DOMINATION OF FAMILY OWNED CORPORATIONS AND PROBLEMS OF CORPORATE GOVERNANCE IN EMERGING MARKETS

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ABSTRACT

Good corporate governance contributes to sustainable economic development by enhancing the performance of the companies and increasing their access to outside capital. The experiences of the developed countries reveal that good corporate governance can reduce risk, stimulate performance, improve access to capital markets, enhance the marketability of goods and services, improve leadership, increase the value of the corporations, enable the corporations to acquire external finances easily at a lower cost. The dispersed ownership and separation between ownership and control resulted corporate governance problems including agency cost in developed and emerging economies. The good corporate governance practices and concentration of share ownership in the baskets of a group of institutions gave them monitoring responsibility to the corporate issues in the western financial markets. However, the corporate governance problems including managerial opportunism still exist in developing economies, where family owned enterprises control their stock markets. The developing and emerging economies are constantly confronted with issues such as the lack of property rights, the abuse of minority shareholders and contract violations. For a strong impact of corporate governance measures on the economy, a set of democratic norms, market institutions and effective legal system should be set up. Over the past decade reforms in corporate governance driven by events such as the 1997 Asian financial crisis, major corporate scandals (such as Enron and WorldCom) and the globalization of capital markets have become an important global policy agenda. Economic development requires a modern, transparent corporate governance infrastructure based on efficient capital markets. This paper evaluates the possible monitoring role of company's creditors and auditors, arguing that a well-developed corporate governance structure, including accounting infrastructure and creditors vigilance, would promote long-term corporate stability and economic prosperity.

Key words: Corporate governance, family-owned firms, corporate monitoring, creditors, auditors, long-term corporate stability, agency theory.

1. Introduction

The experiences of the developed economies reveals that a good corporate governance can reduce risk, stimulate performance, improve access to capital markets, enhance the marketability of goods and services, improve leadership, increase the value of the corporations, enable the corporation to acquire external finances more easily at a lower cost. However, in case of developing and emerging economies, the need for corporate governance extends beyond resolving problems resulting from the separation of ownership and control. The developing and emerging capital markets are continuously dealing with the issues such as the lack of property rights and agency problems, the abuse of minority shareholders, family dominated ownership and contractual violations. Therefore many developing economies implemented reforms of corporate governance that were driven by international donors, for instance, the corporate governance related development agenda promoted by the World Bank and OECD.[1]

The corporate governance is a framework wherein companies are run or governed. The governance framework is established and set by law, by rules and regulations such as the company's own constitution that is made by those who own and fund the company. The corporate governance mechanism involving both rules and institutions may differ from country to country, because it owes much to history and culture, but its effectiveness depends upon its rationality and reliance of the corporate actors including the management and rest of the corporate constituency. For instance, the main weaknesses of the legal and judicial system weaken property rights and contract enforcement.

However, in family owned corporations, the equity ownership devolves through inheritance wherein the shareholders have complete control of companies as their personal business and they do not care to the corporate issues.[2] They run the companies as their own personal property to gain financial benefits, through oppression with minority and utilize the company loan for their own benefits instead of company long-term corporate stability. Therefore effective corporate governance framework requires their monitoring through creditors who fund the company as well as competent and responsible board of auditors. The responsible monitoring behavior of the corporate auditors depends upon to the realization and an effective enforcement of their professional and fiduciary duties. The governance framework changes shape and develops through time. The corporate governance standards are determined by the measures that companies take for themselves, either voluntarily or otherwise, to improve their governance structure.

[1] Farooq Sobhan and Wendy Werner, *A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh* (Bangladesh Enterprise Institute 2003) 2-4
[2] Sobhan and Werner, 16-22

The health of the corporate sector has much to do with the health and governance practices of financial institutions which rely much more on debt financing rather than equity. Healthy procedures and norms help corporate and financial sector growth. The experience of the Asian crisis in 1997-98 clearly demonstrates what poor governance relations between borrowers and lenders can do for the health of both.[3] The Asian financial crisis involves four basic issues: (1) a shortage of foreign exchange that has caused the value of currencies and equities in Thailand, Indonesia, South Korea and other Asian countries to fall dramatically, (2) inadequately developed financial sectors and mechanisms for allocating capital in the troubled Asian economies, (3) effects of the crisis on both the United States and the world, and (4) the role, operations, and replenishment of funds of the International Monetary Fund.[4] Although the macroeconomic variables such as budget balances, both fiscal and trade, were in good shape and they had vast holdings of foreign currency to use to maintain their exchange rates as pegged to the dollar the microeconomic situation was quite different. Firms in the affected countries had obtained large amounts of loans from Western banks and they were borrowing short term loans to finance long term projects. The firms were committing themselves to foreign currency payments and not hedging the exchange rate risk. This meant that if the value of the domestic currency fell with respect to the foreign currencies the amount of domestic currency required to make payment commitments would increase and could increase to the point of bankrupting the firms.[5] The currency crises have similarity to the Enron and WorldCom in USA and Northern Rock in UK – the crises revealed severe problems in the banking and financial sectors of the troubled Asian economies. However, the International Monetary Fund has arranged support packages for Thailand, Indonesia, and South Korea. The packages include an initial infusion of funds with conditions that must be met for additional loans to be made available.[6]

2. Theoretical Perspective of Agency Issues

The agency is a contractual relationship wherein an agent (manager) acts on behalf of principal (shareholder) and the *agency dilemma* deals with principal and agents' opportunistic behaviors that arise from conflicts of interest, bounded rationality, and asymmetric information. The agents seek to maximize their utility on the cost of the shareholders rather than the utility of their firms. The agency problems such as poor monitoring and conflicts of interests among owners exist in family business because the managers who run the family owned corporations are appointed not for their outstanding competence but mainly because of family ties.[7]

The expenditures associated with monitoring by the principal, bonding by the agent, and residual loss owing to divergent interests and contracting imperfection are called agency costs. Both the agency costs and problems of team production are similar and can exist in any cooperative efforts and at any organizational level even when the distinction between agents and principals is ambiguous.[8] The role of owner and manager in corporate framework is considered as utility maximizes wherein utility is derived from a combination of pecuniary and non-pecuniary benefits. Although major shareholders bear some of the costs but they do not share proportionally in the benefits of an owner-managers' consumption of non-pecuniary benefits or assumption of risks.

The separation between ownership and management control led to the agency problems that exist at every organizational level such as concentrated or dispersed ownership structure. However the share price in concentrated ownership structure would be higher because share value in family owned corporation represents the confluence of pecuniary and non-pecuniary benefits that flow to the owners. Block owners, particularly families, have effective control of the majority of the large corporations in the world far in excess of their cash flow rights.

The family owned corporation may suffer from owner-owner agency problems owing to the likely divergence between the interests of family CEO-owners and other shareholders. The lower level executives are more likely to be held accountable for poor firm performance which leads them to conjecture that executives who are not members of the family may be used as escape goats.[9] The family ownership might serve to mitigate owner-manager agency costs because of effective monitoring through family members who work as executives including CEO. The conflicts of interest between owner-managers and lower level management and family managers that enhance agency costs may exist in family owned corporations. For instance, family owners might possess, and be in a position to pursue, objectives that conflict with shareholder value maximization. The self-interest may motivate the family business groups to engage in political rent seeking at the expense of innovation and economic development.[10]

There was a misconception that agency problems do not arise in family owned-corporations because of owners-managers and alignment of their interests with the firms' long-term perspective. The family owners' managers have long-term attachment to the firm therefore they are more inclined to monitor and discipline the whole company and to avoid misuse of resources. The competitive corporate environment does not allow that the managers should be appointed on the basis of their family ties rather than outstanding competence. The competitive financial market compels the family owned corporations to appoint competent and skilful outside directors whose access to knowledge and control of valuable external resources or influential groups can be highly

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3 Sobhan and Werner, 72

4 Dick K. Nanto, "*The 1997-98 Asian Financial Crisis,"* CRS Report for Congress 1998, <http://www.fas.org/man/crs/crs-asia2.htm> (20 August 2011).

5 Mark Clifford and Pete Engardio, *In Meltdown: Asia's Boom, Bust, and Beyond* , (Prentice:Hall Press, 2000), 9-10

6 Nanto, 1-2

7 Ines Herrero, "Agency Costs, Family Ties, and Firm Efficiency," Journal of Management, Vol. 37, No. 3 (May 2011): 887-904, 887-890

8 James J. Chrisman et al., "Intellectual Foundation of Current Research in Family Business: An Identification and Review of 25 Influential Articles," Family Business Review, Vol. 23, No. 1 (2010): 9-26, 14.

9 Chrisman, 16

10 Chrisman, 17

beneficial for the board and the company because of their human, relational, and informational capital.[11] The fact of the matter is that family firms' majority owners often appoint a team of directors with the expectations that they will simply ratify decisions rather than actively monitor the management performance. Therefore in both cases either owner managers or outside directors the agency problems such as conflicts of interests, managerial opportunism and ineffective monitoring exist in family owned corporations.[12]

The agency theory belongs to organizational economics, whose principal concern is to understand the causes and consequences of goal disagreement. Traditionally, it is assumed that the agency theory has trivial role in family owned corporations but there are number of situations that indicate existence of agency issue including governance costs in family-owned corporations.[13] For instance, (a) family owned corporations may face augmented risks due to adverse selection of inferior agents such as unqualified and incompetent family members. The managerial incompetency creates difficulties for companies to safeguard their market shares; (b) the transfer of managerial ownership through family legacy may frustrate the professional and talented employees of the company. This kind of frustration among corporate employees not only creates conflicts of interest but affect their professional working and monitoring efficiency. Resultantly, the agency costs including monitoring costs may increase rather than decrease on the grounds that disadvantage compensation and promotion will discourage agents to monitor each other's behavior.[14]

3. Family owned Model of Corporate Governance

The family-Owned model is a dominant form of business around the world. This form of business can be classified as; sole traders, partnerships, private limited companies, and public companies.[15] The ownership of the family-owned business can be divided into four types: governing owners; active owners; investing owners and passive owners.[16] Traditionally, the founders of the business and their first generation used to be operating and governing owners. The investing and passive owners have their interests to the extent of economic return. The family owned firms usually have a concentrated ownership structure and governing owners with controlling shares actively participate in the day-to-day affairs of the company.[17]

The family ownership in the UK is of limited significance because of dispersed ownership structure. In continental Europe, most of the listed companies have single voting block of shares. The average size of family-ownership blocks in the European countries is 26% in Austria, 27% in Germany, and 20% in Italy while only 5% in the UK.[18] In the beginning of 20th century, the British corporations had strong families' domination which declined in last quarter of the century due to emergence of strong capital markets, legal protection to minority investors, sharp increase in institutional-ownership, and majority companies' mergers into corporate grouping.[19] The intervention of institutional investors and strong role of capital markets led to the disapproval of 'dual-class shares'[20] which created the principle of equal treatment to all shareholders.[21] The institutional investors and financial sector prevented the UK to adopt European continental corporate structure with dual-class share, pyramids, take-over defenses which led to the production of City Code on Take-Over and Mergers. Resultantly, equity-finance was the main reason of the dilution of family holding in the UK.[22]

The family ownership is a dominant form of business in Asian corporate market. The weak legal system, less protection of property rights, industrial-feudalism, corruption, political and bureaucratic nepotism, weak enforcement of law and lack of independent judiciary are main causes of concentrated ownership in the hand of business families.[23] The majority of the companies are controlled by family-members with weak monitoring mechanism. The corporate framework of most part of the Asia based on common-law principles. Recently, the major developing economies of the Asia upgraded their corporate laws. They formulated the codes on corporate governance following the UK approach relating to composition of board and its responsibility, transparency and disclosure, shareholders' and stakeholders' rights, and audit and internal control systems.[24] The compliance of these codes is not encouraging because half of the listed companies in Asian markets are family-owned companies which want to continue family control with weaker board governance mechanism.

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[11] Cristina Bettinelli, "Board of Directors in Family Firms: An Exploratory Study of Structure and Group Process" Family Business Review, Vol. 24 No. 2 (2011): 151-159, 153

[12] Bettinelli, 153

[13] Yong Wang and others, "Founders versus Descendants: The Profitability, Growth and Efficiency Characteristics Comparison in the UK Small and Medium Sized Family Business" The Journal of Entrepreneurship, Vol. 16, No. 2 (2007): 173-195, 176-178

[14] Wang, 176

[15] Christine A. Mallin, *Corporate Governance,* 2nd ed. (Oxford 2008) 65

[16] John Ward, "Keeping the business with in the family," *Financial Times*, Friday 3 June 2005, p. 1.

[17] Mauricio Jara-Bertin et al., "The Contest to the Control in European Family Firms: How Other Shareholders Affect Firm Value," Corporate Governance, Vol. 16, No. 3 (2008): 146-157.

[18] Randall K. Morck, *History of Corporate Governance around the World: Family Business Groups to Professional Managers,* (Chicago, USA: University of Chicago Press, 2006) 582, < http://site.ebrary.com/lib/aberdeenuniv/docDetail.action?docID=10209997 > (28 July 2011)

[19] Morck, 583-590

[20] Those shares that are issued by the companies with different rights, particularly voting rights and dividend payments' rights

[21] Morck, 604

[22] Morck, 605

[23] Alex Lau et al., "In Search of Good Governance for Asian Families Listed Companies: A Case Study on Hong Kong," Company Law, Vol. 28, No. 10 (2007) 306-311

[24] Alex Lau et al. 307-08

The "overseas Chinese" and "the chaebol groups" in South Korea are two main types of family-owned companies.[25] The Chinese business people, who are having their business, outside the mainland China, mostly in South-East Asia, are described "Oversees Chinese". Their boards of directors play supportive role and the real powers exist to the management. The head of family and family members hold key positions on management. The large companies delegate powers to their subsidiary companies which have owner-managers or family oriented management domination. These companies are paternalistic in the management system with close family control by keeping equity-stake within the family. After 2nd World War, the government offered loans on attractive terms to family-owned firms to revive its economy which led to develop the chaebol groups in South Korea.[26] The chaebol groups are listed in stock exchanges but they are controlled by family-dominated insider board which led to the employees' protest and social unrest. Resultantly, the S.K.'s government reduced the powers of chaebol groups by limited sale of companies in the groups.

In family-owned corporations the ownership and control structure is one and same with less chance of agency problems because family members themselves manage and direct the company.[27] But this governance system leads to minority shareholders oppression. The formal agreement among shareholders, which determines the rights and duties of shareholders' participation in the company affairs, can be utilized to resolve the minority oppression problems.[28] Although the management takes a long-term rather than short term view of the success of the company , but family-members take different course of action (due to family differences and diverse views) that can affect the normal business operation and future interests. The remote generations of business' founders face succession problems which lead the lengthy litigation and have detrimental effect on the business. The effective corporate governance system, consisting of family council, board of directors including professional outside directors, clear division of responsibilities among all actors of company and succession planning, is important to avoid the corporate governance problems and for smooth functioning of business.[29]

Compliance to specific corporate governance measures is important for the success and survival of family-owned companies in the international competitive capital market. The compliance of the corporate governance code also provides effective benefits for them at the levels of management efficiency and corporate performance, sound business reputation and sustainability, market access, better performance, investors' confidence, transparency and corporate control, and separation between ownership and control.[30] Azevedo and Behr suggested the 'action plan' for the effective improvement of corporate governance in family owned companies:[31] (i) formulation of corporate governance policy through autonomous document relating to role, remuneration and composition of board of directors; (ii) appointment of corporate secretary who will acts as a communication channel between company and shareholders; (iii) appointment of professional CEO and Chairman, at least one of them should be professional and non-family member; (iv) Formation of Family Council, by providing suitable forum for family members to discuss and communicate business issues to keep family voice united.

Corporate governance is getting a lot of attention in business and corporate circles not only in Pakistan and India but around the world. In India, numbers of listed companies are family promoted and managed. Approximately one-third of the Sensex companies having family ownership which are controlled and managed by the families.[32] However, the corporate governance situation requires serious consideration of corporate community and public authorities regarding corporate issues. The family elders or promoters have complete control in the day-to-day management and are running the enterprises as their private property even when their holding is low in comparison with outside holdings. Several companies of previous era were managed by the principles of the nation's leaders like Mahatma Gandhi and others who were also closely associated with the freedom struggle. Independence of non-executive directors and their role in promoting corporate governance in Indian corporate sector are important issues that need to be focused. The promoters and directors of family-owned corporations should adopt responsible behavior in governing affairs of the companies because they have a fiduciary duty to shareholders to ensure future health of the company through sound governance. The fiduciary duty consists of duty of legitimacy, upholding accountability, openness and probity, trust and loyalty, duty of care, duty of critical review and independent thought, strategy and policy formulation, protecting minority owners' interests and duty of corporate responsibility.[33] The performance of fiduciary duty is an integral part of corporate governance that is seems to be missing in family-owned corporations.

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25 Bob Tricker, *Corporate Governance,* (Oxford: Oxford University Press 2008) 189-190
26 Tricker, 191
27 Mauricio Jara-Bertin et al., "The Contest to the Control in European Family Firms: How other Shareholders Affect Firm Value," Corporate Governance: An International Review, Vol. 16, No. 3 (2008): 146, 147-148.
28 Raquel Azevedo and Simon Behr, "Corporate Governance in Family-run Businesses with Special Reference to Portugal," I.C.C.L.R. Vol. 19, No. 9 (2008): 301, 301-302.
29 Christine A. Mallin, *Corporate Governance,* 2nd ed. (Oxford: Oxford University Press, 2008) 68
30 Azevedo and Behr, 295
31 Azevedo and Behr, 297- 300
32 Satheesh Kumar T N, "Indian Family-Managed Companies: The Corporate Governance Conundrum," The IUP Journal of Corporate Governance (2006): 1-22, 1-5
< http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan033971.pdf > (30 August 2011)
33 Satheesh Kumar T N, 5

4. Monitoring Problems of Corporate Governance in Emerging Economies

*a. **An Example of China**:*

As discussed in the introduction, the corporate governance is directly concerned with an effective legal system wherein the management govern the company with effective monitoring through shareholders. The corporate governance framework vary from country to country, for instance, the China is one of the most important and largest populated country in the world having approximately 1.3 billion people.[34] Its GNP ranked sixth in the world as of 2002 in terms of US dollars. However, if purchasing power parity (PPP) is used to recalculate the GNPs, China's economy is the second largest behind only the USA as of 2002. [35] The average annual growth rate of 11.3 per cent in PPP terms from 1990 to 2002 is much higher than the weighted average annual growth rates of the rest of developing countries. The research reveals that one third (1/3) of the large corporation in China, namely Fortune 500, are controlled by the business families and more than seventy percent (70%) of these corporations are originally incorporated by the family business.[36] Similarly the family ownership in private business is ninety percent (90%).

China's legal system is significantly under-developed compared to the western developed countries - the Chinese corporate governance framework including accounting standards and investor protection is deficient and its banking system is not well developed.[37] However, newly established Shanghai Stock Exchange and ShenZhen Stock Exchange have been growing very fast since their foundation in 1990 and have attracted a lot of attention from both investors and corporate community.

Competition is one of the most important mechanisms for good management and better corporate governance; it is particularly important driving factor of corporate governance in China.[38] In addition to the problem of reputation and trust, the ferocious competition between domestic and overseas investors firms seems one of the fundamental monitoring problems of corporate governance in many industries. A managerial reputation effect can replace governance in an initial public offering (IPO) firm.[39] Greif argues that certain traders' organizations in the eleventh century were able to overcome problems of asymmetric information and deficiencies of legal and contract enforcement mechanisms, because they had developed institutions based on reputation, implicit contractual relations, and coalitions.[40]

Another form of ineffective governance is family-run firms, as it has been shown that these firms emerge as the dominant form of ownership structure in countries with weak minority shareholder protections. Consistent with the findings in other Asian countries, many of China's successful private-sector firms have a very high fraction of the firm's stake owned by their founders and executives, and have performed very well.[41] The success of the private sector is difficult without the significant contribution from foreign investors however they anticipate the possible loss of their investment owing to the failure of the firm due to frauds, poor corporate governance framework and weak monitoring system. The weak regulatory system including non-existent of formal investor protection rules, political risks and interference, bureaucratic monopolies and prevalent corruption of local officials are reckoned as serious threats for investors to protect their investment and expected returns. However, the common objective of sharing high prospective profits that ties local and foreign investors with entrepreneurs and managers could be an effective tool to overcome numerous obstacles to achieve the corporate goals. To achieve the common goal in a multi-period setting, implicit contractual agreements and reputation might be helpful to act as enforcement mechanisms wherein each party should ensure that they fulfill their role to the growth of the firms and their long-term corporate stability because profit sharing also makes it incentive compatible for officials at various levels not to disturb the operation of the firm.

Secondly, the ineffective legal system does not protect the minority from the majority oppression that may be compared to other factors including reputation and trust that prevailed in developed economies such as the UK. In the 19th century and first half of the 20th century minority shareholders had very little legal protection.[42] In the middle of the twentieth century strong legal protections were provided to the minority through the common law because of trust and reputation. The principles laid down by the Common law courts are incorporated in the UK Companies Act 2006 that provides statutory protection to the minority shareholders.

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[34] Allen, F., and Gale, D., *Corporate Governance: Theoretical and Empirical Perspectives*, (London, Cambridge University Press, 2000) 23–94. Allen, F., and Gale, D., 'A Comparative Theory of Corporate Governance', Wharton Financial Institutions Centre, Working Paper, (University of Pennsylvania, 2003) 1-27

Franklin Allen, "Corporate Governance in Emerging Economies," Oxford Review of Economic Policy, Vol. 21, No. 2, (2005): 164-177

[36] Qiao Hu et al., " Job Insecurity and Remuneration in Chinese Family-owned Business Workers," Career Development International, Vol. 16 No. 1(2011): 6-19

[37] Levine, R., "Law, Finance, and Economic Growth," Journal of Financial Intermediation, 8 (1999): 36–67. Levine, R., "Bank-based or Market-based Financial Systems: Which is Better?," Journal of Financial Intermediation, 11 (2002): 1–30. Levine, R. and Zervos, S., "Stock Market, Banks, and Economic Growth," American Economic Review, 88 (1998): 537–58.

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[39] Gomes, A., "Going Public without Governance: Managerial Reputation Effects," Journal of Finance, 55 (2000): 615–6 46

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Franklin Allen, "Corporate Governance in Emerging Economies," Oxford Review of Economic Policy, Vol. 21, No. 2 (2005): 164-177.

[42] Franks, J. et al., "Ownership: Evolution and Regulation', Unpublished Working Paper, (London: Business School, 2003).

b. ***Indian Corporate Ownership as an example***:

India is one of the emerging economies of the Asia, the corporate enterprises are subject to a form of insider control and business groups wherein a family has domination and control over multiple enterprises. However, the share-ownership is concentrated among three groups, the insider ownership held by the families, ownership held by domestic financial institution, and ownership held by foreign financial institution. The three hundred forty six (346) families own the sixty percent (60%) of share-ownership of the top 500 firms in India.[43] It is also projected that the family owned corporation should contribute up to twenty two percent (22%) of the Indian GDP till 2012. The family dominated corporation are reputed to be less transparent, concentrated corporate control and more oppressive towards minority. They run their companies as per their own financial and political objectives. The business families generally have better and close links to the political apparatus and bureaucracy in the country that insulates them from external interference and corporate monitoring.[44] The families only monitor their own interests rather than corporate interests.

The domestic institutions are ineffective to monitor: however the foreign institutional investors not only finance the companies but also strengthen scarce monitoring skills in emerging markets like India.[45] The lack of specialized and skilled investment intermediaries in India are unable to perform monitoring services on behalf of domestic institutions and are a cause of ineffective corporate monitoring. The intermediaries have day-to-day contact with their investee companies and they can be actively engaged in their investee companies. However financial institutions or their investment managers have resources and incentives to acquire monitoring skills but they have conflicts of interest due to concentrated blocks and interlocking share-ownership that discourage them from developing such skills. The large insider shareholding, lack of monitoring skills, poor availability of information and weak enforcement of disclosures rules make it difficult for intermediaries to monitor and impose discipline.

Secondly, the political intervention and dependency of institutional investors in emerging economies is another reason of poor corporate monitoring. The political intervention is one of the hurdles in self-regulatory corporate monitoring. The domestic institutional investors such as insurance companies, pension funds, financial institutions and investment banks are not independent - they work under the complete control of the government and their officials are posted and transferred on the direction of government. The administration of institutional investors without the intervention of the government does not formulate their independent investment policy. Even the government sometime utilizes their investment fund to cope up its own budget deficit or to achieve the objectives of government policy and return them on availability of funds. The administration of domestic institutional investors cannot stand against government because they work on the pleasure of the government. The families that dominate in corporate sector play key role in the formation of the government of emerging economy by keeping their due share in the executive team namely the Cabinet and government agencies. Therefore they use their political influence to instruct the major investors not to disturb the management of their investee companies against their own financial and political interests.[46]

5. Possibility of Responsible Corporate Monitoring in Emerging Economies

The western institutional investors in contrast to major investors of the developing economies work independently in the best interest of their beneficiaries. For instance in the UK, institutional investors have more than 87% equity ownership in their investee companies listed in the London Stock Exchange.[47] They have significant role in the corporate governance of their investee companies being a steward of their companies. They are responsible to actively involve and monitor their companies while in emerging economies, the major shareholders are absentee landlord of their investee companies and that is detrimental to the minority shareholders and corporate stability. However, the perfunctory monitoring behavior of institutional investors is beneficial for corporate families to keep their complete control on their business firms and to run them in their own best political and economic interests. The ineffective monitoring of domestic institutions increased the agency cost. The management exercises their powers and utilizes corporate resources without the fear of accountability.

In the existence of family domination in corporate sector, political interference and ineffective monitoring of the domestic institution, the creditors and professional auditors can play responsible monitoring role. Their responsible monitoring can manage and mitigate the agency problems and provide corporate stability. The high quality of auditors monitoring would not only enhance the confidence of domestic and foreign investors but also ensure the minority shareholders that their interest would be protected.[48] The relationship between auditor choice and ownership structure is evident among firms frequently raising equity capital wherein auditors play a governance role to mitigate agency problems and issue of minority shareholders in emerging

[43] Jayanth Jayaram, Jaideep Motwani, and Mita Dixit, "**A Case Study Analyses of Logistics and Supply Chain Management Strategies in Small and Medium Enterprise Family Owned Businesses in India," (Grand Valley State University, 2010).**

[44] Tarun Khanna and Krishna Palepu, "Emerging Market Business Group, Foreign Investors, and Corporate Governance," Working Paper No. 6955, (Cambridge: February 1999)

[45] Khanna and Palepu, 2-4

[46] Omkar Goswami, ed. *A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh,* (Bangladesh Enterprise Institute 2003) 127-163

[47] The UK, ONS Share Ownership Structure (2007 & 2008) < http://www.statistics.gov.uk/pdfdir/share0110.pdf > (8 September 2011)

Joseph, P.H. Fan and T.J. Wong, "Do External Auditors Perform a Corporate Governance Role in Emerging Markets? Evidence from East Asia," Journal of Accounting Research, Vol. 43, No.1(March 2005): 35-72

markets.[49] The role of auditors would allow using these quantifiable measures to capture the quality of a corporate governance mechanism used by a firm.

On the other hand, both the company's shareholders and creditors finance the company, but shareholders will often be more than merely finance providers in a company because they have role in corporate decision making and control of the board as monitor through their vote. However creditors who are first and foremost providers of finance have limited role in the operation of the company, though their financial interests are clearly prejudiced and they seek to exercise their contractual and proprietary protection. The creditors' role during insolvency proceedings is not enough to protect the corporate stability and their own financial interests.[50] The family owned corporations exercise their political and bureaucratic influence in financial institution to take the overvalued heavy loans for their companies and utilize this credit money for their personal benefits and take the shield of corporate personality as a legal entity in case of insolvency to protect them from personal liability.

Secondly, in concentrated financial markets the directors cum shareholders such as family members run the company to protect their own financial and political interests at the cost of the company. The managerial opportunism increases the agency cost. Therefore, the creditors as capital providers should be in a position to play their significant role in corporate governance during solvency. Creditors can have a monitoring role, as a result of their contractual relationship with the company.[51] The finance is a life-blood for corporate sector; therefore the relationship between shareholders and creditors should be understood in the dynamics of company financing decisions in both solvent and insolvent scenario .

The creditors should protect themselves against two dangers through possible monitoring: firstly, the borrower should deplete the assets either by diminishing their value or by substituting its safe assets for more risky ones and secondly, it should dilute the value of the creditor's debt by adding more liabilities without correspondingly increasing the asset pool.[52] The unsecured creditors should be required to have extensive covenants which give them the ability to monitor the entire business of the borrower and, in conjunction with that monitoring, to stop the borrower depleting the asset pool or increasing liabilities. The creditors' monitoring should be focused on the asset that is given as security. The responsible monitoring can be effective through creditors with a security interest over all the assets of the company.[53]

6. Conclusion

The insufficient focus on the issue of legal framework and institutions ensure that the strategy to run the firms in pursuance of long-term corporate stability is in fact the best interest of shareholders. Secondly, the emerging economies face political interference due to strong family business ownership. The insider strong business groups believe that the effective legal systems and institutional monitoring are neither necessary nor sufficient for ensuring good economic performance. This raises the question of how finance for investment is obtained without investor protection and investor oriented governance. However, the internal finance provided through conglomerates or family business groups is particularly important but monitoring of their investment capital and long-term corporate stability is inevitable to build the investors' confidence and economic growth. Therefore, the effective legal systems wherein minority shareholders should be protected from majority oppression and injustice, responsible monitoring through audits and creditors' institutions could be an alternative monitoring mechanism for fair corporate competition to maintain firms' reputation and investors' trust and confidence. The responsible role of auditors, major shareholders and creditors under legal framework may also be effective to manage the agency issues.

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[49] Fan and Wong, 65
[50] Louise Gullifer and Jennifer, *Corporate Finance Law Principle and Policy,* (London: Hart Publishing, 2011) 80
[51] Gullifer and Jennifer, 14
[52] Gullifer and Jennifer, 294
[53] Louise and Jennifer, 294-295