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PROMOTING A MORE EFFICIENT CORPORATE GOVERNANCE MODEL IN EMERGING MARKETS THROUGH CORPORATE LAW

JINGCHEN ZHAO[*]

ABSTRACT

If we group together corporate governance models in countries with emerging markets, it is worthwhile to consider if reform suggestions could be offered to these counties collectively to address their shared weak points from a legal perspective. This article attempts to find common characteristics in corporate governance models from countries with emerging markets, who suffer from similar problems and challenges. The article traces many dimensions through which corporate governance functions in emerging markets can be characterized, with an emphasis on the legal foundations and responses to problems especially within corporate law, in order to promote the soundness of corporate governance systems measured according to criteria such as accountability, transparency, responsibility, and fairness. Focusing on corporate governance problems arising from state ownership, state control, board independence, and poor stakeholder and minority shareholder protection, several proposals are made at different levels. Hybrid regulatory sources from government legislation and soft law are suggested as appropriate for emerging markets. A series of elements are suggested, although some may have already been enforced individually in certain jurisdictions, including independent directors, employee representatives, more clearly defined directors' duties, especially their duties toward stakeholders, mandatory information disclosure of corporate social responsibility ("CSR") issues, legitimacy of cross-listing, *effective auditing, and the appointment of independent external auditors in*

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order to promote corporate governance and respond to inefficiencies in emerging markets.

I. INTRODUCTION

Corporate governance has attracted a great deal of attention over the past two decades as a global topic, with special attention paid to developing countries and emerging markets. This exposure has been driven by financial turmoil and corporate scandals, namely the Asian financial crisis in the late 1990s, scandals across the United States and Europe (including Enron, WorldCom and Ahold), and the recent financial crisis of 2008. It is widely accepted that poor governance quality hinders economic growth, financial market development, and establishment of a sound economic system that fits a jurisdiction. Academic theories concerning typical and classic corporate governance can be divided into two schools of thought,[1] centered on the shareholder primacy norm and stakeholder theory. These theories are typified by the Anglo-American "market orientated" outsider model and the continental European and Japanese "network orientated" insider model. Each has characteristic sets of structural elements, ownership patterns, and strengths and weaknesses.[2] The former is usually characterized by financing though equity, dispersed ownership, active markets for corporate control, and flexible labor markets.[3] In contrast, the latter is usually described in terms of long-term debt finance, ownership by large blockholders, weak markets for corporate control, and rigid labor markets.[4]

Comparing the "communitarian" and "capitalist" systems, corporate governance in emerging markets refers to the systems adopted in countries which are rapidly entering the global market. With the globalization of the world economy, world trade, and multinational corporations, the

1. There are also academics who divide corporate governance systems into four models, namely the outsider system, the Rhineland or insider system, the Latin system and the Japanese system. *See* LUTGART VAN DEN BERGHE, CORPORATE GOVERNANCE IN A GLOBALIZING WORLD: CONVERGENCE OR DIVERGENCE? A EUROPEAN PERSPECTIVE 1 (2002). Meanwhile, other academics think that, apart from the shareholder oriented model, there are also manager-oriented, labor-oriented, and state-oriented models of corporate law. *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 443 (2001).

2. *See* Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L.J. 493, 494 (2005).

3. *See* Ruth V. Aguilera & Gregory Jackson, *The Cross-National Diversity of Corporate Governance: Dimensions and Determinants*, 28 ACAD. MGMT. REV. 447, 447 (2003).

4. *Id.*

importance of diversity across various corporate governance models is becoming increasingly important.[5] Corporate governance in emerging markets is playing, or is going to play, a particularly active role in such a diversified context. The jurisdictions which are classified as emerging markets go beyond China, Russia, India, and Brazil and are important global powers creating economic and political waves on a global scale. They include Asian countries such as Thailand, Indonesia, South Korea, the Philippines, and Malaysia, as well as European countries such as Romania, Turkey, Poland, Bulgaria, Russia, and Hungary, and Latin American countries such as Argentina, Mexico, and Chile.[6] It is worth pointing out that it is not accurate to equate countries with emerging markets to developing countries[7] because of the rapid economic growth which enables countries with emerging markets to provide a focus for personal and institutional investors and international corporations—it would be equally misleading to judge by relative income per capita.[8]

It is argued by David Held and Anthony McGrew that "globalization, simply put, denotes the expanding scale, growing magnitude, speeding up and deepening impact of transcontinental flows and patterns of social interaction."[9] As for corporate governance and legal transplant,[10] there is no consensus on how globalization will affect legal reform towards global standards. For example Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer, and Robert W. Vishny conclude that countries with a

5. *See* ULRICH BECK, THE COSMOPOLITAN VISION (2006); *See also* JAGDISH BHAGWATI, IN DEFENSE OF GLOBALIZATION (2004).

6. This list was compiled by the International Monetary Fund. *See New Setbacks, Further Policy Action Needed*, INT'L MONETARY FUND (July 16, 2012), http://www.imf.org/external/pubs/ft/weo/2012/update/02/pdf/0712.pdf, at 3.

7. According to the definition provided by the World Bank and the Organisation for Economic Cooperation and Development (OECD hereinafter), developing countries are generally defined as those with a per capita income level less than $1000, while those countries having per capita income levels between $1,000 and $9,999 are normally defined as emerging economies. Developed or mature economics are defined as having a per capita income level greater than $10,000.

8. *See* Chong Ju Choi et al., *Global Corporate Governance: Emerging Market and Strategic Transparency in a New Triad Framework*, 10 ASIA PACIFIC J. ECON. BUS. 48, 50 (2006).

9. *See* DAVID HELD & ANTHONEY MCGREW, GLOBALIZATION/ANTI-GLOBALIZATION: BEYOND THE GREAT DIVIDE 1 (2d ed. 2002).

10. For discussions and examples of corporate governance transplants, *see generally* Curtis J. Milhaupt, *Historical Pathways of Reform: Foreign Law Transplants and Japanese Corporate Governance*, *in* CORPORATE GOVERNANCE IN CONTEXT (Klaus J. Hopt, Eddy Wymeersch, Hideki Kanda & Harald Baum eds., 2005); Mohammad Rizal Salim, *Legal Transplantation and Local Knowledge: Corporate Governance in Malaysia*, 20 AUSTRALIAN J. CORP. L. 55 (2006); Umakanth Varottil, *A Cautionary Tale of the Transplant Effect on Indian Corporate Governance*, 21 NAT'L L. SCHOOL OF INDIA REV. 1 (2009); Kaneko Yuka, *Theories and Realities of Asian Corporate Governance: From "Transplantation" to the Asian Best Practices*, 2 PROCEDIA—SOC. & BEHAV. SCI. 6883 (2010).

common law tradition tend to protect investors better than do countries with a civil law tradition.[11] Thomas Clarke and Marie de la Rama argue that the European and Asian corporate governance systems will converge towards an Anglo-American system with a stronger securities market and higher level of disclosure.[12] Another group of scholars has recognized that a "one size fits all" approach will not work because of path dependence theory.[13] Based on such discussions, countries with emerging markets should avoid simply copying legislation and code implemented in mature markets. The most appropriate and effective regulatory framework will greatly depend on how evolved the market and the legal and governmental institutions are as well as the history and culture that exist in a specific economy,[14] including the shareholding ownership structure that is unique for each nation and brings unique agency problems. The author agrees with the argument of Ozden Deniz that "copying code from one country to another without analyzing the details of a corporate governance system or considering the applicability to a specific country's judicial system or ensuring effective enforcement, will not bring the expected benefit and reform to that country."[15] The corporate governance models in emerging market are still in the developing stage without a certain and clearly predictable end as changing and dynamic hybrid models with characters from both extreme models, which change in line with economic advancement and legal and cultural development.

The post-crisis research has not placed a great deal of focus on emerging markets and even less so on developing countries, and much work still refers to situations in developed countries, in particular the

11. *See* Rafeal La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1132 (1997).

12. *See* THOMAS CLARKE & MARIE DE LA RAMA, 1 CORPORATE GOVERNANCE AND GLOBALIZATION (2006); *see also* Hansmann & Kraakman, *supra* note 10, at 469.

13. *See* Anne-Marie Anderson & Parveen P. Gupta, *Corporate Governance: Does One Size Fit All*, 24 J. CORP. ACCT. FIN. 51, 63 (2013); *see also* Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 69 (Jeffrey N. Gordon & Mark J. Roe eds., 2004); MARK J. ROE, EXPLAINING WESTERN SECURITIES MARKET IN CORPORATE GOVERNANCE: POLITICAL AND LEGAL PERSPECTIVE 279 (Mark J. Roe ed., 2005); Reinhard H. Schmidt & Gerald Spindler, *Path Dependence and Complementarity in Corporate Governance*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 114 (Jeffrey N. Gordon & Mark J. Roe eds., 2004); Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating Corporate Taxonomy*, 119 HARV. L. REV. 1641 (2006).

14. Katharina Pistor, *The Standardization of Law and Its Effect on Developing Economies*, 50 AM. J. COMP. L. 97, 97–130 (2002).

15. Ozden Deniz, *The Importance of Corporate Governance for a Well-Functioning Financial System: Reforming Corporate Governance in Developing Countries and Emerging Market Economies*, 18 NEW ENG. J. INT'L & COMP. L. 67, 77 (2012).

United States and Europe. Furthermore, research often focuses on the relationship between corporate governance and economic development and not on regulation or proposals for legal responses. The purpose of this article is to fill these gaps. Grouping corporate governance frameworks in countries with emerging markets together, it is worthwhile to consider if reform suggestions could be offered to these counties collectively to address their shared weak points from a legal perspective. This article attempts to find common characteristics of corporate governance models in countries with emerging markets. This special economic development stage means that corporate governance in these counties suffers from similar problems and challenges. This article traces many dimensions through which corporate governance functions in emerging markets. However, the emphasis of the article will be on legal foundations and responses to these problems, especially within corporate law, in order to promote the soundness of corporate governance systems measured according to criteria including accountability, transparency, responsibility, and fairness. Therefore, effective corporate governance will lead to greater investment, high growth and greater employment creation; lower costs of capital and associated higher firm valuations; better allocation of resources and better management; lower risk of financial crises; and better relationships with all stakeholders.[16] Current discussions on emerging markets tend to distinguish the business model and governance model in emerging markets and those in development markets, and there is a lack of research on legal responses that could be introduced or improved within emerging markets in order to promote the competitiveness of corporate governance schemes. This article is an original attempt by linking the weaknesses of corporate governance in emerging markets with possible regulatory responses from the domain of corporate law and governance through a combination of both hard law and soft law.

The article is structured as follows. It starts with an introduction to corporate governance in emerging markets, as that determines the scope of the issue in the current economic climate. The article goes on to explore the common characteristics of corporate governance in emerging markets, and argues for the possible weaknesses and problems of these corporate governance models. It does so by proving background on the countries' financial, economic, and institutional environments, including control of companies, political or governance interference, board structure and

16. Stijin Claessens & B. Burcin Yurtoglu, *Corporate Governance in Emerging Markets: A Survey*, 15 EMERGING MKTS. REV. 1, 11–12 (2013).

performance, ownership patterns and stakeholder protection. After analyzing the common problems of corporate governance models in emerging markets, some regulatory reform suggestions will be presented in order to enhance the corporate governance inefficiencies that exist in emerging markets. The author is aware of the limitations of the research, mainly stemming from difficulty in generalizing the findings from one specific country to the others, since optimal governance likely differs between developed and emerging markets as well as between different countries with emerging markets.[17] While selected highly representative examples have been given of different countries to identify the characteristics of corporate governance in emerging markets, the research does have certain limitations in terms of applying the principles and arguments non-exceptionally to every single jurisdiction which falls into the category of emerging markets.

II. CORPORATE GOVERNANCE IN EMERGING MARKETS

Since the 1990s the number of emerging markets has grown rapidly, with the rise of several very large economies such as India and China. Emerging markets play an increasingly significant role in the global economy. These countries collectively account for nearly 40 percent of global gross domestic product (GDP) according to the International Monetary Fund, and they are expected to account for nearly 50 percent of global GDP growth.[18] Also it is estimated by the UN Development Program that the joint economic output of Brazil, India and China alone is expected to exceed the combined production of the United States, Canada, France, Germany, Italy and the United Kingdom.[19] More and more scholars are focusing their research efforts on corporate governance and corporate law in emerging markets, and the differences between regulation and accountability of companies in emerging markets and those in developed markets are becoming a topical issue. These scholars have historically been interested in country-specific governance metrics, rather than in cross-national studies with a focus on emerging markets. It has

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17. Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards* 157 U. PA. L. REV. 12, 63 (2009); J. Harold Mulherin, *Corporations, Collective Action and Corporate Governance: One Size Does Not Fit All*, 124 PUBLIC CHOICE 179 (2005).

18. Ernst & Young, *Six Global Trends Shaping the Business World: Emerging Markets Increase their Global Power*, *available at* http://www.ey.com/GL/en/Issues/Business-environment/Business-redefined---Understanding-the-forces-transforming-our-world.

19. United Nations Development Programme, *Human Development Report* (2013), at iv, *available at* http://hdr.undp.org/sites/default/files/reports/14/hdr2013_en_complete.pdf.

been shown in research by the Global Corporate Governance Forum and the International Finance Corporation (IFC) that less than 1 percent of the available research papers on corporate governance focus on emerging markets.[20] The research on emerging markets seems ever important in light of data from the World Economic Outlook, which demonstrate that "global growth is projected at 3.3 percent in 2015 with a gradual pickup in advanced economies and a slowdown in emerging market and developing economies."[21] Existing country-specific research on emerging markets has delivered mixed results and inconclusive findings about the relationship between corporate governance indicators and corporate performance,[22] so that broader research on emerging markets would seem to be appropriate and necessary. Research on emerging markets is challenging, but rewarding. The economic crises in Russia, East Asia, and Latin America and financial scandals in the United States and Europe have made corporate directors and regulators realize that the way of doing business has changed in terms of new demands for greater corporate accountability.[23] In achieving these corporate governance goals, efficient corporate governance and corporate regulation in emerging markets is an area of great research significance.

The emerging market has always been regarded as a third category that is becoming increasingly important from a corporate governance perspective. Research and a solid understanding of corporate governance in emerging markets will enable multinational companies to secure a strong base in these jurisdictions. This strong base will enable these corporations and countries to seek growth beyond their domestic spheres toward bigger markets with great potential for growth. Stijin Claessens and B. Burcin Yurtoglu collected evidence to show that voluntary and market corporate governance mechanisms have less effect when a country's governance system is weak, which is normally the case in

20. Melsa Ararat & George Dallas, *Corporate Governance in Emerging Markets: Why It Matters to Investors—and What They Can Do About It*, 4 PRIVATE SECTOR OPINION 22 (2011).

21. *World Economic Outlook Update: Slower Growth in Emerging Markets, a Gradual Pickup in Advanced Economies*, INT'L MONETARY FUND, July 9, 2015, *available at* http://www.imf.org/external/pubs/ft/weo/2015/update/02/pdf/0715.pdf.

22. *Id.*

23. Ruth V. Aguilera, Luiz Richardo Kabbach de Castro, Jun Ho Lee & Jihae You, *Corporate Governance in Emerging Markets*, *in* CAPITALISMS AND CAPITALISM IN THE TWENTY-FIRST CENTURY 319 (Glenn Morgan & Richard Whitley eds., 2012).. For a discussion on corporate accountability, *see generally* ANDREW KEAY, BOARD ACCOUNTABILITY IN CORPORATE GOVERNANCE (2015). For discussions on corporate accountability in emerging markets, for example, in China, *see generally* Andrew Keay & Jingchen Zhao, *Ascertaining the Notion of Board Accountability in Chinese Listed Companies*, Feb. 1, 2015, *available at* http://ssrn.com/abstract=2596539 (last visited Mar. 29, 2015).

countries with emerging markets.[24] The characteristics of corporate governance in an emerging market are closely connected with a wide background of economics, as well as the institutional and financial environment in that country, including the shareholding structure and pattern, which help to determine the nature and scope of the corporate governance system.[25] In comparison with mature markets, in an emerging market, the most important corporate governance-related issues are the concentrated ownership structure with a state-owned shareholder system,[26] institutional shareholder ownership within companies, the degree of access to financing, and underdeveloped private financial markets. Corporate governance frameworks will differ greatly among countries with emerging markets according to variations in different elements within their economic framework and other related cultural, traditional, historical, and legal factors; for example, there will be many differences between central and eastern European countries such as the Czech Republic, and East Asian countries such as China. However, research on the collective virtues of corporate governance models in these countries will be important to discover their common features and similar development goals.

While international development agencies such as the World Bank are persuaded to shift their strategy from the financing of physical infrastructure to financing improvements in institutional infrastructure, enhancing corporate governance related reform in emerging markets becomes an absolute priority, most distinctively the establishment of the Global Corporate Governance Forum in 1999 by the World Bank and the OECD.[27] Many jurisdictions within emerging markets have been victims

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24. Claessens & Yurtoglu, *supra* note 112, at 1.

25. *Id.*

26. For more discussions of shareholding ownership and corporate governance in emerging markets, *see* Aguilera et al., *supra* note 126. For more discussions on SOEs and corporate governance, *see* Jiangyu Wang, *Political Logic of Corporate Governance in China's State-Owned Enterprises*, 47 CORNELL INT'L L.J. 631 (2014); Daniel D. Sokol, *Competition Policy and Comparative Corporate Governance of State-Owned Enterprises*, 2009 BYU L. REV. 1713 (2009); Guanghua Yu, *Using Western Law to Improve China's State-Owned Enterprises: Of Takeovers and Securities Fraud*, 39 VAL. U. L. REV. 339 (2004–2005); Kiarie Mwaura, *Failure of Corporate Governance in State Owned Enterprises and the Need for Restructured Governance in Fully and Partially Privatized Enterprises: The Case of Kenya*, 31 FORDHAM INT'L L.J. 34 (2007–2008); Aldo Musacchio, Sergio G. Lazzarini & Ruth V. Aguilera, *New Varieties of State Capitalism: Strategic and Governance Implications*, 29 ACAD. MGMT. PERSPECTIVES 115 (2015).

27. Mariana Pargendler, *Corporate Governance in Emerging Markets*, *in* OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (forthcoming, Jeffrey N. Gordon & Wolf-Georg Ringe eds., Oxford Univ. Press).

of the financial crisis which started in 1997.[28] During the last two decades, the East Asian financial crisis has been one of the reasons for the extensive influence of the formalized Western institutional framework in many Asian countries, such as South Korea, Thailand, and Indonesia. Many countries which were badly affected undertook substantial changes in their legal and corporate governance systems, and carried out structural reform in order to receive assistance from the International Monetary Fund.[29] The OECD White Paper of 2003 was viewed as an ambitious undertaking for a region as diverse as Asia, being a collective effort by Asian policymakers, regulators, and regional and international experts to reach agreement on policy priorities and recommendations with the purpose of improving corporate governance.[30]

Following this White Paper, various documents and further publications have been produced by the OECD, including "Implementing the White Paper on Corporate Governance in Asia 2006," "Policy Brief on Corporate Governance of Banks in Asia 2006," "Asia: Overview of Corporate Governance Framework 2007," "Policy Brief on Corporate Governance of State-Owned Enterprises in Asia 2010," "Corporate Governance in Asia—Progress and Challenges 2011," and "Reform Priorities in Asia: Taking Corporate Governance to a Higher Level 2012." In terms of corporate governance related regulatory framework reforms, different approaches have been adopted in different jurisdictions. These range from fundamental changes in law and regulations on capital markets to partial changes in specific areas of law.[31] To complete the regulatory framework from a soft law perspective, many countries have adopted corporate governance codes. For example, the China Securities Regulatory Commission issued its "Code of Corporate Governance for Listed

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28. Simon Johnson, Peter Boone, Alasdair Breach & Eric Friedman, *Corporate Governance in the Asian Financial Crisis*, 58 J. FIN. ECON. 141 (2000); Todd Mitton, *A Cross-firm Analysis of the Impact of Corporate Governance on the East Asian Financial Crisis*, 64 J. F FIN. ECON. 215 (2002); Michael L. Lemmon & Karl V. Lins, *Ownership Structure, Corporate Governance and Firm Value: Evidence from the East Asian Financial Crisis*, 58 J. CORP. FIN. 1445 (2003).

29. Donald J. Johnston, *White Paper on Corporate Governance in Asia*, OECD, (2003), *available at* http://www.oecd.org/corporate/corporateaffairs/corporategovernanceprinciples/25778905.pdf.

30. *Reform Priorities in Asia: Taking Corporate Governance to a Higher Level* 7, OECD (2012), http://www.oecd.org/daf/corporateaffairs/corporategovernanceprinciples/49801431.pdf.

31. For example, in the case of Korea, reforms have included the amended Part III of the Commercial Code, and the amended Securities and Exchange Act, an amended Act on the External Audit of Joint Stock Companies and an amended Securities Investment Trust Business Act. For more discussion of the case of Korea, *see* Bernard Black, *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness Final Report and Legal Reform Recommendations to the Ministry of Justice of the Republic of Korea*, 26 J. CORP. L. 537, 541 (2001).

Companies in China" in January 2001, while the Ministry of Finance and Economy started establishing a private sector committee with the purpose of improving corporate governance. This committee adopted a non-binding "Code of Best Practices for Corporate Governance." In addition, the Stock Exchange of Thailand published "The Principle of Good Corporate Governance for Listed Companies" in 2006. The Ministry of Corporate Affairs introduced its "Corporate Governance Voluntary Guidelines" in 2009. The Securities and Exchange Board of India also published a "Consultative Paper on Review of Corporate Governance in India" in 2013.

III. COMMON CORPORATE GOVERNANCE DEFICIENCIES IN EMERGING MARKETS

In emerging markets, weak laws and inefficient law enforcement fail to offer adequate protection to minority shareholders and stakeholders such as creditors.[32] Greater protection cannot be offered to investors and stakeholders without enhancing the enforcement and implantation of highly developed regulations or adopting the best practice standards from the experience of developed markets. Research on better regulatory frameworks would seem to be important in order to establish a better understanding for investors and build more organized relationships between stakeholders and companies. This would help achieve higher valuations and improve performance for companies, thereby enhancing business prosperity and corporate accountability. Furthermore, it will be important for companies registered in a jurisdiction with an emerging market, weak legal regimes, thin bond markets and imperfect bank financing systems, to attract investment through a stronger and more accountable corporate governance framework. Similarly, increasing accountability in the corporate governance framework is critical to develop systems in emerging markets and evolve them into more mature forms.[33]

Country-specific research on corporate governance within the domain of emerging markets has delivered mixed results that suggest that empirical evidence on the relationship between corporate governance and the performance of companies in emerging markets is inconclusive.[34] However, this part is going to explore the common characteristics and

32. Claessens & Yurtoglu, *supra* note 112, at 1.
33. Ju Choi, *supra* note 82, at 50.
34. Ararat & Dallas, *supra* note 121, at 4.

problems of corporate governance related issues in countries with emerging markets. Comparative studies between corporate governance systems in emerging markets, and those in mature markets will be studied as case studies. In order to maintain the legitimacy of the governance process, the realization of accountability within corporate governance seems to be more difficult to achieve in a context of government interference and immature markets. Especially after the financial crisis of 2008, there is a strong trend in favor of arguing that corporate governance will produce a more efficient market-based investment processes and establish better relationships between companies and their stakeholders, including shareholders.[35] Conversely, the financial turmoil has reinforced how failures in corporate governance can have a tremendous negative impact on companies' performance and adversely affect national economies as a whole.

A. Government and Political Intervention and Dominance of SOEs

In the liberal political economy proposed by Adam Smith in his milestone work *The Wealth of Nations*,[36] the government monitors and enforces the regulatory environment in which companies compete for profit, but the government should not be directly involved in a company's decisions and transactions. Since then, many reasons have been advanced arguing that state control over commercial transactions will lead to the failure of the business organization. It is argued that based on the efficiency of the corporate form, direct involvement of state officials will impose multiple political interests on companies, which will dilute motives when social objectives collide with shareholders' wealth maximization. It is also argued that informational asymmetry and uncertainty will constrain the effectiveness of coordination and interference from governments. The willingness of governments to share risk might weaken the motives of companies in making more profit and lead to soft budget constraints, with negative effects on the firm's

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35. John C. Coffee, *What Went Wrong? An Initial Inquiry into the Causes of the 2008 Financial Crisis*, 9 J. CORP. L. STUD. 1 (2009); Emilios Avgouleas, *The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy*, 9 J. CORP. L. STUD. 23 (2009); Chris Gentle, *Work in Progress? How the Credit Crunch has its Roots in the Lack of Integrated Governance and Control Systems*, 9 J. RISK FIN. 206 (2008); The Association of Chartered Certified Accountants, *Climbing Out of the Credit Crunch*, ACCA POLICY PAPER 4 (2008); Cary Krosinsky, Nick Robins & Stephen Viederman, *After the Credit Crunch: The Future of Sustainable Investing*, *in* ADVANCES IN BUSINESS ETHICS RESEARCH 9 (T. Hebb ed., 2012).

36. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776).

efficiency. Taking China as an example, the corporate governance policy model in China builds on a strong authoritarian national leadership and an elite state bureaucracy pursuing developmentally oriented policies, including the direct means of governing the market.[37] The economic success in the last two decades is the result of combative policies, sometimes even contradicting government control and interference—including liberalization of the product and labor markets, entering the WTO and opening to free trade, and corporatization. On the route to success, these factors that seemingly contradict administrative factors may hinder the development of corporate governance and be regarded as barriers which limit further improvement of corporate governance in China. One of the main Chinese corporate governance paradoxes at the current stage lies in the conflicting roles of the government, between establishing a functional corporate governance environment to support the market economy with the Chinese characteristics, and incomparable, arbitrary, and politically motivated government control. However, the effectiveness and necessity of government interference in business organizations have been questioned and discussed in various dimensions, especially after the financial crisis of 2008. Instead of having a direct role in facilitating and shaping dynamic growth, the state's ability to create and maintain a supportive growth climate is key for emerging markets to achieve economic miracles.[38] Within government capacity limitations, government interference enable the expansion of production and unstainable corporate strategic development. It has also laid the foundation for government supervision in order to mitigate the problems resulting from unstable financial and stock markets in emerging markets. Government interference could be used as an additional governance mechanism to mitigate conflicts such as those in the cases of company expansion across community boundaries, secondary policers of public procurement, and redundancies and reemployment to secured boarder social consensus.

Sir Roger Carr, president of the Confederation of British Industry ("CBI"), put forward three reasons for failures in the development of governance, including the excessive concentration of power, a lack of

37. ROBERT WADE, GOVERNING THE MARKET: ECONOMIC THEORY AND THE ROLE OF GOVERNMENT IN EASE ASIAN INDUSTRIALIZATION 26 (1990).

38. Guido Bertucci & Adriana Alberti, *Globalization and the Role of the State: Challenges and Perspectives*, UNITED NATIONS WORLD PUBLIC SECTOR REPORT 1, 16 (2001) (Paper is based on United Nations World Public Sector Report 2001 on "Globalization and the State" in which authors were major contributors).

transparency in reporting, and a plain lack of interest by the owners.[39] The state-controlled shareholders exercise influence through regular statutory voting rights in the shareholders' meeting and explicit control-sharing arrangements as parties to shareholder agreements. This will grant these investors both board representation and veto rights over important decisions. In emerging markets with low quality governments, companies will likely have different financing and governance patterns while bureaucrats and politicians take advantage of their position for self-interest and corruption.[40] It is argued by Mara Faccio that political connections are normally more frequently found in countries with higher levels of corruption, more barriers to foreign investment, and less transparent systems.[41] Comparing these with countries with developed markets and low government intervention, investors in emerging markets are always very concerned about political and policy risks that include discriminatory changes to the laws, regulations, or contracts governing an investment, tax increases, loss of subsidies, changes of market policy, breaches of contract, the inability to control inflation, and laws regarding resource extraction.[42] Yadong Luo defined political risk as the probability of disruption of the operation of Multinational Enterprises (MNEs) by political forces of events, whether they happen in the host or home country, or result from changes in international environment.[43] Based on this definition, political risks normally include currency convertibility and transfer, expropriation, political voice, breach of contract by a host government, and the non-honoring of sovereign financial obligations.[44]

Politics, law, and economics have been identified within comparative corporate governance research as the main factors triggering different

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39. Sir Roger Carr, CBI President, *Speech to YouGov Cambridge Symposium: Will Coalition Plan for Shareholder Empowerment Make Any Difference to Either Corporate Excess or Economic Growth?* (Mar. 15, 2012).

40. Joseph P.H. Fan, K.C. John Wei, & Xinzhong Xu, *Corporate Finance and Governance in Emerging Markets: A Selective Review and An Agenda for Future Research*, 17 J. CORP. FIN. 207, 209 (2011).

41. Mara Faccio, *Politically Connected Firms*, 96 AM. ECON. REV. 369 (2006); *see also* Mara Faccio, Ronald W. Masulis & John J. McConnell, *Political Connections and Corporate Bailouts*, 61 J. FIN. 1 (2006).

42. Witold J. Henisz & Bennet A. Zelner, *The Hidden Risks in Emerging Markets*, HARV. BUS. REV. (Apr. 2010); *see also* MULTILATERAL INV. GUARANTEE AGENCY, WORLD INVESTMENT AND POLITICAL RISK 1 (World Bank ed., 2010).

43. Yadong Luo, *Political Risk and Country Risk in International Business: Concepts and Measures*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL BUSINESS 740 (Alan M. Rugman ed., 2d ed. 2010).

44. *Id.*

ownership patterns across countries.[45] State share ownerships are more popular in countries with emerging markets. Governments often put restrictions on transferring corporate ownership to the private sector in emerging markets.[46] Research by the OECD on the 2000 largest companies suggested that one tenth of the companies were identified as majority SOEs in the business year 2010–2012, with ownership spread across thirty-seven countries including China, India, Russia, Brazil, Indonesia, the United Arab Emirates, Malaysia, Thailand and South Africa.[47] It is argued that SOEs always have non-commercial priorities, so they can act on the basis of commercial considerations for the interests of shareholders. In contrast to the dispersed shareholding ownership structure of companies in the US and the UK, the emerging markets boast a system of state shareholding ownership (or sometimes wealthy family ownership), which is one of the common characteristics for countries with emerging markets. It is unavoidable that the incentives and professionalism of these government officials will be doubtful.

In countries with emerging markets, the incentives and the quality of government officials and regulators are key determinants of corporate behavior.[48] Groups who have controlling powers over corporate resources always have political power and affect the level of investor protection, mostly in an unfair manner. For example, controlling shareholders prefer legislation and rules that will put minority shareholders in a disadvantaged position. In the case of China, despite the fact that listed private companies outnumbered SOEs in 2014 (986 of the listed companies were SOEs while the remaining 1,410 were private companies listed on the Shanghai and Shenzhen stock exchanges), SOEs still control $2.43 trillion of market capitalization while private listed companies only control $1.32 trillion.[49] Despite the wave of privatzsation in the 1980s and 1990s across countries with emerging markets, all of the BRIC counties still show a high level of state ownership and companies under direct government control with 60

45. *See* Michel Goyer, *Corporate Governance*, *in* THE OXFORD HANDBOOK OF COMPARATIVE ANALYSIS 423 (Glenn Morgan, John Campbell, Colin Crouch, Ove Kai Pedersen, & Richard Whitley eds., 2010); Ruth V. Aguilera & Gregory Jackson, *The Cross-National Diversity of Corporate Governance: Dimensions and Determinants*, 28 ACAD. MGMT. REV. 447 (2003).

46. Joseph P.H. Fan, K.C. John Wei, & Xinzhong Xu, *Corporate Finance and Governance in Emerging Markets: A Selective Review and an Agenda for Future Research*, 17 J. CORP. FIN. 207, 209 (2011).

47. Przemyslaw Kowalski, Max Büge, Monika Sztajerowska & Matias Egeland, *State-Owned Enterprises: Trade Effects and Policy Implications*, OECD TRADE POLICY PAPERS (2013), *available at* http://dx.doi.org/10.1787/5k4869ckqk7l-en.

48. Ararat & Dallas, *supra* note 121, at 6.

49. *China Securities Index Co. Ltd*., THOMSON REUTERS EIKON.

percent of the market capitalization in Russia and 35 percent in Brazil.[50] This reaffirmed a major concern of corporate governance in listed companies in emerging economies, namely controlling-shareholder expropriation or principal-principal conflict, where controlling shareholders pursue their self-interest at the expense of corporate performance and the interests of minority shareholders.[51] SOEs play an important role in the Chinese economy to achieve the dual goals of shareholder profit maximization and the promotion of national interests. However, it is argued by Wang that SOEs in China still suffer from governance flaws despite the reforms introduced since the 1990s addressing conflicts of interests within SOEs, tightening supervision over the state agency that controls them, the lack of independence of boards as well as the fairness and effectiveness of the board, and the enhancement of more transparent financial reports.[52]

State interference also can be observed from the perspective of immature financial markets. It is argued that "advanced countries have much deeper financial systems, with ratios more than double those of emerging markets and almost three times those of transition economies."[53] Many governments in emerging markets control and influence banks and allocate financial resources based on strategic criteria rather than market rules and market forces.[54] Taking China as an example, the Big Four state-owned banks that comprise the first tier of the banking system in China[55] are well known for their unbalanced allocation of financial resources to SOEs and private sectors and other listed companies.[56] The under-developed regulatory framework composed of banking law, company law, and insolvency law (bankruptcy law) also makes it hard to protect investors' and creditors' rights with the high cost of raising capital. This is also the case in India, where the SBI is by far the largest bank in India

50. *The Company that Ruled the Waves*, ECONOMIST, Dec. 17, 2011, at 109, *available at* http://www.economist.com/node/21541753.

51. Yiyi Su, Dean Xu & Phillip H. Phan, *Principal-Principal Conflict in the Governance of the Chinese Public Corporation*, 4 MGMT. & ORG. REV. 17 (2007); *see also* Michael N. Young, Mike W. Peng, David Ahlstrom, Garry D. Bruton & Yi Jiang, *Corporate Governance in Emerging Economies: A Review of the Principal-Principal Perspective*, 45 J. MGMT. STUD. 196 (2008).

52. Zahofeng Wang, *Corporate Governance under State Control: The Chinese Experience*, 13 THEORETICAL INQUIRIES IN L. 487 (2012).

53. Claessens & Yurtoglu, *supra* note 112, at 9.

54. Rafael La Porta et al., *Government Ownership of Banks*, 57 J. FIN. 265 (2002).

55. Together twelve national-level domestic joint-equity banks form the second tier, and just one hundred city-level commercial banks form the third tier.

56. Franklin Allen, Jun Qian & Mejun Qian, *Law, Finance, and Economic Growth in China*, 77 J. FIN. & ECON. 57 (2005).

with more than 21,500 branches in the SBI group, including five associate banks. The banks are not only aiming for profit maximization, but more importantly for public services.

It is stated by the Planning Commission's Raghuram Rajan Report that "public sector entities do exactly what private sectors entities do, through less well because they have more constraints, a poorer skill pool and poorer incentives."[57] The report also suggests that privatization is the way forward, and "one way is bank privatization, or reducing the government's majority stake so that even if the government has *de facto* control, the bank is not 'public sector.'"[58] The underdeveloped financial markets in emerging economies make it difficult for companies to maintain efficient and balanced access to external capital, debt, and equity. The financial crisis of 2008 highlighted the necessity for strengthening financial systems to ensure they are more resilient to shock, especially for emerging markets that face particular challenges in stabilizing their nascent financial systems, both domestically and externally. Financial reforms are therefore key to these economies in order to "pursue high-growth paths."[59] Besides, overly-heavy reliance on informal mechanisms such as building relationships with bankers and government officers who are in control of the state-owned banks will generate opportunities for corruption and illegal sources of external financial influence.

B. Improved by Still Worrying Stakeholder Protection and CSR Records

The concept of stakeholders may be defined as "those groups without whose support the organisation would cease to exist."[60] They have legitimate interests in or claims on the operations of the firm.[61] These stakeholders are interrelated, and every company has a unique set of stakeholder groups. However, the groups which are most frequently seen as such are employees, customers, creditors, local communities, the

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57. INDIA PLANNING COMM'N, HUNDRED SMALL STEPS: REPORT OF THE COMMITTEE ON FINANCIAL SECTOR REFORM 78 (2009), *available at* http://planningcommission.nic.in/reports/genrep/rep_fr/cfsr_all.pdf; *see also* Rajesh Chakrabarti, *State Bank of India: The Opportunities and Challenges of Being a State-Owned Bank of India*, *in* POLITICAL ECONOMY OF STATE-OWNED ENTERPRISES IN CHINA AND INDIA 247 (Yi-chong Xu ed., 2012).

58. *See* INDIA PLANNING COMM'N, *supra* note 57, at 78.

59. Masahiro Kawai & Eswar S. Prasad, *Introduction to* FINANCIAL MARKET REGULATION AND REFORMS IN EMERGING MARKETS vii (Masahiro Kawai & Eswar S. Prasad eds., 2011).

60. R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 31–32 (1st ed. 1984).

61. ARCHIE B. CARROLL & ANN BUCHHOLTZ, BUSINESS & SOCIETY: ETHICS AND STAKEHOLDER MANAGEMENT 57 (7th ed. 1989).

environment, government, and society or the public at large. Contemporary stakeholder approach arguments have always been paralleled by the emergence of the global CSR movement.[62] According to stakeholder theory, the directors are required to consider the interests of the company's stakeholders apart from the interests of the company shareholders. The directors must manage the corporation not only for the betterment of the shareholders, but also for the interests of a multitude of stakeholders, clearly including the shareholders, who can affect or be affected by the actions of the company.[63] It is argued that a consideration of stakeholders' interests enables the creation of long-term favourable conditions for the company to be more competitive. It is useful to regard "the company" as "the company as a whole," a coherent body in which the various stakeholders are bound together through the business.[64] "The evolution of CSR theory provides a sort of social responsibily and performance paradigm, that is, in essence, a solid foundation for corporate social management and stakeholder engagement."[65] Very early discussions of the CSR concept suggested that CSR is about attending to stakeholder rights and taking proactive, voluntary steps to avoid harm or damaging consequences for stakeholders.[66] CSR theory suggests that corporations should recognize obligations beyond their shareholders, based on the stakeholder theory. Even though the world has witnessed economic growth in the 2000s, ameliorating social considerations for poverty, inequality, and human rights violations remain a major challenge in emerging market economies.

Compared with developed countries, in countries with emerging markets, multinational and domestic companies always suffer more from social and environmental problems. These problems include workplace issues, such as labor standards, marketplace issues—most notably in emerging markets these concern the integrity and quality of products being manufactured—and environment issues to promote the sustainability of

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62. Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L.J. 493, 494 (2005).

63. R. EDWARD FREEMAN, *A Stakeholder Theory of the Modern Corporation, in* ETHICAL THEORY AND BUSINESS 69 (Tom L. Beauchamp & Norman L. Bowie eds., 5th ed. 1997).

64. John Parkinson, *Reforming Directors' Duties*, 12 POL'Y PAPER (Univ. of Sheffield 1998).

65. Robin T. Byerly, *Seeking Global Solutions for the Common Good: A New World Order and Corporate Social Responsibilities in* CORP. SOCIAL RESPONSIBILITY, ACCOUNTABILITY AND GOVERNANCE: GLOBAL PERSPECTIVES 122 (Istemi Demirag ed., 2005).

66. *See* the initial argument for CSR in HOWARD R. BROWN, SOCIAL RESPONSIBILITIES OF THE BUSINESSMAN (Harper & Row 1953); *see also* Archie B. Carroll, *The Pyramid of Social Responsibility: Towards the Moral Management of Organizational Stakeholders*, 34 BUS. HORIZONS 39, 39–48 (1991).

the companies.[67] In the case of multinational companies, the massive shift in manufacturing capacity from Western economies to countries with emerging markets, which offer access to cheaper labor, will not only create jobs in local communities in developing countries but also cause serious employment problems for unskilled workers in more advanced economies.[68] However, this transition may also create social problems concerning employment in developing countries. For example, in the Bhopal incident, 20,000 local employees and local residents were killed or harmed by a chemical leak from an American-owned chemical factory in the city.[69] The leak could have been prevented if procedures, management, and maintenance had been more rigorous. A second example is the use of child labor by multinational companies in their factories in the Third World, in order to facilitate cheap production of the products they sell in Western markets . This issue became an international scandal in the 1990s and the first decade of the new millennium.[70] Therefore, the development of a systematic framework of employment law, consumer protection law, environmental law, and insolvency law, as well as the protection of the basic rights of stakeholders in order to secure the health and safety of the employees and customers, are key in emerging markets.

Exploring and applying the stakeholder theory in emerging markets is regarded as one of the most current and challenging debates on corporate morality.[71] Characterized as ‘‘low-income, rapid-growth countries using

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67. Feng Zhang, *Corporate Social Responsibility in Emerging Market: The Role of Multinational Corporations* 4 (2008), *available at* http://fpc.org.uk/fsblob/919.pdf.

68. PHILIP SADLER, BUILDING TOMORROW'S COMPANY: A GUIDE TO SUSTAINABLE BUSINESS 19 (Kogan Page 2002).

69. *See generally* INGRID ECKEMAN, THE BHOPAL SAGA (Univ. Press 2004); *see also Bhopal Gas Tragedy: Fact Sheet*, HINDUSTAN TIMES (Dec 3, 2004); Steven R. Weisman, *Bhopal Factory a Year Later: Silence and Weeds*, N.Y. TIMES (Dec. 2, 1985), *available at* http://www.nytimes.com/1985/12/02/world/bhopal-factory-a-year-later-silence-and-weeds.html.

70. COLIN FISHER & ALAN LOVELL, BUSINESS ETHICS AND VALUE: INDIVIDUAL, CORPORATE AND INTERNATIONAL PERSPECTIVES 53 (2d ed. 2006).

71. Loke Min Foo, *Stakeholder Engagement in Emerging Economies: Considering the Strategic Benefits of Stakeholder Management in a Cross-Culture and Geopolitical Context*, 7 CORP. GOVERNANCE 379 (2007). The protection of stakeholders and possibilities of adopting stakeholder theory within the company law and corporate governance code have been very challenging and current issues. For discussions on stakeholder theory, *see generally* R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH, (1984); ABBASS F. ALKHAFAJI, A STAKEHOLDER APPROACH TO CORPORATE GOVERNANCE: MANAGING IN A DYNAMIC ENVIRONMENT (1989); JAMES J. BRUMMER, CORPORATE RESPONSIBILITY AND LEGITIMACY: AN INTERDISCIPLINARY ANALYSIS (1991); Kenneth E. Goodpaster, *Business Ethics and Stakeholder Analysis*, 1 BUS. ETHICS Q. 53 (1991); Jingchen Zhao, *The Curious Case of Stakeholder Theory: Calling for a More Realistic Theory*, 17 INT'L TRADE & BUS. L. REV. 1 (2014); Timothy L Fort, *Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 NOTRE DAME L. REV. 173 (1997–1998); Katharine V. Jackson, *Towards a Stakeholder-Shareholder Theory of*

economic liberalization as their primary engine of growth,''[72] market activities in countries with emerging markets have long been "characterized by the prevalence of relationship-based or relationship-governed behaviors"[73] rather than a rule-governed approach. At the institutional level, emerging markets are less developed in terms of their formal rules, demonstrating onlyinformal constraints by building informal networks or relationships with stakeholders[74] to win trust and loyalty and establish greater levels of respected stakeholder engagement. The protection of stakeholders' and corporations' responsibilities should go beyond the explicit legal and regulatory requirements toward practices that are more culturally and traditionally oriented. Reputable relationships with stakeholders are also regarded as important factors and are associated with better performance in countries with emerging markets, such as Thailand.[75] With increasingly worrying CSR records in emerging markets and corporate scandals relating to various socially or environmentally irresponsible corporate behaviors, it is logical to think that legal constraints on stakeholder protection, especially corporate law related to directors' duties and information disclosure, seem more effective in countries with emerging markets. Furthermore, the relationships built with *guanxi* or *renqing* are quite often related to bribery and corruption because of the owners' ability to seek rent from the government.[76] As argued in

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Corporate Governance: A Comparative Analysis, 7 HASTINGS BUS. L.J. 309 (2011); Andrew Keay, *Stakeholder Theory in Corporate Law: Has it Got What it Takes*, 9 RICH. J. GLOBAL L. & BUS. 249 (2010); John Kong Shan Ho, *Economic Theories of the Firm Versus Stakeholder Theory: Is There a Governance Dilemma*, 38 HONG KONG L.J. 399 (2008). For a discussion on *guanxi* and corruption, see *generally* Jing Vivian Zhan, *Filling the Gap of Formal Institutions: The Effects of* Guanxi *Network on Corruption in Reform-era China*', 58 CRIME, L. & SOC. CHANGE 93 (2012); Ling Li, *Performing Bribery in China: Guanxi-Practice, Corruption with a Human Face*, 20 J. CONTEMP. CHINA L. (2011); ANDREW L. FRIEDMAN & SAMANTHA MILES, STAKEHOLDERS: THEORY AND PRACTICE (Oxford Univ. Press 2006); WILLIAM B. WERTHER & DAVID B. CHANDLER, STRATEGIC CORPORATE RESPONSIBILITY: STAKEHOLDERS, GLOBALIZATION, AND SUSTAINABLE VALUE CREATION (3d ed. 2014); Pierre Habbard, *Shifting to the Long-term: The Road Ahead*, *in* SIGURT VITOLS, 3 LONG-TERM INVESTMENT AND THE SUSTAINABLE COMPANY: A STAKEHOLDER PERSPECTIVE (2015).

72. Robert E. Hoskisson, Lorraine Eden, Chung Ming Lau & Mike Wright, *Strategy in Emerging Economies*, 43 ACAD. MGMT. J. 249 (2000).

73. Foo, *supra* note 71, at 383.

74. Raymond Fisman, *Estimating the Value of Political Connection*, 91 AM. ECON. REV. 1095 (2001).

75. Steven White, *Stakeholders, Structure and the Failure of Corporate Governance Reform Initiatives in Post-Crisis Thailand*, 21 ASIA PAC. J. MGMT. 103 (2004).

76. *Id.*; G*uanxi* means personal connections or relationships, and *renqing* means reciprocity. *Guanxi* is a central life philosophy for many aspects of Chinese life. The Chinese have turned the art of personal relationships into a carefully calculated science, and there are people whose lives rely heavily upon *guanxi*. There are arguable benefits of building an extensive *guanxi* network, such as reducing transaction costs, operational uncertainty, information costs, contextual hazards and competitive

Part III.A above, many banks in emerging markets are state-owned and the government has direct controlling power through civil servants. It is reported that state banks frequently give loans and other business privileges to those who bribe or build *guanxi* with the bureaucrats who are in charge of the financial services of the country.[77]

Interesting examples of legal reform of CSR and corporate law have been the approaches adopted by the Indian Companies Act 2013 and Indonesian legislation. The legislative recognition of CSR in Mauritius and India is more advanced than in most Western countries because of codifying CSR spending for targeted companies. CSR law in both jurisdictions recognized the potential for using corporate strength to fulfil the social objectives of the state. According to the Indian Companies Act 2013, a company having a net worth of five hundred crore or more rupees, a turnover of one thousand crore or more rupees or a net profit of five crore rupees or more during any financial year should constitute a Corporate Social Responsibility Committee of the Board, consisting of three or more directors out of which at least one shall be an independent director, to play the function of formulating and recommending a CSR policy to the board, recommending the amount of expenditure to be incurred on CSR activities as specified in Schedule VII and monitor the CSR policy of the company from time to time.[78] Furthermore, the mandatory CSR requirement is quantitative by requiring that the company

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threats. Other benefits include enhancing institutional support, economic returns, business effectiveness, organizational legitimacy and strategic capability, in order to provide more efficient mechanisms for transactions by acting as the catalyst for the development of new market channels and investment opportunities. *Renqing* is about reciprocity in established relationships, and it is obviously closely related to the gift-giving and *guanxi* culture in China. *Renqing* is regarded as a key form of social capital that obliges people and companies to reciprocate in *guanxi* networks. This means that *renqing* is the favors that are offered through well-regarded *guanxi*. *Renqing* is regarded as investment for social capital, with the expectation that the beneficiary will remember it and pay it back when the benefactor is in need. *See* Mayfair Mei-Hui Yang, *The Resilience of Guanxi and Its New Deployment: A Critique of Some New Guanxi Scholarship*, 170 CHINA Q. 459 (2002); Jingchen Zhao & Shuangge Wen, *Gift Giving, Guanxi and Confucianism in a Harmonious Society: What Chinese Law Could Learn from English Law on Aspects of Directors' Duties*, 34 CO. L. 381 (2013); YADONG LUO, GUANXI AND BUSINESS (2d ed. 2007).

77. For more on the Chinese context, *see* Guohua Jiang, Charles M.C. Lee & Heng Yue, *Tunneling Through Intercorporate Loans: The Chinese Experience*, 98 J. FIN. ECON. 1 (2010); J.P.H. Fan, T.J. Wong & Tianyu Zhang, *Institutions and Organizational Structure the Case of State-Owned Corporate Pyramid*, 29 J.L. ECON. & ORG. 1217 (2012).

78. The Companies Act § 135(1)–(3), No. 18 of 2013, INDIA CODE (1993), *available at* http://indiacode.nic.in; *see also* Akanksha Jain, *The Mandatory CSR in India: A Boon or Bane*, 4 INDIAN J. APPL. RES. 301 (2014); Arjya B. Majumdar, *Indian's Journey with Corporate Social Responsibility—What Next*, 33 J.L. & ECON. 165 (2015); Sandeep Gopalan & Akshaya Kamalnath, *Mandatory Corporate Social Responsibility as a Vehicle for Reducing Inequality: An Indian Solution for Piketty and the Millennials*, 10 NW. J.L. & SOC. POL. 34 (2015).

spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.[79] A quantitative requirement is a mandatory regulation that requires corporations to sacrifice a certain percentage of their corporate profit for the purposes of CSR. The obvious advantage of a quantitative requirement is guaranteed compliance with substantial and measurable contributions from corporations in using a slice of their profit for CSR-related actions. It unifies and codifies a common minimum for companies to initiate CSR activities and maintain them at an adequate level. One arguable advantage of a percentage requirement within corporate law is that it may lead to a significant increase in the number of CSR activities. It is important to discuss the nature of CSR in these two jurisdictions to assess the effectiveness of their CSR legislation, considering how likely these legislations are to promote sustainable decision making. Ariya Majumdar argued that the new legislation embedded in Companies Act 2013 did not reflect the intent and spirit of CSR, which is including CSR in the core strategies of the company.[80] It has been suggested that CSR in India "has traditionally been seen as a philanthropic activity as those that were performed but not deliberated,"[81] and the practice of CSR in India still remains within the philanthropic space. As such, CSR may not internalize socially responsible behaviors.[82] This slows the development of CSR in India, although it is argued that contemporary CSR tends to effect community development through various projects, becoming more strategic in nature from the stakeholder perspective.[83]

Indonesia is quite advanced in terms of CSR for a country with an emerging market. Indonesian company law accommodates CSR in its company law legislation in its Limited Companies Act 2007, which defines how companies should incorporate CSR principles in their internal regulation. The introduction of mandatory CSR in Indonesia is a good example of implementing corporate social responsibility by the means of administrative power. This legislation, with a focus on companies in

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79. *Id*. § 135(5).

80. Arjya B. Majumdar, *India's Journey with Corporate Social Responsibility: What Next*, 33 J.L. & COM. 165, 204 (2014–2015).

81. Anupam Singh & Priyanka Verma, *From Philanthropy to Mandatory CSR: A Journey Toward Mandatory Corporate Social Responsibility in India*, 6 EUR. J. BUS. MGMT. 146, 147 (2014).

82. Rhys Jenkins, *Globalisation, Corporate Social Responsibility and Poverty*, 81 INT'L AFFAIRS 525 (2005).

83. Jorge A. Arevalo & Deepa Aravind, *Corporate Social Responsibility Practices in India: Approach, Drivers and Barriers*, 11 CORP. GOV.: INT'L J. BUS. SOC'Y 399 (2011).

relation to natural resources, is regarded as legislative action that prevents company behavior that is irresponsible towards society in order to promote the implantation of good corporate governance. The adoption of No. 40 from the 2007 Companies Act has created significant debate over the nature of CSR, while business interests represented by the Indonesian Chamber of Commerce and several corporations brought a case before the Constitutional Court questioning the legitimacy of Article 74. It is argued that the article violated the Indonesian Constitution with respect to Article 28 D (1) on legal certainty, Article 28 I (2) on discrimination and Article 33 (4) on the efficiency of economic justice. This is always a problem because of the emphasis on voluntary CSR; it may be seen as unjust and discriminatory toward certain companies by creating additional burdens for them.[84] In the opinion of the author, two positive aspects of Article 74 of the New Company Law of the Republic of Indonesia are worth considering in relation to Chinese Company Law. First, it might be helpful to require companies to include the cost of executing CSR in their corporate budgets in future company law or other related legislations, in order to strengthen idea of CSR in the minds of corporate directors. Second, it is important for certain categories of industries to undertake additional social and environmental responsibilities

C. Board Independence

In emerging markets, where external governance is comparatively weak for a competitive and efficient corporate governance mechanism, the capacity of boards to monitor and direct the company as the agent on behalf of shareholders is particularly important. Board independence has been the topic for a number of corporate governance codes.[85] The issue has been particularly important for emerging markets because of their unique agency problems. Agency problems normally arise from two scenarios including the principal-agent problem and the principal-principal

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84. ‘Judicial Review of 2008 Laws No. 40’ (2009) Judgment, Case No. 53/PUU-VI/2008, Indonesian Constitution Court; *see also* Patricia Rinwigati Waagstein, *The Mandatory Corporate Social Responsibility in Indonesia: Problems and Implications*, 98 J. BUS. ETHICS 455 (2011).

85. *See* Patricia Rinwigati Waagstein, *The Mandatory Corporate Social Responsibility in Indonesia: Problems and Implications*, 98 J. BUS. ETHICS 455 (2011).

85. Alessandro Zattoni & Francesca Cuomo, *How Independent, Competent and Incentivized Should Non-Executive Directors Be? An Empirical Investigation of Good Governance Codes*, 21 BRIT. J. MGMT. 63 (2010); *see also* Ruth V. Aguilera, *Corporate Governance and Director Accountability: An Institutional Comparative Perspective*, 16 BRIT. J. MGMT. 38 (2005); Catherine M. Dalton & Dan R. Dalton, *Boards of Directors: Utilizing Empirical Evidence in Developing Practical Prescription*, 16 BRIT. J. MGMT. 91 (2005).

problem, characterized by the separation of ownership and control or conflicts of interest between controlling and non-controlling shareholders.[86] State shareholding and the identity of directors as civil servants make both agency problems more significant than in mature markets. Apart from the problems coming from ownership, the controlling power of the state and the relationship between directors and controlling shareholders also make agency problems in emerging markets more significant due to economic the market's development stage, corruption and legal enforcement.

From relevant recommendations in the codes of China, Brazil, India and Russia, a group of countries which are at a similar stage of economic development with emerging markets, the independence of boards has been suggested in various measures, including the introduction of non-executive or independent directors.[87] These are particularly "valuable in emerging economies because institutional and market forces are too weak to regulate governance matters."[88] The existing empirical evidence delivers limited and mixed results on the relationship between independent directors and the performance of corporations in emerging markets.[89] However, one possible explanation of these mixed results is that the research depends on the presumption that independent directors are not independent enough, or are not really independent of shareholders' control.[90]

An interesting example of legal reform for board independency has been the approach adopted by the Indian Companies Act of 2013. Independent directors were defined and described in Section 149 (6); it is

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86. *See* Josh Bendickson, Jeff Muldoon, Eric Liguori, Phillip E. Davis, *Agency Theory: The Times, They Are A-Changin'*, 54 MGMT. DECISION 174 (2016).

87. CODE OF CORPORATE GOVERNANCE FOR LISTED COMPANIES IN CHINA, at 46, 49–51 (Jan. 7, 2001); IGBC, CODE OF BEST PRACTICE OF CORPORATE GOVERNANCE at 2.21–2.22 (2004); India Corporate Week, *Corporate Governance Voluntary Guidelines* at A.1 (Dec. 2009); CORPORATE GOVERNANCE CODE (Russ.), at 2.2 (2002).

88. Alessandro Zattoni & Francesca Cuomo, *supra* note 85, at 71.

89. For examples of positive results, *see*, e.g., Fernando Lefort & Francisco Urzua, *Board Independence, Firm Independence, Firm Performance and Ownership Concentration: Evidence from Chile*, 61 J. BUS. RES. 615 (2008); Mike W. Peng, *Outside Directors and Firm Performance During Institutional Transitions*, 25 STRATEGIC MGMT. J. 453 (2004); Bernard S. Black et al., *Does Corporate Governance Predict Firm's Market Values? Evidence from Korea*, 22 J.L. ECON. & ORG. 36 (2006); *but see* Yenpao Chen at al., *Is China's Independent Director System Working? The Case of the Electronics Industry*, 38 J. ECON. STUD. 360 (2011); Sanjai Bhagat & Bernard S. Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231 (2002); Melsa Ararat et al., *The Effects of Board Independence in Controlled Firms: Evidence from Turkey*, Working Paper (2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1663403.

90. For a comprehensive discussion of shareholder control and independence of board decisions, see generally Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263 (2009).

stated in the Act that all listed companies and companies notified by Central Government must have at least a third of the board made up of independent directors,[91] although there was no requirement to have independent directors under the Indian Companies Act 1956 of India. However, under the Listing Agreement, the board's listed entities, including the non-executive chairman and the executive chairman, should include at least one third to one half of the total directors as independent directors, depending on the executive or non-executive nature of the chairman. Despite the fact the new law strives to create better norms for corporate governance, the change has not brought any positive effects for board independence in India, a country with an emerging market.[92] Furthermore, one of the independent directors should sit on a Corporate Social Responsibility Committee of the Board to make independent decisions about CSR-related issues for companies having a net worth of five hundred crore rupees or more, a turnover of one thousand crore rupees or more, or a net profit of five crore rupees or more during any financial year. Disregarding the enforcement of these proposed legislative reforms, these approaches have been taken by legislators to deal with some fundamental problems in emerging markets, including board independence and worrying CSR performance, to promote corporate accountability and a healthy investment environment. These are positive attempts in promoting stakeholder protection by making CSR mandatory. However, the enforcement of these provisions remains problematic and subject to many problems, such as corruption.

IV. PROMOTING MORE EFFICIENT CORPORATE GOVERNANCE SYSTEMS IN EMERGING MARKETS

Emerging market countries are going through a hard process of transformation in which corporate governance can play a vital role.[93] Research on emerging markets becomes very important due to their purchasing power. It is reported that the BRIC countries have contributed 36 percent of the world GDP growth in purchasing power parity terms from 2000 to 2010, and this figure is expected to increase to 49 percent

91. S. 149 (4) Indian Companies Act 2013.

92. Srinivasan Ramaswamy, *Companies Act 2013: A Critical Analysis of the Opposed New Company Law in India*, 25 INT'L CO. & COM. L. REV. 31, 32 (2014).

93. Charles Oman et al., *Corporate Governance in Developing, Transition and Emerging-Market Economies*, OECD DEV. CENTRE, Policy Brief No. 23 at 1 (2003).

and overtake the current leading economies by 2020.[94] It is argued that rule-based governance largely relies on publicly verifiable information, while relationship-based governance largely relies on mutually observable information by involving transaction parties.[95] From the discussion of the inefficient characteristics of corporate governance in emerging markets, it is clear that these defects are somehow the result of inefficient legal systems, either because of a lack of legislation or inefficient legal enforcement. In this part, some of the commonly applicable legal responses will be proposed, trying to address these joint problems shared by countries with emerging markets. Despite the fact that a rule-based governance system always involves large total fixed transaction costs, including cost of legislation, interpreting, and implementing laws by the legislative, judiciary and executive branches,[96] the trend towards a rule-oriented system is key for countries with emerging markets in which economic development is heavily hindered by widespread corruption and uncertainties.

Compared to rule-based governance, the acquired information is implicit and specific for every transactional party, it is not publicly verifiable, and it is non-transferable.[97] The controlling parties in network-oriented corporate governance models control the information and make decisions, and these controlling powers make the information structure informal and centralized. The move towards an open, market-friendly, economically more democratic system for an emerging market requires a more functionally operated rule-based system of governance, which is more transparent, accountable and does not rely heavily on relationships.[98]

A. Hybrid Regulatory Sources of Government Legislations and Soft Law

It is argued that soft law has many advantages, including "timely action when governments are stalemated, bottom-up initiatives that bring additional legitimacy, expertise and other resources for making and

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94. Sanjay Peters et al., *How Relevant Is Corporate Governance and Corporate Social Responsibility in Emerging Markets?*, 11 CORP. GOV. 429, 435 (2011).

95. George Baker et al., *Relational Contracts and the Theory of the Firm*, 117 Q.J. ECON. 39 (2002); *see also* Masahiro Okuno-Fujiwara, *Toward a Comparative Institutional Analysis of the Government-Business Relationship*, *in* THE ROLE OF GOVERNMENT IN EAST ASIAN ECONOMIC DEVELOPMENT: COMPARATIVE INSTITUTIONAL ANALYSIS, 373 (Masahiko Aoki et al. eds., 2005).

96. John Shuhe Li, *Relation-based Versus Rule-based Governance: An Explanation of the East Asian Miracle and Asian Crisis*, 11 REV. INT'L ECON. 651, 658 (2003).

97. *Id.* at 657.

98. Charles Oman et al., *Corporate Governance in Developing, Transition and Emerging-Market Economies*, OECD DEVELOPMENT CENTRE, Policy Brief No. 23 (2003), at 5.

enforcing new norms and standards and an effective means for direct civil society participation in global governance."[99] The role played by soft law is considered as a supporting role to enrich and strengthen the traditional legal instruments in the context of today's globalized economies, dynamic and the complicated nature of corporate responsibility and corporate actions and constant but variable social needs.[100] There are two broad regulatory mechanisms in corporate governance: government statutory legislations which regulate corporate behaviors, and standards of best practice which leave compliance to companies and are characterized by a comply-or-explain approach that enables companies to accomplish corporate goals that best fit their particular contingencies.[101] International agencies including the OECD, the World Bank and the Asian Development Bank have already produced various guidelines and principles on corporate governance in order to press developing countries and emerging economies to adopt rule-based standards.[102] Many countries have also promulgated corporate governance codes to which listed companies should adhere, based on the comply-or-explain principle.[103] Many of these codes are based on the OECD principle published in 2004.[104] Together with limited local legal reforms, globalization and the worldwide integration of financial markets are acting as the main drivers of this process.[105]

99. RENGINEE PILLAY, THE CHANGING NATURE OF CORPORATE SOCIAL RESPONSIBILITY: CSR AND DEVELOPMENT IN CONTEXT: THE CASE OF MAURITIUS 136 (2015).

100. Jon Birger Skjærseth, Olav Schram Stokke & Jørgen Wettestad, *Soft Law, Hard Law, and Effective Implementation of International Environmental Norms*, 6 GLOBAL ENVT'L POL. 104, 105–06 (2006).

101. John Armour, Henry Hansmann & Reinier Kraakman, *What Is Corporate Law? in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 2–4 (Reinier Kraakman et al. eds., 2d ed. 2009).

102. THOMAS CLARKE & MARIE DELA RAMA, CORPORATE GOVERNANCE AND GLOBALISATION, at xxvi (2006). Good examples are the OECD Principles of Corporate Governance 2004, Developing and Implementing Corporate Governance Codes by the World Bank 2008, and A Premier on Corporate Governance by the Asian Development Bank 2011.

103. This concept of "comply or explain" originated in the United Kingdom with the Cadbury Report in 1992, which provided the first serious code, and states that a company should comply with a set code of practice, but if it does not then it must state this in the annual directors' report and explain why. *See* Andrew Keay, *Comply or Explain in Corporate Governance Code: In Need of Greater Regulatory Oversight*, 34 LEGAL STUD. 279; Iain MacNeil & Xiao Li, *"Comply or Explain": Market Discipline and Non-Compliance with the Combined Code*, 14 CORP. GOV.: AN INT'L REV. 486 (2006).

104. For research about codes and emerging markets, *see* Mathias M. Siems & Oscar Alvarez-Macotela, *The OECD Principles of Corporate Governance in Emerging Markets: A Successful Example of Networked Governance?*, *in* THOMAS NETWORKED GOVERNANCE, TRANSNATIONAL BUSINESS AND THE LAW 257, 257 (Mark Fenwick, Steven Van Uytsel & Stefan Wrbka ed., 2014).

105. Tarun Khanna, Joe Kogan & Krishna Palepu, *Globalization and Similarities in Corporate Governance: A Cross-country Analysis*, 88 REV. ECON. & STAT. 69 (2006).

Corporate governance codes and other soft law refer to quasi-legal instruments without any penal and binding force, or with weaker binding force than traditional hard law.[106] In relation to corporate governance, soft laws can be used in the context of voluntary principles that acquire recognition by companies, international financial institutions and civil societies as the result of an industry drive towards self-regulation, globally re-enforcing norms that have received multi-lateral and international acceptance.[107]

Abbot and Snidal argue that "legal arrangements are weakened along one or more of the dimensions of obligation, precision, and delegation," and that the softening can occur in varying degrees along each dimension and in different combinations across dimensions.[108] Despite the fact that soft laws has been criticized for being mere window dressing,[109] soft law offers many advantages and avoids some of the costs and impossibilities of hard law—and is often easier to achieve than legalization. Soft laws in place for dealing with corporate governance related issues have been useful in a number of places, especially on issues concerning corporate accountability, corporate transparency and CSR.[110] A code of ethics is a guide that may be used both to regulate corporate behaviors and to create corporate ethical values in order to enhance corporate responsibilities towards stakeholders. These are soft laws which companies adhere to in a voluntary manner, above and beyond the legal requirements. The OECD Guidelines for Multinational Enterprises, the Global Compact, the Norms on the Responsibilities of Transnational Corporations and other Business with Regard to Human Rights,[111] and other voluntary codes for corporate conduct have functioned as useful and influential documents for companies. Corporate governance codes from various countries with

106. Catherine Redgwell, *International Soft Law and Globalization*, *in* REGULATING ENERGY AND NATURAL RESOURCES (Barry Barton et al. eds., 2006).

107. *See* Jon Birger Skjærseth, Olav Schram Stokke & Jørgen Wettestad, *Soft Law, Hard Law, and Effective Implementation of International Environmental Norms*, 6 GLOBAL ENVTL. POL. 104 (2006); Bede Nwete, *Corporate Social Responsibility and Transparency in the Development of Energy and Mining Projects in Emerging Markets; Is Soft Law the Answer?* 8 GER. L.J. 311, 327 (2007).

108. Kenneth W. Abbot & Duncan Snidal, *Hard and Soft Law in International Governance*, 54 INT'L ORG. 421, 422 (2000).

109. *See generally* George W. Downs, David M. Rocke & Peter N. Barsoom, *Is the Good News about Compliance Good News about Cooperation?*, 50 INT'L ORG. 379 (1996).

110. Eugene K.B. Tan, *Corporate Social Responsibility as Corporate Soft Law: Mainstreaming Ethical and Responsible Conduct in Corporate Governance*, 31 SINGAPORE L. REV. 227 (2013).

111. The full title is "Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights." *See* U.N. Sub-Commission on the Promotion and Protection of Human Rights resolution 2003/16, U.N. Doc. E/CN.4/Sub.2/2003/L.11 at 52 (2003).

emerging markets also act as important legislative instruments to promote the efficiency and success of public companies.[112]

The European Corporate Governance Institute provides an index of official corporate governance codes and principles from ninety-one countries as well as principles and guidelines from the OECD, the United Nations and Europe.[113] Positively, more than half of these principles are from countries with emerging markets, including the Code for Corporate Governance for Bangladesh 2004, the Code of Best Practice of Corporate Governance (4th edition) 2009, the Code of Corporate Governance for Securities Companies (China) 2004, the Corporate Governance Code based on the OECD Principles 2004 (Czech Republic), the Code of Corporate Governance for Listed Companies 2001 (Egypt), the Corporate Governance Voluntary Guidelines 2009 (India), the Malaysian Code on Corporate Governance 2012, the Código de Mejores Prácticas Corporativas 2010, Corporate Governance Codes and Principles 2011 (Nigeria), the Code of Best Practice for WSE Listed Companies (Poland), the Russian Code of Corporate Conduct 2002 (Russia), and the Principles of Good Corporate Governance for Listed Companies 2006 (Thailand). These corporate governance codes are regarded as soft-law and principles that offer guidance and rule for regulating listed companies. The adoption of a corporate governance code should raise funds in debt and equity market more efficiently for listed companies, resulting in a lower cost of capital and higher values for the companies.[114] These codes normally focus on a few common aspects including boards of directors, shareholders and shareholders' meetings, the rights of stakeholders, and information disclosure. These parts seem to tackle the problems listed in the first Part of this article, which are significant in emerging markets.[115] The comply-or-explain approach always acts as a start for transformations towards compulsory principles.[116] Depending on the legal system and corporate

112. *See Corporate Governance Issues in Emerging Markets: Theory and Practical Execution*, HHL CTR. CORP. GOVERNANCE & GLOBAL CORP. GOVERNANCE (2012), *available at* http://www.hhl.de/fileadmin/texte/publikationen/proceedings/Conference_Key_Corporate_Governance_Issues.pdf.

113. To access the index, *see* the European Corporate Governance Institute website, *available at* http://www.ecgi.org/codes/all_codes.php.

114. *See* generally *Reform Priorities in Asia: Taking Corporate Governance to a Higher Level*, OECD (2013).

115. *See supra* Part III, COMMON CORPORATE GOVERNANCE DEFICIENCIES IN EMERGING MARKETS.

116. *See, e.g.*, Gralf-Peter Calliess & Moritz Renner, *From Soft Law to Hard Code: The Juridification of Global Governance* (U. Bremen, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1030526##; Eryürekli Law Office, *Turkey: Turkish Corporate Governance: Moving from Soft Law to Hard Law!*, MONDAQ.COM (Jan. 13, 2012), http://www.mondaq.com/x/160770/Corporate+Governance/Turkish+Corporate+Governance+Moving+From+Soft+Law+To+Hard.

governance model development in each jurisdiction, a unique combination of compulsory rules and comply-or-explain guidelines and principles will work effectively to promote sound corporate governance.

Corporate governance in emerging markets is different from mature markets in many ways, including national legalization, the enforceability of legislation, the consistency of enforcement, the applicability of stock market rules, and the level of national securities market development.[117] For emerging markets, more efficient regulatory frameworks could be established through a combination of hard laws, such as statutes and treaties, and soft laws, such as codes and principles which are nonbinding and less precise, and which rely on less centralized forms of interpretation and enforcement. The statutes and treaties will ensure the enforcement of corporate governance legislation. The soft laws, on the other hand, will provide flexibility to various corporate sectors in emerging markets which are older and less stable.

B. Taking Positive Aspects of Government Interference and Incentives in Emerging Markets

Heavy government intervention in business activities has been regarded as a common feature of emerging markets, which makes their corporate governance models differ from those in mature markets.[118] Governments influence and control corporations through taxation, regulatory frameworks and share ownership, from output, including production process, to input such as labor, land, mines, energy and financing.[119] Of these approaches, state investment in business corporations is probably the least desirable, because of its lower efficiency and higher pollution.[120] This interference has been normally regarded as a political hazard, together with issues such as political instability, unpredictable regulatory

117. Sanjay Peters, Mariah Miller & Sophia Kusyk, *How Relevant is Corporate Governance Corporate Social Responsibility in Emerging Market*, 11 CORP. GOVERNANCE: INT'L J. BUS. SOC'Y 429, 436 (2011).

118. Joseph P.H. Fan, K.C. John Wei & Xinzhong Xu, *Corporate Finance and Governance in Emerging Markets: A Selective Review and An Agenda for Future Research*, 17 J. CORP. FIN. 207, 208 (2011).

119. *Id.*

120. Amir N. Licht, *State Intervention in Corporate Governance: National Interest and Board Composition*, 13 THEORETICAL INQUIRIES L. 597, 599–600 (2012). *See also* Bernardo Bortolotti & Enrico Perotti, *From Government to Regulatory Governance: Privatization and the Residual Role of the State*, 22 THE WORLD BANK RES. OBSERVER 53 (2007).

changes and bureaucratic red tape and corruption.[121] Nevertheless, it may have positive impact on companies and corporate governance in emerging markets, especially by prompting an efficient model. Shleifer and Vishny took a dynamic view that "[c]orporate governance mechanisms are economic and legal institutions that can be altered through political process."[122] While a number of disadvantages of self-regulation have been noted, including conflicts of interest, inadequate sanctions, under-enforcement, global competition and insufficient resources,[123] it is argued that it is worth maintaining a balance between government regulation and self-regulation. Unlike the early path of internationalization for multinational corporations from mature and advanced markets[124] and newly industrialized economies which already run under efficient market power, companies in emerging economies benefit tremendously by cooperating with governments. The non-subsidy assistance and control from state and government will help companies in fledgling industries in emerging economies and enable them to be more competitive in the globalized market. The concentration of political power can also potentially help corporate governance systems by enforcing soft law and government policy more efficiently, in order to ensure the transparency and accountability of corporate governance. The interference of government will mitigate the exclusive reliance on the market and regulate corporate behavior through direct and enforceable regulations.

Despite the fact that the ultimate goal of SOEs should be to enhance economic performance and market integrity, often in emerging markets with SOEs the enterprises do have dual goals, including shareholder wealth maximization and political goals to promote political support and power,[125] especially for SOEs in industries such as transportation, oil and gas, telecommunications and banking. The political economy literature

121. *See* Yadong Luo & Rosalie L. Tung, *International Expansion of Emerging Market Enterprises: A Springboard Perspective*, 38 J. INT'L BUS. STUD. 481 (July 2007).

122. Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 THE J. OF FIN. 737, 738 (1997).

123. Cary Coglianese, Elizabeth K. Keating, Michael L. Michael & Thomas J. Healey, *The Role of Government in Corporate Governance*,1 N.Y.U. J.L. & BUS. 219 (2004).

124. In those markets, the contractual theory of company law emphasizes the supremacy of private contracting and the importance of reducing transaction costs through minimum government interference in the private ordering of intra-corporate relationships.

125. *See* Antonio Capobianco & Hans Christiansen, *Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options*, OECD (2011), at 3; Mette Morsing, *State-Owned Enterprises: A Corporatization of Governments?*, 24 MGMT. COMM. Q. 710 (2011); Juliet Roper & Michele Schoenberger-Orgad, *State-Owned Enterprises: Issues of Accountability and Legitimacy*, 25 MGMT. COMM. Q. 693 (2011); Peggy H. Cunningham, *State-Owned Enterprises: Pursuing Responsibility in Corporate Social Responsibility*, 25 MGMT. COMM. Q. 718 (2011).

discussed that government and administrative agencies are typically serving multiple goals. Government interference may ease the pressure of the companies in pursuing shareholder value in the short-term and put the emphasis on the long-term value of the companies and the national goals at large.[126] Government interference could be used as an additional governance mechanism mitigate conflicts such as those in the cases of company extension across community boundaries, secondary polices in public procurement and redundancies and reemployment to secured boarder social consensus. Thus, the interference could facilitate and shaping dynamic economic growth by establishing supportive business environment and introducing legislations that enable rather than hinder investors to set up companies as vehicle to do business or to trade in the stock exchanges in China. Government interference, supervision and control over these companies will secure the steady and harmonious development of the society. The political goals of SOEs in emerging economies are particularly important for guaranteeing public services at a competitive level. SOEs are able to achieve a combinative objective of national goals and corporate performance, setting a model for good compliance with the law and undertake social responsibility. It will be comparatively easier for them to take advantages of scientific technology to maintain a sustainable and effective business operational environment in order to achieve strategic goals of corporations in the longer terms.[127] Most of the jurisdictions in emerging market are undergoing considerable corporate governance evolution but has yet to establish a unifying system that balances social-economic forces with the economy.

It is s argued by Musacchio et al that government have improved corporate governance practices of SOEs, taking Sinopec (China's national oil companies) as an example, on aspects of listing companies on stock exchanges, recruiting independent board members and enhancing financial reporting and these reforms have reduced agency conflicts and attracted minority private investors.[128] In companies that the government outsources management to the private sector due to the reason of privatization and international investment, the State still has veto power over key strategic

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126. David E. M. Sappington & Joseph E. Stiglitz, *Privatization, Information, and Incentives*, 6 J. POL'Y ANALYSIS & MGMT. 567 (1987).

127. Petronas, a SOE in Malaysia, is a good example of success as an industrial top quartile, which began an operational excellence campaign focusing on technical capabilities and more effective working cultural. *See Petronas*, 2009 SUSTAINABILITY REPORT, *available at* www.petronas.com.my/sustainability/.../sustainability%20report2009.pdf.

128. Musacchio, Lazzarini & Aguilera, *supra* note 129, at 115.

decisions.[129] The govenrment interference through different percentages of ownership will inevitably have an impact on the strategic planning in companies in China

C. Legal Responses

A weak legal environment and weak enforcement mechanisms will prevent the efficient allocation of resources and hinder global competition and economic development.[130] Corporate governance reforms in emerging economies share certain collective characters by involving a transition from a close, opaque and relation-based governance model to a more open, transparent and rule-based governance system.[131] Maher and Andersson discussed the important link between law and legal enforcement and the governance of firms, the economic performance of companies, and profit growth.[132] More sound corporate governance models generally pay for better companies, more mature markets and better national economies. In the last decade, countries with emerging markets have introduced reforms and changes at different levels in their legal systems. Taking South Korea as an example, a series of reforms have been introduced in responses to the Asian financial crisis in the late 1990s in order to establish more effective internal and external control mechanisms, such as transparent management and excessive expansion since.[133] As for the legal reform proposal in capital market law and regulation, changes or proposed changes can be classified into the following categories. The first legal response that is normally introduced to counter corporate governance weakness is to enable board structure reform. Boards constitute a key internal governance mechanism. It is argued that there is a strong connection between board

129. *Id.* at 116

130. Christoph Lattemann, *On the Convergence of Corporate Governance Practices in Emerging Markets*, 9 INT'L L.J. EMERGING MKTS. 316, 317 (2014); *see also* Simeon Djankov et al., *The Law and Economics of Self-dealing*, 88 J. FIN. ECON. 430, 436 (2008).

131. Charles Oman, Steven Fries & Willem Buiter, *Corporate Governance in Developing, Transition and Emerging-Market Economies,* OECD DEV. CTR. POL'Y BRIEF NO. 23 9 (2003).

132. Maria Maher & Thomas Andersson, *Corporate Governance Effects on Firm Performance and Economic Growth*, (Paris, OECD Publ'ing 1999); *see also* Thorsten Beck & Ross Levine, *Legal Institutions and Financial Development*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 251, 269 (Claude Menard & Mary Shirley eds., 2005).

133. *See* SWATI R. GHOSH, WORLD BANK, EAST ASIAN FINANCE: THE ROAD TO ROBUST FINANCIAL MARKETS 67 (2006); Curtis J. Milhaupt, *Privatization and Corporate Governance in a Unified Korea*, 26 J. CORP. L. 199 (2000–2001); Bernard Black, Barry Metzger, Timothy J. O'Brien, Young Moo Shin, *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness—Final Report and Legal Reform Recommendations to the Ministry of Justice of the Republic of Korea*, 26 J. Corp. L. 537 (2000–2001).

structure and the market value of companies operating in emerging markets.[134] Suggested reforms include a mandatory requirement for independent outsiders on the board, or employee representatives on the board.[135]

Second, reforms are always introduced regarding directors' duties; the legislation dealing with directors' duties should be comprehensively developed. Their fiduciary duties should be more clearly defined by legislation in emerging markets. Examining English Law for reference, duties are traditionally drawn from two broad non-statutory sources, and are manifest as fiduciary duties and expectations drawn from common law.[136] The fiduciary duties emphasize the need for trustworthiness and the essence of acting in the best interests of the company, while the common law expectation is concerned with ensuring that directors exercise reasonable care and show requisite skill and diligence.[137] An occupant with fiduciary duties was defined by Lord Justice Millett in *Bristol & West Building Society v. Mothew* as "someone who has undertaken to act for or on behalf of another in a particular matter in a circumstance which gives rise to a relationship of trust and confidence."[138] In the case of a company, since directors have complete power and management responsibility over the company and the company's assets, they should indisputably be fiduciaries.[139] Fiduciary duties to which directors are subject include: the

134. *See, e.g.*, Bernard S. Black & Woochan Kim, *The Effect of Board Structure on Firm Value: a Multiple Identification Strategy Approach Using Korean Data*, 104 J. FIN. ECON. 203, 203 (2012); Gongmeng Chen et al., *Ownership Structure, Corporate Governance, and Fraud: Evidence from China*, 12 J. CORP. FIN. 424, 426 (2006); Agnes W.Y. Lo et al., *Can Corporate Governance Deter Management from Manipulation Earning? Evidence from Related-party Sales Transactions in China*, 16 J. CORP. FIN. 225, 226 (2010); Beverley Jackling & Shireenjit Johl, *Board Structure and Firm Performance: Evidence from India's Top Companies*, 17 CORP. GOVERNANCE: AN INT'L REV. 492, 495 (2009).

135. Kenneth Scott, *The Role of Corporate Governance in South Korea Economic Reform*, 4 J. APPLIED CORP. FIN. 8 (1998); Jill Solomon, Aris Solomon & Chang–Young Park, *A Conceptual Framework for Corporate Governance Reform in South Korea*, 10 CORP. GOV.: INT'L REV. 29 (2002); Craig Ehrlich & Dae-Seob Kang, *U.S. Style Corporate Governance in Korea's Largest Companies*, 18 UCLA PAC. BASIN L.J. 1 (2000); Bernard Black, Barry Metzger, Timothy J. O'Brien & Shin, Moo Young, *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness—Final Report and Legal Reform Recommendations to the Ministry of Justice of the Republic of Korea*, 26 J. CORP. L. 537 (2000–2001).

136. *See* ANDREW KEAY, DIRECTORS' DUTIES, CH. 4 (2d ed. 2014); Lionel Smith, *Fiduciary Relationship: Ensuring the Loyal Exercise of Judgment on Behalf of Another*, 130 L. Q. R. 608 (2014); Ernest Lim, *Directors' Fiduciary Duties: A New Analytical Framework*, 129 L.Q. R. 242 (2013).

137. Companies Act, 2006, c. 46, § 174(1) (Eng.).

138. Bristol & W. Bldg. Soc'y v. Mothew [1997] 2 W.L.R. 436 (C.A. 1996).

139. Paul D. Finn, *The Fiduciary Principle*, *in* EQUITY, FIDUCIARIES, AND TRUSTS 1, 33 (T.G. Youdan ed., 1989); Regal (Hastings) Ltd. v. Gulliver, [1967] 2 A.C. 134 (H.L. 1942) (appeal taken from Eng.).

duty to act *bona fide* (in good faith)[140] for the interest of the company and not for other collateral purposes,[141] the duty that a director must not put himself in a position where there is an actual or potential conflict between his personal interests and his duty to the company,[142] and the duty not to make secret personal profit from any opportunity resulting from their positions, even if they are acting honestly and for the good of the company.[143]

Logically, another question that arises in terms of reform suggestions for directors' duties is to whom these duties are owed. Again, taking English Law as a positive example for reference, in general, directors' duties are owed to the company as a whole and not to individual members.[144] However, directors' duties may be enlarged and extended beyond general principles in certain circumstances when considering the interests of wider audiences such as employees,[145] creditors,[146] individual shareholders[147] and so forth. Corporate responsibilities including ethical, social, workforce, environmental and even philanthropic concerns have to be included in the corporate management agenda as the result of the enforcement of Section 172 of the Companies Act 2006, in which the enlightened shareholder value principle was enshrined, along with increasing pressure to take account of companies' social responsibilities. Due to the fact that the principle itself is still a subject of controversy in the UK, it might not be logical or reasonable to give a definite answer about the validity and effectiveness of the adoption of such an approach in company law for directors' duties in emerging markets. However, it is important to integrate this legislative attitude into the provisions regarding directors' duties in order to enforce CSR more efficiently, and it will be a positive legislative step for governments in emerging markets to include

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140. *In re* Smith & Fawcett Ltd. [1942] Ch. 304 (C.A. 1942); *In re* W & M Roith Ltd. [1967] 1 W.L.R. 432 (Ch. 1966); J.J. Harrison (Props.) Ltd. v. Harrison, 2001 WL 1135159 (C.A. 2001).

141. For directors using their power to raising capital for other purposes, *see* Punt v. Symons & Co. Ltd. [1903] 2 Ch. 506 (Ch. 1903) and Hogg v. Cramphorn Ltd. [1967] Ch. 254 (Ch. 1963) for directors using their power to raising capital for other purposes.

142. *See* Companies Act, 2006, c. 46, § 175 (Eng.) for description on avoiding conflict of interests; *see also* Aberdeen Ry. Co. v. Blaikie Bros. [1854] 17 D. (H.L.) 20; Knight v. Frost & Ors [1999] B.C.C. 819 (Ch. 1998); Ball v. Eden Project Ltd., 2001 WL 273005 (EWHC 2011); Bhullar v. Bhullar, 2003 WL 1202661 (C.A. 2003).

143. *See* Regal (Hastings) Ltd. v. Gulliver [1967] 2 A.C. 134 (H.L. 1942) (appeal taken from Eng.); Gencor ACP Ltd. v. Dalby, 2000 WL 1881279 (EWHC 2000).

144. *See* Percival v. Wright [1902] 2 Ch. 421 (Ch. 1902); Peskin v. Anderson [2000] BCC 1110 (Ch. 1999).

145. *See* Hutton v. W. Cork Rwy. Co. [1883] 23 Ch. D. 654 (C.A.).

146. *See* Lonrho Ltd v. Shell Petroleum Co Ltd [1981] 2 All E.R. 456, [1980] 1 W.L.R. 627.

147. *See* Allen v Hyatt [1914] 30 T.L.R. 444.

various stakeholders' interests in the directors' fiduciary duties. It would be sensible to remind directors that as well as the interests of shareholders, they also have to consider the interests of other constituencies who are part of the company and have certain claims, either fixed or residual, on the corporations' profits.

Third, mandatory information disclosure on both financial aspects and non-financial issues such as environmental matters, company employees and social and community issues will also greatly enhance the efficiency of corporate governance in emerging markets. Information disclosure at a mandatory level is one part of a combination that makes corporate responsibilities towards various constituencies possible and enforceable. Beattie and McInnes argue that mandatory rules will help to produce narrative disclosures of a higher quality, which will lead to an increase in the amount of disclosure and reduce variability by an absolute amount attributable to the size of the company.[148] While the reporting system is still underdeveloped, it is necessary to further enhance sustainability reporting and CSR reports in a more enforceable manner, adopting a more systematic and standardized format in comparison with traditional economic reporting.[149] Europe is a good example, where CSR-related information disclosure requirements under the existing framework are applicable to both listed and other types of companies. The Transparency Directive regulates the ongoing periodic disclosure of listed companies, making it mandatory for companies to draw up their annual reports (or management reports for listed companies) in accordance with the provisions of the accounting company law directives concerning annual reports.[150] The Modernization Directive modifies the company law directive on annual accounts, making the disclosure of certain non-financial key performance indicators mandatory under EU law, including an annual report on environmental and employee issues.[151] Looking at a

148. VIVIEN BEATTIE & BILL MCINNES, NARRATIVE REPORTING IN THE UK AND THE US—WHICH SYSTEM WORKS BEST? 15 (2006).

149. Ataur Rahman Belal & Vasily Lubinin, *Corporate Social Disclosure (CSD) in Russia*, *in* GLOBAL PRACTICE OF CORPORATE SOCIAL RESPONSIBILITY 165, 165 (Samuel O. Idowu & Walter Leal Filho eds., 2008).

150. Directive 2004/109/EC, of the European Parliament and of the Council of 15 December 2004 on the Harmonization of Transparency Requirements in Relation to Information About Issuers Whose Securities Are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC, art. 4, 2004 O.J. (L390) 38, 45.

151. *See* Directive 2003/51/EC, of the European Parliament and of the Council of 18 June 2003 Amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the Annual and Consolidated Accounts of Certain Types of Companies, Banks and Other Financial Institutions and Insurance Undertakings, 2003 O.J. (L178) 16, 20.

regulatory perspective, it is crucial that while the EU initially shied away from mandatory regulation in relation to CSR, it embraced indirect encouragement in the form of a non-financial reporting requirement applicable to large scale undertakings in 2014. Predicated as a regulatory driver for transparent corporate engagement with sustainability within the EU, mandatory narrative reporting will be introduced as a means to implement the Directive on Non-Financial Information and Diversity Information ("the Non-Financial Reporting Directive").[152] The introduction of mandatory sustainability reporting and the enforcement and practice of this information disclosure requirement can be contextualised with a broader EU regulatory focus concerning corporate governance matters. The adoption of similar mandatory requirements will promote the transparency and accountability of corporate governance in emerging markets. Positively, corporate law related reform in China has set a progressive example. The current business inspection system was changed in February 2014. Instead, an annual reporting system will be introduced in China with annual reports open to public inspection.[153]

Fourth, the legitimacy of cross-listing by having access to foreign capital markets has been widely recognized as an incentive to improve corporate governance.[154] Cross-listing securities is an efficient way to access international financial markets and is always related to improved corporate governance practices in a stronger investment environment with higher requirements for information disclosure and corporate governance rules.[155] Voluntarily embracing the stronger regulatory regimes may also help companies to improve their corporate governance. Soft laws, including regulations for stock exchanges and corporate governance codes required by the host exchange, may also help.[156] As far as companies in emerging markets are concerned, the cross-listing through American Depositary Receipts programs is associated with more cross-border flows

152. Directive 2014/95/EU of the European Parliament and of the Council of October 22, 2014, amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups OJ L 330/1. Member States must introduce the non-financial reporting regime by December 6, 2016.

153. Notice of the State Administration for Industry and Commerce on Ceasing the Annual Enterprise Inspection (State Administration for Industry and Commerce, 2014) (Lawinfochina) (China).

154. Rene M. Stulz, *Globalization, Corporate Finance, and the Cost of Capital*, 12 J. APPLIED CORP. FIN. 8 (1999).

155. John C. Coffee, *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151 (2001).

156. Amir N. Licht, *Legal Plug-Ins: Culture Distance, Cross-Listing, and Corporate Governance Reform*, 22 BERKELEY J. INT'L L. 195, 197, 201–02 (2004).

and greater integration in globalized capital markets.[157] South Korea is a good example of enhanced cross-listing, where listed companies are given the option to cross-list in nine foreign stock markets, including NESE, NASDAQ, AMEX, and stock markets in London, Frankfurt, Paris, Tokyo, Hong Kong and Singapore, as part of the country's modernization, globalization and convergent corporate governance practice. It is argued that cross-listing, as a form of regional market integration scheme, will facilitate and enhance competition among stock exchanges, including competition for more sound regulatory framework between the home market and the host market, and/or harmonization and convergence as a result.[158] This is particularly important for internationalization of corporate governance scheme in emerging market for the reason that the stock markets in emerging market have remained effectively isolated despite the rapid integration of economy into the world system in the areas such as international trade, globalization of capital markets, corporate governance convergence.[159]

Fifth, effective auditing and an independent external auditor will help safeguard to protect accounting information and ensure fairer and more efficient corporate governance. Independent auditors are expected to be neutral and free from all influence, either directly or indirectly, from those affected by their work. An auditor required "to be free from situations and relationships which would make it probable that a reasonable and informed third party would conclude that the auditor's objectivity is either impaired or could be impaired."[160] The relationship between boards of directors and shareholders gives rise to an agency problem, and financial statements verified by independent auditors are prepared to ensure corporate governance accountability and to promote efficiency in corporate governance. For example, it is argued that problems arising from concentrated ownership can be mitigated by effective auditing.[161] This is

157. G. Andrew Karolyi, *The Role of American Depositary Receipts in the Development of Emerging Equity Markets*, 86 REV. ECON. & STAT. 670 (2004).

158. Hwa-Jin Kim, *Cross-Listing of Korean Companies on Foreign Exchange: Law and Policy*, 3 J. KOREAN L. 1, 13 (2003).

159. Wei Huang & Tao Zhu, *Foreign Institutional Investors and Corporate Governance in Emerging Markets: Evidence of a Split-share Structure Reform in China*, 32 J. CORP. FIN. 312, 313 (2015).

160. IAIN GRAY & STUART MANSON, THE AUDIT PROCESS: PRINCIPLES, PRACTICE AND CASES 98–99 (2008).

161. Joseph P. H. Fan & T.J. Wong, *Do External Auditors Perform a Corporate Governance Role in Emerging Markets? Evidence from East Asia*, 43 J. ACCT. RES. 35 (2005); Ferdinand A Gul, Jeong-Bon Kim & Annie A. Qiu, *Ownership Concentration, Foreign Shareholding, Audit Quality, and Stock Price Synchronicity: Evidence from China*, 95 J. FIN. ECON. 425 (2010).

regarded one of the most important issues, especially after the collapse of the Enron Company and others in the United State during the early years of this century, and legislations or proposals for legislation have been introduced or suggested for regulatory purposes.[162] As the result of these scandals, the Sarbanes-Oxley Act was introduced in the US to ensure successful auditing and management. "Proposal for a Regulation of the European Parliament and of the Council on Specific Requirements Regarding Statutory Audit of Public Interests Entity 2011," is another good example of legal responses to corporate scandals or financial crisis, this case based on the experience of the financial crisis which began in 2008.[163] Related legislative experience in emerging markets is far from competent, while issues of independence have always been ignored.

Lastly, a more efficient derivative claim action should be embedded in corporate law to protect the interests of minority shareholders in order to achieve fairer corporate governance mechanisms in emerging markets. Derivative action is an exception to the rule in proper plaintiff rule and majority rule in company law.[164] If a shareholder can establish that the action harming the company constitutes a fraud on the minority and that the wrongdoers control the company, he or she will be permitted to take derivative proceedings which are derived from the company.[165] The

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162. *See* JOHN C. COFFEE, GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 32–36, 225–56 (2006). *See also* Joseph E. Murphy, *Can the Scandals Teach Us Anything? Enron, Ethics and Lessons for Lawyers*, 12 BUS. L. TODAY 11 (2003); Joel Seligman, *No One Can Serve Two Masters: Corporate Law and Security Law After Enron*, 80 WASH. U. L.Q. 449, 467 (2002); William S. Lerach, *Plundering America: How American Investors Got Taken for Trillions by Corporate Insiders—The Rise of the New Corporate Kleptocracy*, 8 STAN. J.L. BUS. & FIN. 86, 122 (2002); Simon Deakin, *The Coming Transformation of Shareholder Value*, 13 CORP. GOVERNANCE 11 (2005); AFTER ENRON, IMPROVING CORPORATE LAW AND MODERNIZING SECURITIES REGULATION IN EUROPE AND THE US 11 (J. Armour & J.A. McCahery eds., 2006); John R. Kroger, *Enron, Fraud, and Securities Reform: An Enron Prosecutor's Perspective*, 76 U. COLO. L. REV. 57 (2005); Geoffrey P. Miller, *Catastrophic Financial Failures: Enron and More*, 89 CORNELL L. REV. 423 (Jan. 2004); Karolina Eriksson, *Corporate Governance in the European Union Post-Enron*, 15 BOND L. REV. (2003).

163. European Parliament, Proposal for a Regulation of the European Parliament and of the Council on Specific Requirements Regarding Statutory Audit of Public-interest Entities (Nov. 30, 2011), http://ec.europa.eu/internal_market/auditing/docs/reform/COM_2011_779_en.pdf.

164. *See* Foss v. Harbottle [1843] 2 Hare 461; Kenneth W. Wedderburn, *Shareholders' Rights and the Rule in Foss v. Harbottle*, 16 CAMBRIDGE L.J. 194 (1957); A.J. BOYLE, MINORITY SHAREHOLDERS' REMEDIES (2009); Jingchen Zhao, *A More Efficient Derivative Action System in China: Challenges and Opportunities Through Corporate Governance Theory*, 64 N. IR. LEGAL Q. 233 (2013); Andrew Keay, *Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006*, 16 J. CORP. L. STUD. 39 (2016); Andrew Keay, Joan Loughrey, *Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action under the Companies Act 2006*, 124 L.Q. REV. 469 (2008).

165. Andrew Keay & Joan Loughrey, *Derivative Proceedings in a Brave New World for Company Management and Shareholders*, 3 J. BUS. L. 151, 151–52. (2010)

system is designed to overcome certain inadequacies of common law in the area of shareholder remedies, including the prohibitive cost of litigation, the restrictive standing requirement, and the uncertainties of the rule and exceptions.[166] Statutory derivative action is designed to make the rule more practical and feasible,[167] and it has been adopted in jurisdictions such as the UK,[168] Australia,[169] Canada[170] and New Zealand.[171] It is widely accepted that the derivative action rule has a number of functions which can facilitate the development of a more sound corporate governance system, in particular by deterring directors from misusing their power by holding them accountable for their misconduct.[172] The system is related to the control of the corporate form in which plaintiff shareholders theoretically act in the collective interests of all shareholders, employing a legal mechanism to address the agency problem between the directors and the shareholders. In emerging markets where the agent-principal problem and principal-principal conflict are equally important, private enforcement of shareholder action will provide an alternative to regulating and controlling corporate conduct.[173] The derivative claim system, together with the statutory derivative claim rule, plays a fundamental part in aligning the interests of directors and shareholders which makes the system work coherently with the other five legal reform proposals suggested here to promote corporate governance efficiency and competitiveness in emerging markets.

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166. Ian M. Ramsay & Benjamin B. Saunders, *Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action*, 10–14 (2006) (unpublished Melbourne Law School Legal Studies Research Paper No. 250).

167. *See* CORPORATE LAW ECONOMIC REFORM PROGRAM, DIRECTORS' DUTIES AND CORPORATE GOVERNANCE: FACILITATING INNOVATION AND PROTECTING INVESTORS (1997), http://archive.treasury.gov.au/documents/283/PDF/full.pdf.

168. *See* Companies Act, 2006, 7, 236 (Eng.). *See also* Keay & Loughrey, *supra* note 165; Mahmoud Almadani, *Derivative Actions: Does the Companies Act 2006 Offer a Way Forward*?, 30 COMPANY LAW. 131 (2009).

169. *Corporations Act 2001* (Cth) § 231 (Austl.).

170. *See* Canada Business Corporations Act, R.S.C. 1985, c C-44 (Can.).

171. *See* Companies Act 1993 §§ 165–66 (N.Z.). *See also* Peter Prince, *Australia's Derivative Action: Using the New Zealand Experience*, 18 CO. SECURITIES L.J. 493 (2000), Susan Watson & Owen Morgan, *A Matter of Balance: The Statutory Derivative Action in New Zealand*, 19 COMPANY LAW. 236 (1998).

172. *See, e.g.*, ARAB REISBERG, DERIVATIVE ACTIONS AND CORPORATE GOVERNANCE: THEORY AND OPERATION, CH. 2, 4, 5 (2007); Zhong Zhang, *Shareholder Derivative Action and Good Corporate Governance in China: Why the Excitement is Actually for Nothing*, 28 UCLA PAC. BASIN L.J. 174 (2010-2011); DAN W. PUCHNIAK, HARALD BAUM & MICHAEL EWING-CHOW, THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH (2012).

173. William Kaplan & Bruce Elwood, *The Derivative Action: A Shareholder's 'Bleak House?',* 36 UNIV. BRITISH COLUMBIA L. REV. 443, 443 (2003).

V. PATH DEPENDENCE THEORY AND THE UNIQUENESS OF ENFORCING LEGAL RESPONSES IN INDIVIDUAL COUNTRIES WITH EMERGING MARKETS

As Coffee states, "corporate governance is more than simply a technology";[174] it is "infused with politics and shaped by history; it is not a variable that a firm can simply elect or contract around."[175] Path dependence, a comparatively new theory originating in the 1980s, suggests "that an outcome or decision is shaped in specific and systematic ways by the historical path leading to it," as well as by other factors within the socio-economic context.[176] The theory of path dependence attributes national differences in corporate law and corporate governance models to the divergent historical and social underpinnings of different jurisdictions. The insight of path dependence is captured by Moore and Lewis, who state that "the lesson of history . . . is that while markets have always been there, they have always operated in the context of geography, religion, language, folk ways, families, armies, and government, never in a vacuum."[177] While convergence theorists predict that countries, especially countries with weak legal systems, will adopt certain legal rules that have been demonstrably efficient in other jurisdictions, theorists who adhere to path dependence normally argue that divergence will still exist because legal rules are shaped by pre-existing political and social forces.[178] In many ways, "the law is in thrall to history and not merely as a matter of judicial psychology."[179]

Path dependence theory can be regarded as a theoretical base for the adoption of a series of reform suggestions proposed in this article, with unique national characteristics shaping a particular country's corporate governance model, corporate law background, enforcement process, shareholder structure, civil procedure law, and stage of economic development. Since a variety of economic, social and political factors help to explain why corporate governance in emerging markets has become an

174. John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 646 (1999).

175. *Id.*

176. Oona A. Hathaway, *The Course and Pattern of Legal Change in a Common Law System*, 88 IOWA L. REV. 101, 103–04 (2001).

177. KAL MOORE & DAVID LEWIS, FOUNDATIONS OF THE CORPORATE EMPIRE: IS HISTORY REPEATING ITSELF 219 (2000).

178. Katharina Pistor, *Patterns of Legal Changes: Shareholder and Creditor Rights in Transition Economies*, 1 EUR. BUS. ORG. L. REV. 59, 4 (2004).

179. Richard A. Posner, *Past-Dependency, Pragmatism, and Critique of History in Adjudication and Legal Scholarship*, U. CHI. L. REV. 573, 583 (2000); *see also* RICHARD A. POSNER, FRONTIERS OF LEGAL THEORY 153–60 (New York: Harvard University Press 2004).

increasingly prominent theme in business, academic and policy circles, path dependence related factors have a big impact on shaping corporate governance in countries with emerging markets, and sometimes even make corporate governance models unique. It has been argued by Bebchuk and Roe that the initial ownership structure in a country will directly influence the subsequent development of ownership structure and laws.[180] They developed path dependence theory to suggest that the interested parties possessing the power to influence ownership structure and corporate law will have both the incentive and the power to impede changes that might improve efficiency, but which are contrary to their private control interests.[181]

Path dependence theorists argue in favor of this disparity using legal, political and cultural variables. There are hundreds of legal systems around the world, and researchers always group them by legal families based on criteria such as the geography, language, official ideology and religion. The two main legal families are the common law world and civil law system.[182] Within emerging markets, for example, Bangladesh, Pakistan and India belong to the common law family, while Brazil, China, the Czech Republic, Russia and Turkey are civil law countries. The legal origin of laws is regarded as the primary factor that affects almost all other variables that have an impact on corporate governance.[183] Apart from the legal origins, corporate governance systems in each emerging market jurisdictions also vary in the context of the widespread diffusion of regulatory agencies. These agencies always have the triple roles of regulator, promoter and supervisor. Their roles are always unique in each jurisdiction, depending on the shareholding structure and the degree of government interference in listed companies. Roe argued that political factors are key for differing ownership structure and corporate governance models.[184] Peter Gourevitch also suggests a link between political

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180. Lucian Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127, 139 (2000).

181. *Id*. at 132.

182. Hamadi Matoussi & Maha Khemakhem Jardak, *International Corporate Governance and Finance: Legal, Culture and Political Explanations*, 47 INT'L J. ACCT. 1, 5 (2012)

183. *See* Rafael LaPorta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership around the World*, 54 J. FINANCE 471(1999); Rafael LaPorta, Florencio Lopez-de-Silanes, Andrei Shleifer, & Robert Vishny, *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 J. ECON. LIT. 285 (2008).

184. MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT (2003); MARK J. ROE, CORPORATE GOVERNANCE: POLITICAL AND LEGAL PERSPECTIVES (2005); Mark J. Roe & Jordan I. Siegel, *Political Instability: Its Effects on*

mechanisms, corporate governance and share ownership, interest group preference and cross-class coalitions between shareholders, directors and employees on the one hand, and political institutions including electoral law, legislative-executive relations and the number of political parties on the other.[185] Obviously, these political elements differ dramatically between countries with emerging markets. However, the central element in the political impact of the regulation of corporate governance lies in the differing extent to which the political climate of a jurisdiction is conducive to the pursuit of shareholder wealth and market-oriented policies.[186] This also has an impact on different legislative philosophies of corporate law in terms of directors' duties and mandatory information disclosure for stakeholder protection.

Amir Licht is in the top tier in terms of developing the cross-cultural theory of the role of culture in the development of corporate governance and financial regulation.[187] Cultural elements including ethnicity, customs, beliefs, shared values, and religion are regarded as primary factors that affect effective systems of corporate governance.[188] For example, the impact of g*uanxi* and r*enqing* in China will make the related corporate governance reform different from that in other emerging markets.[189] The Confucian philosophy has a wide impact in defining the corporate governance agenda in China, South Korea and Japan.[190] The strongly authorized cultural embeddedness and hierarchy in Eastern European

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Financial Development, Its Roots in the Severity of Economic Inequality, 39 J. COMP. ECON. 279 (2011).

185. Peter A Gourevitch, *The Politics of Corporate Governance Regulation*, 112 YALE L.J. 1829, 1853 (2003).

186. ROE, *supra* note 184, at 21–22.

187. Amir N. Licht, *The Mother of All Path Dependencies: Towards a Cross-cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147 (2001); *see also* Amir N. Licht, Chanan Goldschmidt & Shalom H. Schwartz, *Culture, Law and Corporate Governance*, 25 INT'L REV. L. & ECON. 229 (2005); Amir N. Licht, *Culture and Law in Corporate Governance*, ECGI Working Paper Series in Law, Law Working Paper No. 247/2014 Mar. 2014, *available at* http://ssrn.com/abstract=2405538.

188. Matoussi, *supra* note 182, at 7.

189. *See* Jingchen Zhao & Shuangge Wen, *Gift Giving, Guanxi and Confucianism in a Harmonious Society: What Chinese Law could Learn from English Law on Aspects of Directors' Duties*, 34 COMPANY LAW. 381 (2013); Raymond S. Chan, Daniel Ho, Alex K.L. Lau & Angus Young, *Chinese Traditional Values Matter in Regulating China's Company Directors: Findings from an Empirical Research*, 34 COMPANY LAW. 146 (2013).

190. Lilian Miles, *The Application of Anglo American Corporate Practices in Societies Influenced by Confucian Values*, 111 BUS. & SOC'Y REV. 305 (2006); Lilian Miles and Say Hak Goo, *Corporate Governance in Asian Countries: Has Confucianism Anything to Offer?*, 118 BUS. & SOC'Y REV. 23 (2013); Patrick Kim Cheng Low & Sik Liong Ang, *Confucian Ethics, Governance and Corporate Social Responsibility*, 8 INT'L J. BUS. & MGMT. 30 (2013).

countries that endured Communist rule are also rooted in those jurisdictions. Another example from a cultural perspective is a growing concern regarding the Islamic principles of corporate governance in proving justice, honest and fairness to ensure all parties, shareholders and other stakeholders in corporations receive their rights and dues.[191] As emerging markets becoming more important as dominating economies for inward investors from developed economies, these non-business elements may also influence the behavior of foreign MNCs in emerging markets.

National corporate governance systems exhibit significant variation in terms of the appointment of national regulatory agencies and civil servants, legal impediments for removing regulatory officials, the finance and staffing of regulatory agencies, and the execution of power authorized by law to overturn decisions made by regulators.[192] This variation is particularly distinct in emerging markets with SOEs and regulatory agencies at different levels. Civil servants act as directors, and regulations and guidelines are produced by agencies with unclear authorities. As part of the domestic legal and financial framework, a corporate law system has significant sources of path dependence, which include historical accidents as well as economic and political particulars of the domestic system.[193] The persistence of these sources significantly contributes to the stability of the domestic corporate governance system in any local socio-economic environment. Path dependence is an important phenomenon in law, and evidence of this is that the convergence of legal systems is much slower than the convergence of technology and economic institutions.[194] Therefore, in terms of legal responses to corporate governance problems in emerging markets, the strategy of legal reform is not to "create an ideal set of rules and then see how they can be enforced, but rather to enact the

191. Abdussalam Mahmoud Abu-Tapanjeh, *Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles*, 20 CRITICAL PERSPECTIVES ON ACCOUNTING 556 (2009); *see also* Mervyn K. Lewis, *Islamic Corporate Governance*, 9 REV. ISLAMIC ECON. 5 (2005).

192. Ruth V. Aguilera, Michael Goyer & Luiz Richardo Kabbach-Castro, *Regulation and Comparative Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE GOVERNANCE 23–27 (2013)

193. Bebchuk et al., *supra* note 180, at 127.

194. Stan J. Liebowitz & Stephen E. Margolis, *The Fable of the Keys*, 33 J.L. & ECON. 1 (1990); Stan J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In and History*, 11 J.L. ECON. & ORG. 207 (1995); John Bell, *Path Dependence and Legal Development*, 87 TUL. L. REV. 787 (2013); Reinhard H. Schmidt & Gerald Spindler, *Path Dependence, Corporate Governance and Complementarity*, 5 INT'L FIN. 311 (2002); Thomas Clarke, *The Continuing Diversity of Corporate Governance: Theories of Convergence and Variety*, 16 EPHEMERA: THEORY & POL. ORG. 19 (Feb. 2016).

rules that can be enforced with the existing enforcement structure."[195] It has been argued that principles of good and effective corporate governance are converging while variations in national company law and practice remain in accordance with the path dependence theory.[196] For applicable and sound corporate governance principles for emerging markets, this should be also be the case, if not even more so. Therefore, in spite of the common problems of corporate governance and reform suggestions for emerging markets, the ways of accommodating these reform suggestions in legislation will always depend on the history, culture, tradition and legal enforcement of a country. Even the legal reform suggestions that have been given largely depend on experiences from best practice in convergent sound corporate governance models, but the enforcement will be a unique process in every jurisdiction. Jacques tried to change some common prejudices from the Western world about China, for example by noting: "even if China moves in the direction of a more representative government and a more independent judiciary, as it probably will in the long term, it will surely do so in very much its own way, based on its own history and traditions, which will owe little or nothing to any Western inheritance."[197]

VI. CONCLUSION

At the level of the corporation, the importance of corporate governance for access to financing, valuation, the cost of capital and performance has been documented in various disciplines, using a variety of methodologies for countries with emerging markets, especially BRICs. It is not arguable that more sound corporate governance will lead to higher returns on equity and greater efficiency. The reform proposals described above were driven by forces including more sound corporate governance standards, more proficient investor protection, developed corporate law and securities

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195. LaPorta, *supra* note 183, at 22.

196. Stephanie Maier, *How Global is Good Corporate Governance*?, RESEARCH BRIEFING OF ETHICAL INVESTMENT RESEARCH SERVICES (2005), http://www.eiris.org/files/research%20 publications/howglobalisgoodcorpgov05.pdf. According to Hathaway, path dependence means, in broad terms, that an outcome or decision is shaped in specific and systematic ways by the historical path leading to it; *see* Hathaway, *supra* note 176, at 103–04; Sewell puts it simply when he states that "path dependent," that is, that what has happened at an earlier point in time will affect the possible outcomes of a sequence of events occurring at a later point in time"; *see* William H. Sewell Jr., *Three Temporalities: Toward an Eventful Sociology*, *in* THE HISTORIC TURN IN HUMAN SCIENCE 245, 262–63 (Terrence J. McDonald ed., 1996); path dependence plays a role in creating and maintaining differences in corporate structures in corporate governance, and minor divergences of corporate governance result from differences in history, culture, politics and traditions.

197. MARTIN JACQUES, WHEN CHINA RULES THE WORLD: THE END OF THE WESTERN WORLD AND THE BIRTH OF A NEW GLOBAL ORDER 122 (2d ed. 2012) Chapter 12.

regulation, and economically, socially and politically sustainable development. This article approached the issue of corporate governance in emerging markets from the viewpoint that the deficiencies of corporate governance in those jurisdictions can be promoted and enhanced in common legal reform proposals. However, this stance is prompted by the argument put forward by path dependence theorists that corporate governance regimes and the corporate law development of each jurisdiction with an emerging market is a product of its own heritage and value system, which is entrenched in a unique way of thinking and interwoven into its cultural identity. It is a mistake to measure efficiencies of corporate governance in emerging market in terms of a developed Western yardstick because the heritage and value systems of those jurisdictions are deeply entrenched in a unique way of thinking and individual cultural entities. The recent experience of the global financial crisis in 2008 and the Euro-zone crisis have exposed shortcomings and problems in the Western model and in rule-oriented rather than relationship-oriented corporate governance.[198] However, these failures that shook the economies of developing countries have also drawn attention to the weak corporate governance in emerging markets, especially in terms of raising capital and attracting foreign investors.

The relationship between corporate governance, legal enforcement, economic growth and the efficiency of investment allocation has been discussed in relation to emerging markets. According to the World Investment Report 2005, of the top six most attractive global business locations, five are emerging economies, including China, India, Russia, Brazil, and Mexico.[199] It is noted in the article that emerging markets tend to have weaker corporate governance systems. From this discussion, the author agrees that emerging markets are characterized by "an absence of norms, values of business standards caused by turbulent socio-economic and political conditions and with a weak legal system."[200] Companies in emerging markets are challenged by the markets' poor reputations and

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198. Kun Luen Alex Lau & Angus Young, *Why China Shall Not Completely Transit from a Relation Based Governance Regime: A Chinese Perspective*, 21 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 577, 583 (2013); for arguments in favor of rule-based corporate governance systems in emerging markets, see Charles Oman, Steven Fries and Willem Buiter, *Corporate Governance in Developing, Transition and Emerging-Market Economies*, OECD 8–10 (2003), http://willembuiter.com/oecd.pdf.

199. UNCTAD, *World Investment Report 2005* (2005), http://unctad.org/en/Docs/wir2005_en.pdf.

200. Sanjay Peters, Mariah Miller & Sophia Kusyk, *How Relevant is Corporate Governance Corporate Social Responsibility in Emerging Markets, in* CORPORATE GOVERNANCE INTERNATIONAL JOURNAL OF BUSINESS IN SOCIETY 429, 233 (2011).

their lack of accountability and transparency in terms of corporate governance. This article opens a new avenue for future development in emerging markets, especially from legal aspects. Focusing on corporate governance problems arising from state ownership, state control, board independence, and poor stakeholder and minority shareholder protection, several proposals were made at different levels. From a more generalized point of view, hybrid regulatory sources from government legislations and soft laws, including guidelines and regulations from government departments and agencies, were suggested as appropriate for emerging markets. Logically, these hybrid regulatory sources lead to a discussion of the positive impact of government intervention in the regulation of listed companies in emerging markets. At a more specific level in the corporate law domain, a series of elements were suggested, although they may already have been enforced individually in certain jurisdictions, including independent directors, employee representatives, more clearly-defined directors' duties (especially their duties toward stakeholders), mandatory information disclosure on CSR issues, legitimacy of cross-listing, effective auditing, and the appointment of independent external auditors, in order to promote corporate governance in emerging markets and facilitate responses to inefficiencies in emerging markets. These necessary measures should be taken to improve the enforcement and application of reform principles and rules in order to accomplish a full and successful reform. The author also recognizes that a one-size-fits-all approach to corporate governance will not work for countries with emerging markets. It is discussed that these legal reform proposals and standards will achieve most of the goals for the improvement of domestic corporate governance if they are adopted and enforced with a consideration for the market, laws, culture, history and governmental institutions that exist in the specific economy. There is an urgent need for countries with emerging markets to promote effective corporate governance rules and regulations, as well as to ensure the effective enforcement of these rules if they are to be competitive globally, using successful experiences and information to make their systems stronger and more efficient.

The BRICs have become an eminent economic force, and generally speaking, emerging economies have taken a large share of world trade in the last two decades. It is predicted that BRICs, particularly China and India but together with other countries with emerging markets, will continue their rise, while global economic patterns will continue to change geo-politically.[201] With promising economic growth but a lack of strong, long-established financial institutions, infrastructure and securities markets, corporate governance with more efficient enforcement of corporate law and securities regulations is key for these countries. Emerging markets, compared with mature markets, face additional hurdles due to their lack of institutional memory and experience from boards of directors in these countries.[202]

In the 1980s and 1990s, as the result of the "Washington Consensus,"[203] countries with emerging markets undertook legal and orthodox macro-economic policy reforms to mitigate the impacts of state intervention in the economy and subject most firms to greater competition.[204] The privatization process was one of the most informative policy reforms of the business organizational environment in emerging markets at the time.[205] The advent and spread of this significant economic transformations, namely the privatization carried out through the creation of new regulatory institutions.[206] Many legal proposals in corporate law and employment law have been enforced to secure the smooth running of this policy change. After a few decades, corporate governance changes continue to be a key driver for a more competitive economy and sustainable development. This article highlights the importance of good corporate governance and its impact on share price and the liquidity of capital markets. Legal responses to corporate governance problems were discussed and categorized. Transparency, board independence, and a separate audit committee are emphasized in the article to promote respectful corporate governance principles.

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201. UWE BECKER, *Prospects and Politics*, *in* THE BRICS AND EMERGING ECONOMIES IN COMPARATIVE PERSPECTIVE 183, 183 (Uwe Becker ed., Routledge 2014).

202. Robert W. McGee, *Corporate Governance in Developing Economies Economies*, *in* CORPORATE GOVERNANCE IN DEVELOPING ECONOMIES 3, 4 (Robert W. McGee ed., Springer Science+Business Media 2009).

203. John Williamson, *What Should the Bank Think about the Washington Consensus*, *in* LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED? (John Williamson ed., 1990).

204. Ruth V. Aguilera, Luiz Richardo Kabbach de Castro, Jun Ho Lee & Jihae You, *Corporate Governance in Emerging Markets*, *in* CAPITALISMS AND CAPITALISM IN THE TWENTY-FIRST CENTURY 319, 321 (Glenn Morgan & Richard Whitley eds., Oxford University Press 2012).

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