspecify the importance of tying everyone in a single circle.

Firstly, dealing with several interested parties at the same time may distract managers' from showing tenacity in making decisions (Jensen, 2001), which may influence them to be unaccountable for their activities (Nwanji and Howell, 2005). In these circumstances, agents (directors and/or managers) may tend to be opportunistic (Sternberg, 1997), for which companies may fail to implement required CG instruments that seek to achieve the goal of the firm.

Secondly, as long as profitability is considered to be one of the indicators of measuring performance, ensuring the welfare of all the participants may negatively affect it. For instance, if an organisation intends to offer better compensation and bonuses to its employees, this increases the cost of operations and hence lowers profit. This is supported by Griffin and Mahon (1997), who are also dubious about the extent of the interrelationship between stakeholder theory and firm performance.

Thirdly, one of the major issues of stakeholder theory is the problem of addressing the disparate interests of stakeholders. It has been argued that divergence of interest arises since every unit of an organisation has its expectation, which differs from the others, or is even dissimilar from the participants belonging to the same cohort (Letza et al., 2004). Moreover, scholars (like Jansson, 2005; Plaza-Ubeda et al., 2010) argue that stakeholder theory has no guidelines for the managers to prioritize the interest of diverse parties; nor has it identified the magnitude of significance that a manager provides to each of the stakeholders.

Apart from the criticisms discussed above, researchers also question the effectiveness of the stakeholder theory from some other aspects. While shareholder's theory postulates how to control the self-interested behaviour of agents, stakeholder theory does not suggest any confined idea to regulate managerial actions, let alone endeavoured to benefit all the parties of an organisation. Moreover, Jansson (2005) and Letza et al (2004) affirm that the theory does not even specify the procedures for disseminating residual claims.

### 2.3. Stewardship Theory

From the discussions of the two most dominating theories to date, it is evident that managers are the key to a firm for a smooth operation. Managers, by putting themselves at the hub of an organisation are responsible for efficient performance. In this connection, they concentrate on satisfying the interests of either the shareholders only (agency theory) or all the components relating to a business, namely stakeholders (stakeholder theory). As far as the agency theory is concerned, managers always have an inherent inclination to demonstrate their selfishness by expropriating the benefit of the owners and thus to benefit from their short-term motives. However, this notion of selfishness from the managers as evident in agency theory is questioned by stewardship theorists (Donaldson and Davis 1991, 1994), specifying that the principal-manager relationship is too narrowly defined by the model of the shareholders.

The fundamental assumption of stewardship theory is managers are the key stewards of an organisation (Donaldson and Davis, 1991, 1994). Moreover, unlike agency theory, stewardship theorists view managerial behaviour as prioritising the interests of principals leaving behind their own benefit (Davis et al., 1997), even though there exists no monitoring takes place (Podrug et al., 2010). While agency theory depicts a divergence of interests between principal and agent, stewardship theory focuses on the scenarios where the interests of these parties are mutually congruent. Therefore, the manager as a steward tries to fit in their interests with the expectation of principals and help to attain organisational welfare.

#### 2.3.1. CEO Non-duality and Inside Directors

Davis et al (1997) delineate how stewards are influenced by the CG framework. In this regard, the governance framework set by companies helps the CEO to achieve a premier outcome, insofar as the role of the CEO is explicit and recognised by the company (Donaldson and Davis, 1991). One strong argument to attain this kind of superior performance is to assign the duties and responsibilities of both the CEO and board chair into the hands of a single person (CEO duality). Stewardship theory supports the idea of merging the roles of both the board chair and CEO (Donaldson and Davis, 1991) as it ensures harmony in the organisational structure since an identical individual has the sole right to decision-making. Moreover, this unified role of the CEO-chair can minimise the conflict of authority between two high officials, which eventually fosters mutual understanding. Whereas, agency theory postulates a separation of CEO and chair, stewardship theory, believes in CEO duality for better performance.

Stewardship theory refuses the inclusion of outside directors for monitoring purposes (Rashid, 2015). According to Fama and Jensen (1983), one of the key reasons for preferring insiders to outsiders is, that the former has superior access to information that makes them more dominant than the latter. Not to mention, information becomes critical in assessing and supervising the actions and initiatives taken by the executives. As insiders have a superior understanding of the corporate affairs of the company they work for, scholars (e.g., Booth and Deli 1996; Donaldson and Davis 1991; Nicholson and Kiel 2007) argue that the directors from inside the orgnisations have better decision-making capability than the outside executives, which in turn help them in performing managerial duties efficiently (Baysinger and Hoskisson, 1990).

One of the key reasons why insiders have an edge over outsiders is, that the former design policies and strategies of a company and the latter generally are opaque about the ‘whys’ and ‘wherefores’ of the initial decisions. As a result, the camp of steward theorists argues that outside directors are mostly dependent on insiders for a better understanding of operating affairs (Finkelstein and Hambrick, 1996). Even for monitoring, if it is a matter of observing the performance over a period, the outsiders need to obtain the previous assessments from the insiders to make comparative judgements. It implies that insiders have an informational superiority, while outsiders are dependent on the information served by the member of staff of a company. The reason behind this information gap, to some extent, for the fact that most of the outsiders’ job in the company is not permanent, and thus, have a possibility to underperform than what they are supposed to do (Brennan, 2006). However, this is not the case for insiders due to their relative long-term commitment to the company they serve. Therefore, the organisation may experience an inferior supervisory role from the outside directors (Rashid, 2015). Moreover, Mobbs (2013) in support of qualified inside directors claims that they facilitate monitoring by working as an instant proxy to CEO and can bargain with the CEO in favour of shareholders. Nevertheless, many of the studies illustrate varying results aimed at putting too much trust in the inside directors only.

### 2.3.2. Control and Reward Systems of Stewardship Theory

Stewardship theory not only identifies the complex nature of relationships in an organisation but also proposes the forces that control managerial behaviour to outperform through competency. While agency theory puts stress on managerial control, stewardship theory emphasises managerial empowerment (Muth and Donaldson, 1998). According to Miller et al (2008), control systems encourage mutual influence that corresponds to flexible inclusive culture; where the people tend to exercise independence, however, share the responsibility with all the stakeholders (Donaldson, 2008).

While agency theory chiefly relies on financial motivators and direct monitoring, the incentives are mostly non-financial in nature in stewardship theory to control the behaviour of managers. As stewardship theory believes in managers for the sake of prioritising principals’ expectations, participating in an organisation can be an effective tool to lessen goal congruence in an organisation. Hence, companies may choose to offer shares to their managers with a view to incorporating them into the ownership cohort. Managers with this flavour of ownership right in the firms induce to make better decisions (Nicholson and Kiel, 2007) that enhance firm value

(Rashid, 2015). Accordingly, a sense of adherence exists between executives and firms in the form of a shared understanding (Barnett and Schubert, 2002).

Like agency theory, stewardship theory also finds stock options as an effective tool to mitigate agency costs (Rashid, 2015). It also establishes a sense of job security and ensures rational understanding among fellow workers. The Reward system in the stewardship theory, according to Davis et al (1997), is linked to carrying out corporate initiatives that convey to managers their identity of authority and independence. An organisation can also establish a reward system for stewards by instilling self-confidence (Lawler, 1986; 1992; Sundaramurthy and Lewis, 2003), which reinforce competence and flexibility for the managers. Moreover, corporations can demonstrate freedom for stewards in the organisational structure so that they can take control of their behaviour (Deci et al., 1989). Besides, organisations can tailor programs that lead to executive advancement through training, providing amplified responsibility, ensuring variation in tasks, and tackling challenges (Lawler, 1986; 1992), which build confidence in executives and so boost their performance.

**2.3.3. Criticisms of Stewardship Theory**

The stewardship view is criticised by its agency camp because CEO duality works as a tool to establish the independence of the board, which helps the boardroom to effectively perform its monitoring services (Rahman et al., 2017) and minimises agency costs (Fosberg and Nelson; 1999). Moreover, in the real world, not all managers may work as stewards who prioritise the stockholder's benefit over self-interest. Furthermore, it is a very strong logic to believe that inside directors provide all the necessary competencies that a company seeks, and thus, leaves the idea of incorporating outside resources (outside directors) that are essential to provide monitoring and advising services (Kiel and Nicholson 2003).

**2.4. Resource Dependence Theory**

The theories discussed above have developed chiefly to explore the role of managers in an organisation in different contexts, except for the significance of including outsiders on the board as resources. The significance of incorporating external parties as a valuable resource remained unexplored until Pfeffer and Salancik (1978) published an article on the emergence of resource dependence theory titled 'The External Control of Organizations: A Resource Dependence Perspective.

Resource dependence theorists (e.g., Daily et al., 2003, Dalton et al., 1999; Hillman et al., 2000; Johnson et al., 1996; Pfeffer and Salancik, 1978) recognise the inevitability of the knowledge and industry expertise of the outsiders and provides an academic footing on resource function of the external members into the board. Accordingly, it highlights how the board can affect an organisation and its environment and thus can approach acquiring required assets for the firm (Dalton et al., 2003). Therefore, resource dependence theory tries to conceptualise the consequences of hiring directors from outside who neither contribute towards company assets nor an internal executive who currently (in the past) has (had) a connection with company affairs. These individuals are the directors who bring additional skills and understandings to the current stock of a company's knowledge.

Moreover, the organisations can be endowed by appointing outsiders with the incomparable skills and expertise that they gain from their long-standing business involvement (Ahmed et al. 2006). Furthermore, independent directors counsel the management, which aids to enhance firm value (Rashid, 2015). A similar view is held by Daily et al (2003) that the independent directors can provide advice and counsel as inputs either in the board meetings or in person with officials; which, in most cases is expensive to acquire from an unidentified setting. The qualifications of independent directors coupled with knowledge and efficiency are critical for acquiring outside resources (Johnson et al. 1996; Pfeffer and Salancik 1978), which successfully affect the overall decisions of the board and eventually add firm value (Fields and Keys 2003).

#### 2.4.1. Criticisms of Resource Dependence Theory

This theory is criticised on the ground that it fails to capture the other outlooks of an external resource, for instance, agency theory treats this kind of resource as an effective tool to monitor managerial self-interested behaviour and thus thwart managerial expropriation. In this vein, Rashid (2015) argues that the efficiency of an outside independent director largely depends insofar as they can monitor the executive decision-making. Moreover, unlike the other theories of CG, resource dependence theory exclusively prioritises the external resources rather than seeking the complementary activities of the board, for example, monitoring (Fama, 1980; Johnson, et al., 1996; Kiel and Nicholson, 2003), setting strategies (Lorsch and MacIver, 1989) and ensuring disclosures. Although this view of CG finds ways to acquire external resources, it gives no idea of how to utilize these resources efficiently.

## 3. Do the Westernised Theories Fit Emerging Economies

### 3.1. Distinct Institutional Characteristics of Emerging Nations

CG practices in developing countries are endowed with feeble external governance instruments (Peters et al., 2011), poor legal framework (Young et al., 2008), incompetence in the human capital market (Allen, 2005) and poor protection of property rights (Hu et al., 2010) that leads to weak protection of minority shareholders' rights (Claessens and Yurtoglu, 2013; Globerman et al., 2011; La Porta et al., 2000; Young et al., 2008). Khanna et al (2005) observe, that some of the built-in components such as dearth of professional intermediaries, weak legal framework, lack of sophisticated labour, product, and capital markets, and poor enforcement of contracts are apparent as a consequence of the weak institutional framework that prevails in these countries. Moreover, in emerging markets, the dominance of concentrated ownership (Hu et al., 2010) is the norm in which controlling shareholders are in charge of two-thirds of the firms (La Porta et al., 1999). Therefore, companies are significantly exposed to the manifestation of controlling shareholders' expropriation (Chen et al., 2011), through which major shareholders exercise their power at the expense of minority shareholders that subsequently jeopardize firm performance (Young et al., 2008). It is evident that these shareholdings of controlling shareholders are largely dominated by family and business groups.

Family control and the existence of business groups lead to a pyramidal structure in organisations (Chhillar and Lellapalli, 2015) that ensures their outright control over the operations of a company. Consequently, family firms with major shareholdings manage operations with confidentiality (Dess and Beard, 1984; Gedajlovic et al., 2004). Chen et al (2011) argue that controlling shareholders can affect minority shareholders or a firm's overall performance by any of the following four means. Firstly, family members with their clans and political ties are given priority in case of appointment in the top positions (Faccio et al., 2001; Su et al, 2007; Young et al., 2008), rather than seeking qualified personnel in a competitive marketplace (Morck and Yeung, 2004). Secondly, involved in transactions with the other affiliated firms by selling assets at a less price or purchasing at a higher price compared to the market (Young et al., 2008), or spinning off a high-yielding section of a firm to a related party (Jiang and Peng, 2011). Thirdly, with major control rights, instead of focusing on the advancement of a firm, may wish to concentrate more on private, ancestral and political benefits (Young et al., 2008). Finally, the ownership structure in emerging economies often follows a pyramidal arrangement, whereby control rights exceed cashflow rights (Faccio et al., 2001; Young et al., 2008). In the case of business groups, the top-tier firm can expand business at the expense of the assets of the lower-tier firms to support the pick of the pyramid (Claessens et al., 2000; Morck et al., 2004). Moreover, due to high ownership concentration, external corporate control measures like the takeover market are non-functional in these countries (Nam et al., 2001). A conceptual model of the relationship between the governance mechanisms and the organizational outcome is depicted below.

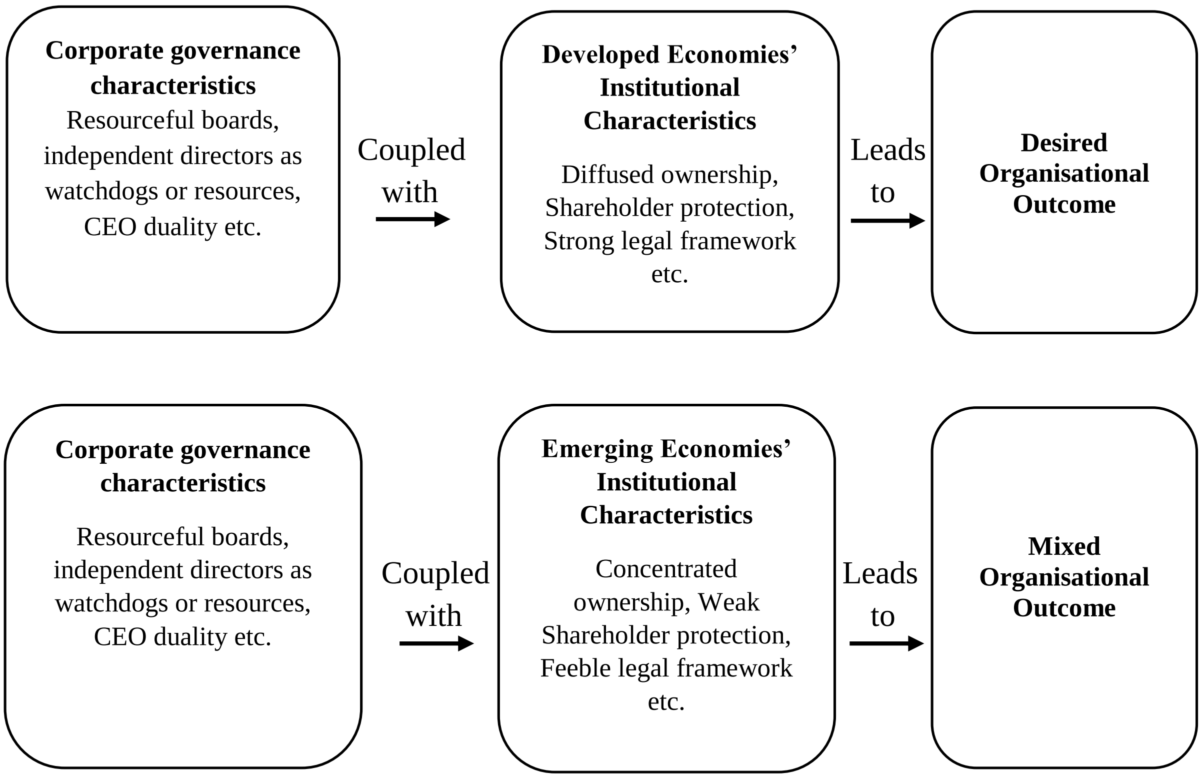


**Figure 1: Conceptual framework on the association between the CG instruments and the organizational consequence in developed and emerging economies**

### 3.2. Need for a new bundle of theories

From the earlier discussion and figure 1, it is evident that conventional CG practices may not always be beneficial to the firms of developing countries. Because distinct firm characteristics and institutional framework of these nations lead to a different dimension of relationship that exists in the organisations (Chhillar and Lellapalli, 2015). After a comprehensive review of the research on emerging markets, it is evident that the uniqueness of relationship issue that thrives in these countries are between the major (controlling) shareholders and the minority shareholders, which researchers (e.g., Dharwadkar et al., 2000; Shen et al., 2015; Young et al., 2008) label as 'principal-principal' problem. In the Anglo-American nations with diffused ownership structures, with diffused ownership, the conflict between owners and managers is much more pronounced (Jensen and Meckling, 1976; Shleifer and Vishny, 1997) which is known as the type I agency problem. In these instances, managers may tend to window-dress financial transactions to maximise their economic benefit (Leuz et al., 2003) and thus there exists the conventional agency problem between the owners and managers. On the contrary, the firms in developing countries follow concentrated ownership, in which individuals and families expropriate the interest of the minority shareholders (Fama and Jensen, 1983; Shleifer and Vishny, 1997). Here lies the conflict between the controlling shareholders and the other shareholders and termed a type II agency conflict. Moreover, in many Asian countries, controlling shareholders with their large stakes can transfer funds from their mother firms to a lower-tier firm (Claessens et al., 2000), which can be termed tunnelling (Johnson et al., 2000).

It is now evident that the conventional Anglo-American model of CG, principally followed by the United States of America (USA) and the United Kingdom (UK), contradicts that of developing nations due to the prevailing institutional settings of those developed countries. The market is also endowed with high protection of minority shareholders (La Porta et al., 1997), an efficient labour market (Aoki, 1990) and the existence of an active takeover market. Studies on developing nations reveal that, unlike the developed countries, conventional 'principal-agent' relationship does not exist due to varying cultural dimensions (Lau and Young, 2013) and institutional void (Young et al., 2008; Peng and Jiang, 2010). Chen et al (2011), in this vein, argue wholesale adoption of the OECD codes in emerging markets is found to be ineffective as those guidelines were originally developed to tackle the principal-agent problems. While in the Anglo-Saxon area shareholder concentration is considered a cure to address the principal-agent dilemma (Grossman & Hart, 1986), it is incongruous in the setting of emerging economies (Singh & Zammit, 2006) and may even make things more complex in these regions (Faccio et al., 2001). Thus, the regulatory body needs to develop a different set of governance mechanisms that is not a replica of the systems followed by developed nations. No doubt, some of the CG criteria of the Westernised models may also be adopted into the codes of governance of emerging nations, but the proportion of the factors should follow the prevailing cultural, economic and institutional dynamics and merely a mimicry of the models of developed countries.

## 4. Conclusion

The study investigates the core theories of corporate governance, such as agency theory, stakeholder theory, stewardship theory and resource dependence theory. While agency theorists propose the departure of ownership from administration, stewardship philosophers postulate CEO non-duality as a tool for managerial harmony. Moreover, as opposed to the agential view, stewardship theory prefers appointing insiders to outsiders on the grounds of better knowledge and information of internal directors. Furthermore, agency theory prioritises shareholders only while the stakeholder view proposes an all-inclusive model for the community. The resource dependence view finally, highlights the necessity of including directors with expertise and experience who might work as resources for the boards.

After a rigorous review of the literature, the study claims that the philosophies discussed are suitable for the countries whereby diffused shareholders are the norm for the stock markets. Moreover, these theories are replicable to the economies in which the protection of shareholders' rights is given priority and the institutions maintain the required standards. In developed countries, both internal mechanisms are used complementarily. However, in emerging countries where the external mechanisms are immature (Filatochev et al., 2013), internal governance works as a substitutive arrangement. Therefore, companies of developing nations mostly rely on internal governance instruments such as ownership concentration, board committees, disclosure practices and the inclusion of independent members on the board (Mishra and Kapil, 2017) to harmonise the relationship between the owners and managers. In this case, the conventional theories are not applicable, rather a different bundle of CG mechanisms need to apply for a better organizational outcome.

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