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Corporate governance in emerging economies: Understanding the game

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Abstract Corporations now face the oftentimes daunting task of integrating the interests of multiple stakeholders. The general intent behind this multiple stakeholder focus has been to ensure that corporations operate for the benefit of society as a whole, with corporate governance in the oversight role for all activities. Our research suggests doing business in an emerging economy is confounded by the fact that rules, regulations, and marketplace expectations of the home market do not apply. Due to their evolving nature, the environments in emerging economies are uncertain and complex. Governance is not just an oversight issue related to making the most appropriate decisions. Instead, responsible governance in emerging markets entails governing bodies understanding the characteristics of the unsettled environment in which the company is, or will be, operating. Four major characteristics (demographic trends, technological development, natural resources, and political/legal unease) of emerging economies have led to significant challenges and stormy passage with respect to governance. The continual evolution and understanding of these factors must, of necessity, shape a company's governance process in the developing marketplace.
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. . .how to play the game, when the rules of the game are changing and not completely known. . .(Peng, Wang, & Jiang, 2008)

1. Rules and regulations of the game

According to the Cadbury Committee (1992), *corporate governance* is the system by which companies are directed and controlled. Governing implies rules, processes, and regulations that guide the strategies and operations of an organization. Unfortunately, periodic governance scandals, laden with tales of fraudulent business behaviors, have been the bane of 21st century corporations. These scandals—ranging from Enron to Tyco to MCI-WorldCom to Parmalat (Italy) to Satyam (India) and the underpinnings of a worldwide financial crisis—have prompted considerable government regulation (e.g., Sarbanes-Oxley). Further, the accompanying environment and subsequent public

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disdain and regulatory response have led to a persistent need for enhanced governance, particularly regarding control of managerial actions.

Over the past few years, the focus of corporate governance issues has resided largely in recognition of the need to take into account the interests of a wide range of constituents or stakeholders. Practitioners and scholars have tended to converge on six stakeholders of particular interest to governance issues: customers, employees, suppliers, shareholders, regulators, and local communities within which firms operate (Hult, Mena, Ferrell, & Ferrell, 2011). The intent behind this stakeholder focus has been to ensure that corporations operate for the benefit of society as a whole.

While a focus on stakeholders has augured well for corporations in developed countries, our research suggests environmental turbulence in emerging markets is the critical driver of governance issues faced by corporations attempting to do business in these transitional economies. Thus, as corporations enter the choppy waters where developed and emerging economies struggle to compete, it is imperative that those charged with governance understand the factors that could foster turbulence and, ultimately, impact managerial decisions and shape the stakeholder environment in which the firm operates.

2. The game in a turbulent environment

The boundaryless marketplace, coupled with the rapidity at which change can impact worldwide economies, has necessitated understanding by those in governance roles of the turbulent forces operating in the external environment in which corporate decisions are made. Given the economic uncertainty in many developed nations, corporations are increasingly exploring emerging markets as a means of economic survival. At the same time, emerging economies are taking advantage of this external turbulence to facilitate internal economic change (Crittenden & Crittenden, 2010).

For over a quarter century, practitioners and researchers have endeavored to understand emerging economies and have attempted to identify low-income, rapid-growth countries employing economic liberalization as the primary engine of growth. The first recognized set was the BRIC countries: Brazil, Russia, India, and China. South Africa was added on, to form BRICS. The 'Next Eleven'—including Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, South Korea, Turkey, and Vietnam—joined the BRICS emerging economies soon thereafter (Cherian, Crooker, Knight, McPhaul, & Manion, 2010). With GDP in these nations expected to account for approximately 20% of the world economy and close to 85% of the world population, these emerging economies present both opportunities and significant challenges.

According to the Center for Board Governance at PricewaterhouseCoopers LLP (2012), directors must recognize and discuss the opportunities and threats present in the economic transformation of emerging markets. These two dynamics create the turbulent environment in which decision makers must operate in these very different market economies. Doing business in an emerging economy is confounded by the fact that rules, regulations, and marketplace expectations of the home market do not apply. Due to their evolving nature, the environments are uncertain and complex. Governance is not just an oversight issue related to making the most appropriate decisions. Instead, responsible governance in emerging markets entails governing bodies—from directors to the lower echelons of management—understanding the characteristics of the unsettled environment in which the company is, or will be, operating.

Four major characteristics of emerging economies have led to significant challenges and stormy passage with respect to governance, and the continual evolution of these factors must of necessity shape a company's governance process in the developing marketplace. The four major characteristics are: demographic trends, technological development, natural resources, and political/legal unease. It is important to note that, as depicted in Figure 1, these four characteristics affect governance—not vice versa. Traditionally, governance is discussed as the overarching process that guides decision making. In emerging economies, however, managers must make decisions based on these generally unsettled environmental characteristics. Here, we suggest that turbulence in the environment actually shapes governance processes; that corporations must understand the game itself to be able to have the appropriate rules.

2.1. Demographic trends

A country's demographics directly affect the potential size of its economy and, ultimately, its governance as the country moves toward global economic growth and development. According to researchers at the Center for Strategic and International Studies, the world is on the brink of a demographic transformation that will have a huge impact on the economies of both developed and developing countries (Jackson, Howe, & Nakashima, 2011). This

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