ELSEVIER

Volume 17, issue 2, April 2011

ISSN 0929-1199

Journal of CORPORATE FINANCE

CONTENTS

Special Issue: Corporate Finance and Governance in Emerging Markets
Edited by: Joseph P.H. Fan, K.C. John Wei, and Xinzhong Xu

J.P.H. Fan, K.C.J. Wei and X. Xu, Corporate finance and governance in emerging markets: A selective review and an agenda for future research 207

B. Lauterbach and Y. Yafeh, Long term changes in voting power and control structure following the unification of dual class shares 215

C.J.P. Chen, Z. Li, X. Su and Z. Sun, Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence 229

N. Boubakri, J.-C. Cosset, O. Guedhami and W. Saffar, The political economy of residual state ownership in privatized firms: Evidence from emerging markets 244

(Contents continued on outside back cover)

Journal of Corporate Finance 17 (2011) 207–214

Contents lists available at ScienceDirect

Journal of Corporate Finance

journal homepage: www.elsevier.com/locate/jcorpfin

Preface

Corporate finance and governance in emerging markets: A selective review and an agenda for future research

Joseph P.H. Fan [a,*], K.C. John Wei [b], Xinzhong Xu [c]

[a] *Faculty of Business Administration, The Chinese University of Hong Kong, Shatin, N.T., Hong Kong SAR*
[b] *Department of Finance, Hong Kong University of Science and Technology, Clear Water Bay, Hong Kong SAR*
[c] *Guanghua Graduate School of Management, Peking University, Beijing China*

ARTICLE INFO

Available online 13 December 2010

ABSTRACT

There are important organizational and behavioral differences between firms in emerging markets and those in developed markets. We propose a top-down approach to understand how key institutional forces shape the structures and policies of firms in emerging markets. We review a selective set of prior studies as well as papers included in this Special Issue in identifying government quality, state ownership, and financial development as critical institutional forces that shape the financing and governance of firms in emerging markets. We suggest that future research should pay attention to several important but unanswered topics related to informal enforcement, government incentives, family firms, and network organizations.

1. Introduction

The world is dominated by emerging economies in terms of population and geographic size. However, emerging markets historically lag behind developed economies in terms of economic significance. It is no surprise that the wealth of finance research concentrates in developed countries. However, just in the past two decades, emerging markets have grown swiftly, with the rise of several very large economies such as China and India. Researchers' interests in emerging markets are also growing. More and more institutional and behavioral differences between firms in emerging markets and those in developed markets are discovered. The publication of this Special Issue is in time.

We propose a top-down approach to understand the causes of emerging market firm behaviors (Fig. 1). Various institutional factors fundamentally influence business organizations and managerial behaviors in these markets. Comparing firm behaviors and their performance in emerging markets with those in developed markets would be misleading if their critical institutional differences are ignored.

The emphasis of institutions is consistent with the growing law and finance literature and the associated availability of cross-country institutional data. This literature highlights the importance of laws and enforcement in firm behaviors and performance (e.g., La Porta et al., 1997, 1998). Other studies focus on a single economy or a small group of countries with similar institutional backgrounds. An advantage of focused-country studies over cross-country studies is that the former can control data quality better, which allows researchers to analyze the impacts of a key institutional factor on various issues in-depth, while holding constant other factors that might be difficult to disentangle in cross-country studies.

This Special Issue includes 10 papers. Some explore cross-country differences, while others focus on within-country institutional variations in firm financing and governance choices. These decisions include firm investment and financing policies, mergers and restructuring, managerial compensation, accounting reporting, ownership structures, and business/political

* Corresponding author. Tel.: +852 2609 7839.
E-mail addresses: pjfan@cuhk.edu.hk (J.P.H. Fan), johnwei@ust.hk (K.C.J. Wei), xuxz@gsm.pku.edu.cn (X. Xu).

0929-1199/$ – see front matter © 2010 Elsevier B.V. All rights reserved.
doi:10.1016/j.jcorpfin.2010.12.001

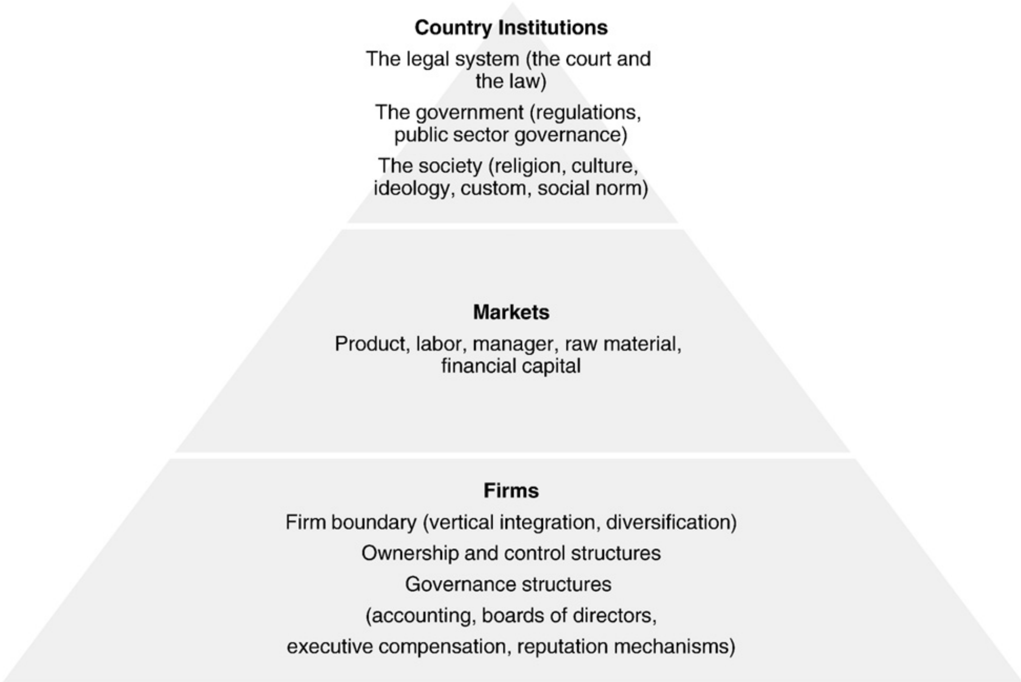

Fig. 1. Top-down research approach on emerging market firm behaviors.

networking. Specific institutional factors shaping these firm decisions include ownership restrictions (e.g., state ownership and privatization), government interventions, and financial sector development.

We do not intend to give a comprehensive survey of emerging market finance research, nor do we simply summarize the papers in this Issue. Instead, we select several key institutional factors which are important in emerging markets and discuss how these factors shape corporate financing and governance decisions, including the decisions analyzed by the papers in this Special Issue. We conclude this overview by discussing several future research topics.

2. Institutions and emerging market firm behaviors

There exist various institutional factors at country, industry, and market levels (Fig. 1). Among the many institutional forces, it is often easy to be confused with which are fundamental and which are secondary. Moreover, most of the institutional factors are correlated. Disentangling these relations and identifying fundamental institutional factors are ongoing tasks by researchers in economics, political and social sciences. However, it would be a mistake not to consider institutional effects. Notwithstanding the primitive nature of our knowledge of how institutions are related, we selectively discuss several institutional features that we believe are important in corporate finance and governance decisions.

2.1. Government quality

Heavy government intervention on business activities is a common feature of emerging markets.[1] Through taxation, regulation, and state ownership, governments influence and control various aspects of business: from output, production process, to input such as labor, land, mines, energy, infrastructures, and financing.[2] Given the heavy government involvement in business, the quality of government policies, and ultimately the quality of bureaucrats and politicians who make these policies is a critical impacting factor of emerging market firms (Shleifer and Vishny, 1994, 1998; La Porta et al., 1999a). Government quality is the

[1] Mainstream economists have heavily criticized government intervention as opposed to laissez-faire. This thinking has influenced government policies of developed countries such as the U.S. and the U.K. However, the free-market approach is an exception rather than a norm both historically and around the world. Even in the U.S., there have been many periods of heavy government intervention, including the current one in the aftermath of the 2008 financial crisis.

[2] In China, all business resources used to be in the hands of the Central Government and it was not until the 1980s the Chinese Government began to decentralize selective decision rights of the country's business resources to various layers of lower governments. Bureaucrats at the various levels of government, with the newly given decision rights, intervene its local businesses subject to different incentives. Some bureaucrats, with their promotion tied to local economic development, encourage firm decisions that help boost the local economy. Other bureaucrats use the newly gained power to intervene firms for personal gains, sometimes involving corruption. Still other bureaucrats are attracted by new business opportunities and become business owners themselves. Government intervention is not unique to China but widespread in other emerging markets. In Thailand, the Royal family owns numerous businesses and properties. In Singapore, the government owns significant stakes of numerous businesses. South Korean and Taiwan governments are well known for their sponsorship of strategic sectors. Even in Hong Kong, a role model of free market according to Milton Freidman, the government influences business activities through its land control.

extent to which government officials' and politicians' decisions benefit the citizen they serve, and whether the decisions are made and executed in a legally and socially acceptable manner. Of course, the quality of government depends on other institutional constraints such as constitution, laws, and the political system. However, we observe that conventional constraints of executive power are typically weak to regulate the behaviors of political leaders in emerging markets.[3] Therefore, government quality deserves separate attention in the analysis of emerging market firms.

Bureaucrats and politicians make mistakes; they may have self-interests or be even corrupt. Firms under the influence of low quality government will likely have different financing and governance patterns. An important behavior distortion under low government quality is bribery and political connection building. Substantial value of emerging market firms comes from owners' ability to seek rent from government (Fisman, 2001). For example, numerous studies report that firm owners and managers may bribe or build connections with bureaucrats who can influence state banks to give loans and other business privileges to these firms (e.g., Sapienza, 2004; Dinc, 2005; Khawaja and Mian, 2005; Charumilind et al., 2006; Claessens et al., 2008; Fan et al., 2008). As a consequence, firms in more corrupt countries tend to have more debt in their capital structures relative to equity (Fan et al., forthcoming). Firms under the influence of low quality government tend to have complex organizational structures, poor transparency and weak corporate governance (e.g., Leuz and Oberholzer-Gee, 2006; Fan et al., 2009; Jiang et al., 2010).

2.2. State ownership

Government restrictions of transferring firm ownership to private sectors pose another important constraint of emerging market firms. By definition, the shares and assets of state owned firms (SOEs) cannot be transferred freely. These transfer restrictions implied in state ownership critically impact managerial incentives, firm organizational structures and policies (Alchian, 1965). State ownership is typically associated with low productivity. As pointed out by Shleifer (1998), the poor performance of SOEs is not only due to the lack of ownership incentives, but also due to bureaucrats' and politicians' interfering SOEs to transfer wealth. Bureaucrats may use their ownership position to interfere SOEs to support the economy. Less than benevolent bureaucrats may outright expropriate SOEs for personal gains. Government owners can send bureaucrats to a firm as managers or directors through which government policies of firms are executed (Fan et al., 2007). As a result of the incentive and intervention effects, the financing and governance traits of SOEs are expected to be different from those of private sector firms. Understanding the incentive and, again, the quality of bureaucrats is important in predicting the behaviors of state owned firms.

2.3. Financial market development

Many emerging markets share weakness in their financial market development. Many governments still control or influence banks (La Porta et al., 2002), allocating financial resources based on not just market rules but also other strategic criteria. For example, China's big-four state banks are well known in their reluctance of lending to the private sector, while they tend to extend their funds to SOEs in the name of public interest (Allen et al., 2005). Financial development in emerging markets is also hampered by their weak legal systems for protecting investors' rights. For example, bankruptcy laws are often weakly enforced and courts are often very costly to use for resolving conflicts. Capital markets in emerging countries are subject to weak oversight, long regulatory delay, weak investor protection, and ultimately high capital raising cost. For example, a typical IPO in China's A-share markets would have to underprice by almost 200% not long ago (Chan et al., 2004). Chen et al. (2009) find that, in emerging markets, firm-level corporate governance has a significantly negative effect on the cost of equity capital and this corporate governance effect is stronger in countries that provide relatively poor legal protection of investors.

As financial market development lags behind, emerging market firms have poor access to external capital, debt or equity. As discussed earlier, competing for external financial resources often involves non-price mechanisms such as building relationships with bankers and government officers. Entrepreneurs controlling essential financial resources and political capitals can leverage up these advantages by diversifying into various sectors, and form business groups within which scarce financial and other resources can be exchanged among affiliated firms (Morck et al., 2004; Khanna and Yafeh, 2007).

3. Empirical evidence

We will sketch hypotheses of how key corporate financing and governance policies are affected by institutional forces, and bring in the evidence reported by the studies included in this Special Issue.

3.1. Ownership and organizational structures

3.1.1. Ownership structures

Different from diffusely held firms in the U.S. and the U.K., the ownership of a typical emerging market firm is concentrated in a family or a government agency. The firm is affiliated with a business group, controlled by the owner through a complex web of

[3] Chen Shui-bian was the first president of Taiwan elected by true democratic votes. He was also the first president of Taiwan being charged of corruption and embezzlement of taxpayers' money to overseas accounts during the presidency, and was recently sentenced to jail for 19 years. In Mainland China, Chen Liangyu received corruption charges in 2004 during his term as the Party Secretary of Shanghai, and was jailed for 14 years. It appears that corruption and poor government quality are prevalent across emerging markets, regardless of their differences in political and economic systems.

ownership formed by stock pyramids, cross-shareholdings, and/or dual class shares (La Porta et al., 1999b; Claessens et al., 2000). These ownership structures are known to enhance the owner's control of the firm and the overall business group beyond the owner's ownership level. Prior studies report that the excess control over ownership is associated with stock value discounts (Claessens et al., 2002, and many others) and various firm policy distortions such as overinvestment (Wei and Zhang, 2008). A popular interpretation is that the ownership structures are designed for expropriating wealth of minority shareholders, and the share price discounts reflect the risk premium demanded by stock investors. However, if the cost of expropriation is ultimately born by a controlling owner, what does the owner gain by employing control enhancing mechanisms? It is conceptually difficult to attribute expropriation as the sole reason of the ownership and organizational structures in emerging markets. Indeed, other recent studies begin to reveal potential financing benefits of pyramidal group structures (Almeida and Wolfenzon, 2006; Almeida et al., forthcoming).

In this Issue, Lauterbach and Yafeh (2010-this issue) examine a sample of firms in Israel that are forced by government regulation to unify their dual-class stocks into a single class. By unifying the stocks, the voting power of controlling owners would be diluted. The controlling owners respond to the unification by increasing their shareholding, maintaining their voting power as a result. There is little evidence that firm performance and stock value change subsequent to the unification. If expropriation is the main concern of the dual-class ownership structures, firm value should have changed in response to the unification events and the associated changes in controlling owners' shareholdings. The study by Lauterbach and Yafeh shows that effective control is important to these owners, but whether the ownership structures are motivated by expropriating minority investors' wealth is unclear.

As another attempt in this Special Issue to understand the ownership structures of emerging market firms, Chen et al. (2010-this issue-a) examine the possibility that political incentives shape the ownership of private sector firms in China. Given that substantial business resources remain controlled by various government agencies, Chen et al. (2010-this issue-a, 2010-this issue-b) find that these private firms would need to build connections with bureaucrats, particularly when the bureaucrats' intervention incentives are strong. Interestingly, they also find that the ownership of politically connected firms is more concentrated. This relation is not only significant across firms, but also across time. That is, controlling owners' shareholdings become higher as they gain more political relationships. Moreover, politically connected private firms outperform non-connected firms in terms of post-IPO cumulative net-of-market stock returns. Their evidence suggests that ownership concentration facilitates the firms' rent seeking activities with bureaucrats and helps the controlling owners capitalize the gain from these activities.

3.1.2. Privatization

State ownership has been under transition. Governments around the world, most significantly in the ex Soviet Union countries, China and India have allowed state ownership transferred to the private sector. Performance issue is a well known reason for the privatization of SOEs (Boubakri and Cosset, 1998; Megginson and Netter, 2001; Djankov and Murrell, 2002; D'Souza et al., 2005; Boubakri et al., 2005; Gupta, 2005; and many others). Prior studies have also discovered that the decisions and the methods of privatization depend on institutional factors which also affect privatization outcomes (e.g., Perotti, 1995; Jones et al., 1999). In this Special Issue, Boubakri et al. (2010-this issue) examine a sample of privatized firms in 27 non-transition emerging markets. They pay attention to partial privatization — government retaining residual ownership of the privatized firms. Prior studies identify that political concerns might motivate government to retain significant ownership of privatized firms, for example, to signal its continuing support of the firms after privatization (Perotti, 1995). However, the study by Boubarkri et al. does not find this factor relevant in their sample. Instead, the extent of government ownership and control of privatized firms is affected by the type of political systems and political constraints faced by politicians. When politicians are subject to tighter check and balance, the speed of privatization is slower and government retains higher ownership stakes of privatized firms at a given point in time.

3.2. Investment, growth, and financing decisions

3.2.1. Investment

This Special Issue includes several studies on how institutional factors in emerging markets influence firm investment decisions. For example, Chen et al. (2010 — this issue-b) examine the roles of government intervention in firm investment decisions. They compare capital expenditures of publicly traded SOEs in China relative to those of non-SOEs. They report that the capital investment of SOEs is less sensitive to their investment opportunities (a sign of lower investment efficiency), when the SOEs' leaders (chairmen or CEOs) have served as government bureaucrats. By contrast, the sensitivities of investment to growth opportunities for non-SOEs are unrelated to the bureaucrat backgrounds of firm leaders.

Different roles of political connection on SOEs and non-SOEs are found in other studies of firm performance. Fan et al. (2007) examine post-IPO performance of SOEs in China, and report that when ex or current bureaucrats serve as CEOs, the stock performance of SOEs deteriorates more significantly than that of other firms led by CEOs without bureaucrat backgrounds. In contrast, in this Special Issue, Chen et al. (2010 — this issue-a) find that politically connected private firms outperform other private firms without political backgrounds. Overall, these studies suggest that bureaucrat involvement has different effects on state-owned and private-owned firms. The role of bureaucrats in SOEs seems to be the intervention of firms' decisions at the expense of shareholders, while their participation in private firm activities helps the firms' competitiveness.

In this Special Issue, Zhou et al. (2010 — this issue) compare the restructuring decisions of domestic firms with those of foreign owned firms in Thailand subsequent to the 1997 Asian financial crisis. The comparison is interesting because it provides an opportunity to examine how different ownership types and associated different institutional backgrounds affect firm decisions in response to external shocks. They report that the asset restructuring patterns of foreign firms are less affected by the crisis, compared with those of domestic firms. This might suggest that foreign firms are more influenced by foreign institutions that are less affected by the crisis. The study does not find a significant difference in the change of restructuring patterns between domestic firms controlled by individuals or families and those by corporate organizations. This might suggest that the restructuring decisions of domestic firms are mainly influenced by the common shock, rather than by the ownership type per se. Finally, the study reports that domestic firms do not respond to the crisis by cutting back peripheral segments. Rather, they hold on to their core segments while reducing the acquisitions of new subsidiaries.

Interestingly, through an investigation of cross-border mergers, in this Issue, Zhu et al. (2010 — this issue) reach a similar conclusion. They investigate a sample of partial acquisition of firms in 22 emerging market countries, comparing between targets acquired by domestic acquirers and those acquired by foreign acquirers. They report that the pre-acquisition performance of target firms is better when acquirers are foreigners. In contrast, the post-acquisition performance of target firms is better when acquirers are domestic firms. The results are consistent with the view that foreign acquirers are subject to information asymmetry and cherry pick productive firms, while domestic firms acquire local targets for synergistic gains. The findings of this paper, together with those of Zhou et al. (2010 — this issue), do not support the conventional view that emerging market firms' decisions are primarily influenced by agency problems and financial constraints. More in-depth research is needed to find out the causes of their decisions.

3.2.2. Internal capital market

The business groups in emerging markets are associated with vibrant internal transfers of labor, raw and intermediate materials, physical assets, and financial resources. These “internal market activities” are difficult to keep track from outside. Prior studies reports that some of the related party transactions within the business groups are subject to conflicts of interest, in particular with the minority investors of publicly traded subsidiaries (Johnson et al., 2000). Friedman et al. (2003) suggest that related party transactions are more complicated and that the controlling owner sometimes injects resources to prop up a subsidiary in addition to extracting resources from it. In this Issue, Peng et al. (2010 — this issue) study public announcements of related party transactions of publicly traded companies in China. It is typically difficult to measure controlling owners' propping and tunneling incentives. The study by Peng et al. takes advantage of the listing and capital raising financial requirements by the Chinese security regulator to classify firms subject to controlling owners' propping or tunneling incentives. They report positive stock price reactions when the firms are identified by the Chinese security regulator as in financial distress. In contrast, stock announcement effects are negative when the firms are expected to be financially sound. The related party transactions potentially benefit the Chinese business groups by maintaining the public listing status and capital raising options of the groups' flagship companies.

3.2.3. Bank-firm relationships

Numerous studies report weak banking systems in emerging markets. Banks' lending decisions are often distorted by institutional constraints, mainly government interventions of various means, such as state ownership and corruption as discussed before. But even in these weak environments, firms optimize their financing decisions in ways not necessarily different from those in developed countries. In this Issue, Ongena et al. (2010 — this issue) examine whether firms choose and build long-term relationships with lenders, using a unique survey data from the Czech Republic. They find that it depends on whether firms emphasize relationship or market-based financing. Firms that emphasize bank reputation tend to have fewer bank relationships and are less likely to cut back services provided by the banks. Other firms that emphasize price would be more likely to end the relationships or to reduce the services.

3.3. Governance

3.3.1. Managerial compensation

Until now, we still do not know much about how managers of emerging market firms are paid and promoted and factors that influence these decisions. This is partly due to the opacity of data, but also due to the lack of economic analysis of how pay and promotion decisions are influenced by institutional factors. For example, state ownership imposes critical constraints on pay and promotion. In China, government imposes the ceiling of how much can be paid to SOE managers. Like price control of commodities induces grey markets, the control of managerial pay also changes managerial behavior and the form of compensation. If the pay ceiling is binding, some managers may shirk instead of being productive, while other productive managers may enjoy on-the-job consumption or perquisites.

Empirically estimating the amount of managerial perks is difficult because of the lack of data. In this Issue, Luo et al. (2010 — this issue) attempt to estimate perks from accounting expense items for publicly traded companies in China. Based on data of almost 1400 companies between 1998 and 2006, they report that the cash pay of the top-three highest pay managers is about 0.5 million Ren Min Bi (RMB) (around US$60,000), while their perks amount to almost 110 million RMB, almost 200 times the cash pay. Of course, one should not be overly dependent on these statistics because of likely estimation errors. However, these numbers suggest that any studies of managerial pay in China and possibly in other emerging markets subject to pay distortions can be misleading if perks are not considered. The study by Luo et al. argues that rent seeking of bank officers might be a contributing factor of executive perks of the Chinese firms, adding to the literature of the roles of bank governance in corporate governance.

3.3.2. Corporate transparency

Poor disclosure and financial opacity are a common trait of emerging market firms. The information opacity can arise from various institutional factors including complex organizational structures, weak property rights protection, regulatory distortions, and so on. It is well acknowledged that the financial opacity of emerging market firms cannot be improved by changing the accounting system alone, because the enforcement of accounting rules depends on strong institutions which are lacking in these markets (Ball et al., 2000). Does accounting disclosure enforcement have any effects on emerging market firms at all? In this Issue, Firth et al. (2010 — this issue) examine accounting restatements by publicly traded companies in China. They report that firms are more likely to restate their financial statements after raising debt and/or equity capital. Chinese security regulator requires a good earnings track record before a firm can go public or raise capital subsequently. It is well documented that firms manipulate accounting prior to equity raising events (Aharony et al., 2000; Chen and Yuan, 2004). The study by Firth et al. therefore provides the auxiliary evidence of regulatory induced accounting distortion. Such distortion is costly to managers and shareholders. As reported in the paper, restatement firms suffer significant negative abnormal stock returns and greater rates of CEO turnovers.

4. Research agenda

Emerging markets pose both challenges and opportunities for researchers. Time and effort required for understanding how key institutional forces shape corporate behaviors and collecting data for testing theories can be very significant. At the same time, emerging market research is also rewarding, because interesting differences of firms and new theories are to be discovered in these markets. For example, interesting issues include how emerging market firms invest, finance, and govern their projects, how they structure their organizations and ownership to circumvent institutional constraints such as government interventions and underdeveloped capital markets, and so on. In the following, we suggest several broad topics for future emerging market finance research.

4.1. Informal enforcement

Business conflicts in emerging markets are typically not resolved in the court or by government. Much of the enforcement of contractual relations in emerging markets is through alternative means that help establish the expectation of parties involving the contracts. The expectation might be established on culture, custom, industrial or social norm (Alchian, 1965; Demsetz, 1964, 1967), and the enforcement that supports the expectation can also be informal, such as the damages of reputation and relationship. What the forces of enforcement are and how they work to safeguard the relationships in financial contracts are an important but unanswered question (Allen et al., 2005; Ayyagari et al., forthcoming).

4.2. Government incentives

As discussed before, government is typically the most important stakeholder of firms beside firm owners in emerging markets. More research is needed to understand the incentives of government in its relationship with firms under its jurisdiction. This entails an analysis of the political system and the understanding of how bureaucrats are compensated and promoted, how politicians are selected into power, and how misconducts are detected and punished. The political system will, in turn, affect the government's objectives of firms and its methods and degrees of intervening firm decisions. We have seen such analysis of SOEs and their privatization decisions in prior studies. However, even private sector firms are subject to heavy government influences in both emerging markets and developed countries. How government incentives affect corporate finance and governance therefore represents a promising research area.

4.3. Network organizations

Researchers are beginning to understand that emerging market firms, even though legally independent, are actually connected through various formal and informal means (Allen and Babus, 2009). A typical emerging market firm is affiliated with a network of companies or a business group (Khanna and Yafeh, 2007). The affiliation could be formed through formal ownership arrangement, such as a parent company owns a controlling interest of a subsidiary (e.g., a control pyramid). However, the glue that binds firms into a group is not limited to formal ownership. The firms can be connected through informal relationships of their key personnel, such as through marriages (Bunkanwanicha et al., 2009), blood ties, school ties, job relationships (Khanna and Thomas, 2009), and so on. The group-like hybrid organizational form (Williamson, 1985) challenges our traditional assumption that firm decision rights are completely decentralized to firm managers, managers compete and collaborate in an arm's length manner, and conflicts are resolved in the court. Future research could seek to understand how and why these network organizations are formed, how decisions such as investment and financing are made, how the relationships among member firms are governed, and how the organizations evolve over time.

4.4. Family firms

Most private sector firms in emerging markets are family owned and/or family managed. Unlike family firms in the U.S. and the U.K whose ownership diffuse quickly after they become publicly traded, family ownership in emerging markets is typically highly concentrated and remain so even long after going public. Moreover, unlike their U.S. and U.K. counterparts that typically employ professional managers, emerging market firms are often managed by family members and less often by non-family professional managers. Given the prevalence of family businesses in emerging markets, we are interested in knowing why ownership and control are different in emerging markets, what the unique contributions provided by families to their firms might be, and how family ownership and management are related to firm growth and investment, as well as their governance decisions.

5. Conclusion

Future research would benefit from the top-down approach we have proposed at the beginning of this paper (Fig. 1). This entails three steps. First, we seek to understand the basic structural and behavioral differences between firms in emerging markets and those in developed economies. For example, we should not assume that emerging market firms are free-standing and families own and manage the firms in the same fashion as firms in developed countries. Second, we employ theories to guide our search of basic institutional factors that shape the firm behavior. Here, we emphasize that both formal and informal institutional forces are important in regulating key stakeholders in emerging markets. And third, we seek to understand whether other lower market or firm level factors might also contribute to the behavioral differences between emerging market firms and those in developed markets. However, we do not assume that these factors work in the same way as those in developed markets. For example, the roles of boards of directors and the contracts that motivate managers will be quite different for emerging market firms. In a nutshell, we will begin to learn many interesting behaviors and why the behaviors in emerging markets as soon as we do not impose the standard views of firms.

References

Aharony, J., Lee, J., Wong, T.J., 2000. Financial packaging of IPO firms in China. J. Acc. Res. 38, 103–126.

Alchian, A., 1965. Some economics of property rights. Il Politico 30, 816–829. (Originally published in 1961 by the Rand Corporation). Reprinted in Alchian, A., Economic Forces at Work. Liberty Press, Indianapolis, IN.

Allen, F., Babus, A., 2009. Networks in finance. In: Kleindorfer, P.R., Wind, Y.J., Gunther, R.E. (Eds.), Chapter 21 of The Network Challenge. Wharton School Publishing, N.J.

Allen, F., Qian, J., Qian, M.J., 2005. Law, finance, and economic growth in China. J. Financ. Econ. 77, 57–116.

Almeida, H.V., Wolfenzon, D., 2006. A theory of pyramidal ownership and family business groups. J. Finance 61, 2637–2679.

Almeida, H., Park, S., Subrahmanyam, M., Wolfenzon, D., forthcoming. The structure and formation of business groups: Evidence from Korean chaebols. J. Financ. Econ.

Ayyagari, M., Demirguc-Kunt, M., Maksimovic, V., 2010. Formal versus informal finance: Evidence from China. Rev. Financ. Stud. 23, 3048–3097.

Ball, R., Kothari, S.P., Robin, A., 2000. The effect of institutional factors on properties of accounting earnings: international evidence. J. Acc. Econ. 29, 1–52.

Boubakri, N., Cosset, J., 1998. The financial and operating performance of newly privatized firms: evidence from developing countries. J. Finance 53, 1083–1112.

Boubakri, N., Cosset, J., Guedhami, O., 2005. Liberalization, corporate governance and the performance of newly privatized firms. J. Corp. Finance 11, 767–790.

Boubakri N., Cosset, J., Guedhami, O., Saffar, W., 2010e. The political economy of residual state ownership in privatized firms: Evidence from emerging markets. J. Corp. Finance 17, 244–258.

Bunkanwanicha, P., Fan, J.P.H., Wiwattanakantang, Y., 2009. Family Matters: Valuing Marriage in Family Firms. Working Paper. The Chinese University of Hong Kong.

Chan, K., Wang, J., Wei, K.C.J., 2004. Underpricing and long-term performance of IPOs in China. J. Corp. Finance 10, 409–430.

Charumilind, C., Kali, R., Wiwattanakantang, Y., 2006. Connected lending: Thailand before the financial crisis. J. Bus. 79, 181–217.

Chen, K.C.W., Yuan, H., 2004. Earnings management and capital resource allocation: evidence from China's accounting-based regulation of rights issues. Acc. Rev. 79, 645–666.

Chen, K.C.W., Chen, Z., Wei, K.C.J., 2009. Legal protection of investors, corporate governance, and the cost of equity capital. J. Corp. Finance 15, 273–289.

Chen, C.J.P., Li, Z., Sun, X., Sun, Z., 2010a. Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence. J. Corp. Finance 17, 229–243 (this issue).

Chen, S., Sun, Z., Tang, S., Wu, D., 2010b. Government intervention and investment efficiency: Evidence from China. J. Corp. Finance 17, 259–271 (this issue).

Claessens, S., Djankov, S., Lang, L.H.P., 2000. The separation of ownership and control in East Asian corporations. J. Financ. Econ. 58, 81–112.

Claessens, S., Djankov, S., Fan, J.P.H., Lang, L.H.P., 2002. Disentangling the incentive and entrenchment effects of large shareholdings. J. Finance 57, 2741–2771.

Claessens, S., Feijen, E., Laeven, L., 2008. Political connections and preferential access to finance: the role of campaign contributions. J. Financ. Econ. 88, 554–580.

D'Souza, J., Megginson, W.L., Nash, R., 2005. Effect of institutional and firm-specific characteristics on post-privatization performance: evidence from developed countries. J. Corp. Finance 11, 747–766.

Demsetz, H., 1964. The exchange and enforcement of property rights. J. Law Econ. 3, 11–26.

Demsetz, H., 1967. Towards a theory of property rights. Am. Econ. Rev. 57, 347–359.

Dinc, I.S., 2005. Politicians and banks: political influences on government-owned banks in emerging markets. J. Financ. Econ. 77, 453–479.

Djankov, S.D., Murrell, P., 2002. Enterprise restructuring in transition: a quantitative survey. J. Econ. Lit. 40, 739–792.

Fan, J.P.H., Wong, T.J., Zhang, T., 2007. Politically connected CEOs, corporate governance and post-IPO performance of China's partially privatized firms,. J. Financ. Econ. 84, 330–357.

Fan, J.P.H., Rui, M., Zhao, M., 2008. Public governance and corporate finance: Evidence from corruption cases. J. Comp. Econ. 36, 343–364.

Fan, J.P.H., Wong, T.J., Zhang, T., 2009. Institutions and organizational structure: the case of state-owned corporate pyramids. Working Paper. The Chinese University of Hong Kong.

Fan, J.P.H., Titman, S., Twite, G., forthcoming. An international comparison of capital structure and debt maturity choices. J. Financ. Quant. Anal.

Firth, M., Rui, O.M., Wu, W., 2010. Cooking the books: Recipes and costs of falsified financial statements in China. J. Corp. Finance 17, 371–390 (this issue).

Fisman, R., 2001. Estimating the value of political connections. Am. Econ. Rev. 91, 1095–1102.

Friedman, E., Johnson, S., Mitton, T., 2003. Intra-group capital flow and propping. J. Comp. Econ. 31, 732–750.

Gupta, N., 2005. Partial privatization and firm performance. J. Finance 60, 987–1015.

Jiang, G., Lee, C.M.C., Yue, H., 2010. Tunneling through intercorporate loans: the Chinese experience. J. Financ. Econ. 98, 1–20.

Johnson, S., La Porta, R., Lopez-de-Silanes, F., Shleifer, A., 2000. Tunneling. Am. Econ. Rev. 90, 22–27.

Jones, S.L., Megginson, W.L., Nash, R.C., Netter, J.M., 1999. Share issue privatizations as financial means to political and economic ends. J. Financ. Econ. 53, 217–253.

Khanna, T., Thomas, C., 2009. Synchronicity and firm interlocks in an emerging market. J. Financ. Econ. 92, 182–204.

Khanna, T., Yafeh, Y., 2007. Business groups in emerging markets: paragons or parasites? J. Econ. Lit. 45, 331–372.

Khawaja, A.L., Mian, A., 2005. Do lenders favor politically connected firms? Rent provision in an emerging financial market. Q. J. Econ. 120, 1371–1411.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., 1997. Legal determinants of external finance. J. Finance 52, 1131–1150.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., 1998. Law and finance. J. Polit. Econ. 106, 1113–1155.
La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., 1999a. The quality of government. J. Law Econ. Organ. 15, 222–279.
La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., 1999b. Corporate ownership around the world. J. Finance 54, 471–517.
La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., 2002. Government ownership of banks. J. Finance 57, 265–301.
Lauterbach, B., Yafeh, Y., 2010. Long term changes in voting power and control structure following the unification of dual class shares. J. Corp. Finance 17, 215–228 (this issue).
Leuz, C., Oberholzer-Gee, F., 2006. Political relationships, global financing, and corporate transparency. J. Financ. Econ. 81, 411–439.
Luo, W., Zhang, Y., Zhu, N., 2010. Bank ownership and executive perquisites: New evidence from an emerging market. J. Corp. Finance 17, 352–370 (this issue).
Megginson, W.L., Netter, J.M., 2001. From state to market: a survey of empirical studies on privatization. J. Econ. Lit. 39, 321–389.
Morck, R., Wolfenzon, D., Yeung, B., 2004. Corporate governance, economic entrenchment and growth. J. Econ. Lit. 43, 657–722.
Ongena, S., Tümer-Alkan, G., Vermeer, B., 2010. Corporate choice of banks: Decision factors, decision maker, and decision process – first evidence. J. Corp. Finance 17, 326–351 (this issue).
Peng, W.Q., Wei, K.C.J., Yang, Z., 2010. Tunneling or propping: Evidence from connected transactions in China. J. Corp. Finance 17, 306–325 (this issue).
Perotti, E., 1995. Credible privatization. Am. Econ. Rev. 85, 847–859.
Sapienza, P., 2004. The effects of government ownership on bank lending. J. Financ. Econ. 72, 357–384.
Shleifer, A., 1998. State versus private ownership. J. Econ. Perspect. 12, 133–150.
Shleifer, A., Vishny, R., 1994. Politicians and firms. Q. J. Econ. 109, 995–1025.
Shleifer, A., Vishny, R., 1998. The Grabbing Hand: Government Pathologies and their Cures. Harvard University Press, Cambridge, MA.
Wei, K.C.J., Zhang, Y., 2008. Ownership structure, cash flow, and corporate investment: evidence from East Asian economies before the financial crisis. J. Corp. Finance 14, 118–132.
Williamson, O.E., 1985. The Economic Institutions of Capitalism. Free Press, New York.
Zhou, Y.M., Li, X., Svejnar, J., 2010. Subsidiary divestiture and acquisition in a financial crisis: Operational focus, financial constraints, and ownership. J. Corp. Finance 17, 272–287 (this issue).
Zhu, P.C., Jog, V., Otchere, I., 2010. Partial acquisitions in emerging markets: A test of the strategic market entry and corporate control hypotheses. J. Corp. Finance 17, 288–305 (this issue).