

## CHAPTER 29

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# CORPORATE GOVERNANCE AND PRINCIPAL–PRINCIPAL CONFLICTS

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## INTRODUCTION

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Principal–principal (PP) conflicts refer to the conflicts between two classes of principals—controlling shareholders and minority shareholders (Dharwadkar et al., 2000; Young et al., 2008). While principal–agent (PA) conflicts are especially relevant in firms characterized by a separation of ownership and control, PP conflicts are important in firms with concentrated ownership and control with a controlling shareholder (Globerman et al., 2011; Young et al., 2008).

Why do corporations in many parts of the world have a controlling shareholder (La Porta et al., 1999)? An institution-based view of corporate governance suggests that institutions—defined as the “rules of the game” (North, 1990)—are the driving forces behind concentrated firm ownership (Peng et al., 2009; Peng and Jiang, 2010). According to this view, weak formal institutions such as laws and regulations for investor protection result in high ownership concentration (La Porta et al., 1998, 1999). Concentrated firm ownership in combination with weak investor protection is a *root cause* of PP conflicts (Dharwadkar et al., 2000; Young et al., 2008). PP conflicts are often found in emerging and transition economies characterized by concentrated firm ownership and weak institutional support. In developed economies, on the other hand, the predominant corporate governance problems are PA conflicts—defined as conflicts of interest between shareholders (principals) and managers (agents) (Jensen and Meckling, 1976). The PP model brings institutions into the foreground and complements agency theory that has focused on PA conflicts with more attention to institutional conditions (Young et al., 2008).

The argument that institutions matter is hardly novel or controversial, but the debate on *how* institutions matter is far from being solved (Peng et al., 2008). Institutions play a

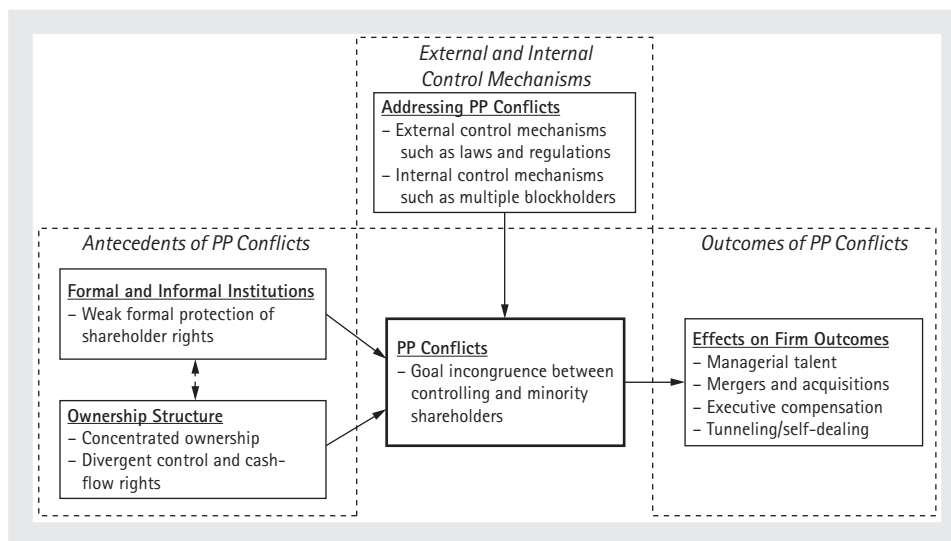


FIGURE 29.1. Causes and consequences of principal–principal conflicts

Source: Adapted from Young et al. (2008: 204).

major role in PP conflicts by directly affecting the incentives of the controlling shareholder to extract private benefits of control—defined as the tangible and intangible benefits from firm control that are not shared with other shareholders (Dyck and Zingales, 2004; Young et al., 2008). Private benefits of control are experienced by minority shareholders as expropriation (Shleifer and Vishny, 1997) and affect firm performance as well as economic development (Morck et al., 2005). Institutions are typically considered external control mechanisms that complement and substitute for internal control mechanisms such as board of directors (Dharwadkar et al., 2000; Walsh and Seward, 1990). The better the external control mechanisms provided by the institutional framework, the less willing or able controlling shareholders are to extract benefits at the expense of other shareholders (Dyck and Zingales, 2004).

Following a call to study how institutions matter (Jiang and Peng, 2011a; Peng et al., 2009; Peng and Jiang, 2010; Peng et al., 2008; Young et al., 2008), this chapter addresses PP conflicts by focusing on three questions. (1) What are the antecedents of PP conflicts? (2) What are the consequences of PP conflicts? (3) How can PP conflicts be addressed? Figure 29.1 illustrates the flow of our arguments.

## PRINCIPAL–PRINCIPAL CONFLICTS


Agency theory assumes that shareholders as principals of the firm share common objectives such as shareholder value maximization. Managers as agents of principals are assumed to be potentially opportunistic actors that may take advantage of dispersed shareholders and extract firm value for their own benefit (Eisenhardt, 1989; Shleifer and

Vishny, 1997). Accordingly, the resulting PA conflicts are addressed by *internal* governance mechanisms such as board of directors and *external* governance mechanisms such as an active takeover market. ~~As a result,~~ different institutional arrangements and ownership structures are not explicitly considered and often assumed away (Lubatkin et al., 2007; Young et al., 2008). The PP model, on the other hand, emphasizes the importance of the institutional environment by referring to institutional conditions as important antecedents of PP conflicts. As such, the PP model acknowledges that many institutional environments do not lend themselves to efficient enforcement of arm's-lengths agency contracts (Peng, 2003; Zhou and Peng, 2010). Consequently, the controlling party cannot effectively transfer firm control to professional managers and therefore must maintain control (Young et al., 2008). This leads to situations in which the classic agency model assumption of separation of ownership and control becomes irrelevant. The controlling shareholder not only owns but also controls the firm, thus shifting the research focus to conflicts of interest between controlling shareholders and minority shareholders.

A related stream of research addresses the multiple governance roles of agents, a perspective known as multiple agency model (Arthurs et al., 2008; Bruton et al., 2010; Filatotchev et al., 2011). The multiple agency model applies to situations in which some agents are connected to more than one principal. For instance, venture capitalists (VCs) on the board of a firm that underwent an initial public offering (IPO) are agents to at least two principal groups: (1) the shareholders of the new public corporation and (2) the investors in the VC fund. These complex interdependencies may result in conflicting choices concerning which principal's interests to serve (Arthurs et al., 2008). Similarly to the PP model, the multiple agency model assumes that different principal groups influence organizational decision-making and have potentially conflicting interests (Arthurs et al., 2008; Hoskisson et al., 2002). The PP model and multiple agency model also differ in some ways. On the one hand, the PP model applies to situations in which a controlling shareholder has both the ability and incentives to influence organizational outcomes (Young et al., 2008). Hence, principals are either directly involved in organizational decision-making or entrust a close associate with this task. On the other hand, the multiple agency model applies to situations in which agents are supposed to protect the interests of different principals (Arthurs et al., 2008). Principals in this model may not be able to effectively monitor their agents' actions. In our earlier example, the VC fund and IPO firm shareholders may be too dispersed to effectively monitor their agents on the board of directors.

## ANTECEDENTS OF PP CONFLICTS

PP conflicts are most likely to emerge from a combination of (1) concentrated firm ownership and control and (2) poor institutional protection of minority shareholder rights (Peng and Jiang, 2010; Young et al., 2008). Concentrated firm ownership is an important internal governance mechanism, whereas institutions are an important external governance mechanism (Gedajlovic and Shapiro, 1998; Walsh and Seward,

1990). The combination of external and internal governance mechanisms determines the effectiveness of a given corporate governance system (Gedajlovic and Shapiro, 1998; Young et al., 2008). For two reasons, concentrated firm ownership is a central construct in the PP model because it is both a root cause and a ~~possible answer~~ to PP conflicts (Young et al., 2008). 

First, concentrated ownership accompanied by weak external institutions is a direct cause of PP conflicts. Agency theory assumes that managers are in quasi-control of the firm—a condition that requires dispersed firm ownership. In many emerging economies, however, ownership and control are concentrated in a controlling shareholder. As such, controlling shareholders are able to use their voting power to decide who sits on the board of directors and who is appointed to the top management team. The resulting internal organizational structure puts the controlling shareholder in a position of ultimate control (Jiang and Peng, 2011b). This powerful internal position provides the opportunities to take advantage of minority shareholders, thus increasing the potential for PP conflicts if the institutional environment does not effectively protect (minority) shareholder rights.

Second, concentrated ownership is also a strategic response by the controlling shareholder to potential PP conflicts when facing weak external corporate governance mechanisms, thus making it an important internal governance mechanism (Peng and Jiang, 2010; ~~La Porta et al., 1998~~; Young et al., 2008). The economic consequences of concentrated ownership are controversial and depend on external constraints such as laws and regulations (La Porta et al., 1998) and internal constraints such as dividend rights that are tightly coupled to control rights (Dyck and Zingales, 2004; La Porta et al., 1998: 1126). The institutional framework can help to create more effective internal constraints by, for instance, imposing regulations that align voting and dividend rights (La Porta et al., 1998). External governance mechanisms, however, do not work perfectly (Jiang and Peng, 2011b). Internal constraints therefore may substitute for external constraints (Gedajlovic et al., 2004; Gedajlovic and Shapiro, 1998). From this point of view, weak institutional protection of shareholder rights is an important reason for the controlling shareholder to remain in control. Hence, controlling shareholders will only diversify their portfolio if they can be assured of sufficient investor protection because otherwise the threat of another party buying up a controlling stake in the firm and extracting private benefits of control is too high.

Interestingly, in countries with strong investor protection, concentrated firm ownership is considered to have positive effects on firm value and performance (Fama and Jensen, 1983). Concentrated ownership structures in these countries—typically found in developed economies such as the United States—give the controlling party enough incentives to monitor firm performance, while external governance mechanisms prevent expropriation of minority shareholders, thus emphasizing the importance of institutions for the protection of investor rights. Sampling firms from eight Asian countries, Jiang and Peng (2011a) report supportive evidence. In Hong Kong, which is characterized by a high level of investor protection, concentrated ownership is *beneficial* to firm performance. But in Indonesia, which is characterized by a low level of

investor protection, concentrated ownership is *detrimental* to firm performance (Jiang and Peng, 2011a).

## CONSEQUENCES OF PRINCIPAL–PRINCIPAL CONFLICTS

PP conflicts manifest themselves at multiple levels of analysis. At the country level, for example, PP conflicts negatively affect capital market developments and standards of living (Morck et al., 2005). At the firm level, PP conflicts directly affect firm performance. As we have shown earlier, PP conflicts emerge from differences in principals' goals and objectives that are not countered by appropriate internal or external control mechanisms (Wright et al., 2005; Young et al., 2008). Different interests among shareholders allow the controlling party to extract private benefits at the expense of minority shareholders. This form of expropriation can be accomplished through legal or illegal means. However, the distinction is not always clear-cut and often a "gray area" (La Porta et al., 2000; Young et al., 2008). Tangible private benefits of control result from real firm resources that are divided unevenly between controlling and minority shareholders. Intangible private benefits of control, on the other hand, involve no transfer of real firm resources.

In this section, we highlight the consequences of PP conflicts in four areas: (1) managerial talent, (2) mergers and acquisitions, (3) executive compensation, and (4) tunneling/self-dealing. The firm-level consequences following from each of these areas can directly affect organizational performance and/or increase operating costs (Bae et al., 2002; Dalziel et al., 2011; Filatotchev et al., 2001).

### MANAGERIAL TALENT

Controlling shareholders—and especially family owners—value intangible private benefits such as the ability to run a major business empire (Gomez-Mejia et al., 2003; Morck et al., 2005). Although the intangible value derived from running a business itself does not extract real assets from the firm, organizational consequences that may impact firm performance are nonetheless likely to occur. In the case of family businesses, successive generations are likely to regress to the mean in terms of managerial talent (Gilson, 2006). Hence, placing unqualified family members or close relatives in control and overlooking better qualified outside professional managers reduces the competitiveness of the firm and harms stock performance (Faccio et al., 2001).

The degree to which intangible benefits affect the ownership structure of corporations depends on the institutional environment (Gilson, 2006). This institution-based

perspective helps us to explain why we can find concentrated firm ownership in countries with strong shareholder protection. The functionally good protection of shareholder rights in many countries characterized by concentrated ownership (e.g. Sweden) should give controlling shareholders a strong economic incentive to diversify their portfolio. However, the intangible benefits of being one of the leading business families in a small economy such as Sweden seem to provide high intangible private benefits that motivate the controlling owners to stay in control (Gilson, 2006: 1666). It seems likely that the limited managerial talent pool puts these firms at a disadvantage, thus creating PP conflicts because minority shareholders cannot access the intangible benefits of running the business empire while at the same time bearing lower firm performance and financial returns.

## MERGERS AND ACQUISITIONS

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Mergers and acquisitions (M&As) are a major strategic decision with different performance consequences for acquiring and acquired firms (Hitt et al., 2005). Recent corporate governance research has identified PP conflicts in M&A deals in both emerging and developed economies. Chen and Young (2010) examine the effects of concentrated government ownership on the stock market consequences of cross-border M&As undertaken by Chinese state-owned firms. They find that the government as a controlling shareholder has political motives to push through deals that are not in the best interest of minority shareholders, thus destroying value for minority shareholders. Political motivations and a lack of effective corporate governance drive many mergers with concentrated state ownership in emerging economies (Chen and Young, 2010). Other studies in the same national context support the position that government ownership creates PP conflicts (Su et al., 2008).

PP conflicts during M&As are not restricted to emerging economies such as China. Interestingly, PP conflicts also affect M&As in developed countries with formally strong investor protection (Goranova et al., 2010). According to agency theory, negative returns to the acquiring firm are attributed to weak governance mechanisms because managers are pursuing their self-interest. The PP model, on the other hand, highlights divergent interests among shareholders. Goranova et al. (2010) show that merger activity with well-diversified institutional investors on both sides of M&A deals results in PP conflicts. Shareholders who hold ownership positions in the acquiring and acquired firms are willing to take a loss in one transaction when their wealth at the aggregate level is increased. Managers of the acquiring firm may still pursue their self-interest (e.g. empire building), but shareholders with overlapping ownership positions are silent about this issue because they still come out positive. Hence, controlling shareholders with a stake in both the acquiring and acquired firms may benefit, while minority shareholders lose out, thus creating PP conflicts from looking the other way and failing to monitor firm management effectively. Controlling shareholders on both sides of the M&A deal may

undertake a related party transaction—defined as a transaction between two parties that established a relationship prior to the M&A deal. Although in many countries related party transactions are not illegal per se, they entail extensive disclosure and approval requirements ~~in many countries~~.

## EXECUTIVE COMPENSATION

The effect of concentrated ownership on executive compensation is another field of potential PP conflicts. Excessive executive compensation is a tangible private benefit of control that transfers real firm resources to top executives of the firm. The quality of internal and external governance mechanisms plays an important role in setting executive compensation (Sun et al., 2010). Su et al. (2010) investigate the effects of ownership concentration on executive compensation in China—a national context prone to PP conflicts. They find a U-shaped relationship between ownership concentration and executive compensation in private Chinese firms. This suggests that low levels of ownership concentration allow managers to set high compensation levels, thus resulting in PA conflicts (Core et al., 1999). High ownership concentration, on the other hand, allows owner-managers to set high compensation levels, thus resulting in PP conflicts that put minority shareholders at a disadvantage (Su et al., 2010).

Other studies have found that ownership structure directly influences the CEO pay-performance link. Sun et al. (2010) highlight how ownership structure and owner identity affects executive compensation. Their study highlights the prevalence of conflicts of interest between different ownership categories, thus creating PP conflicts. For instance, Firth et al. (2006) show that state agencies as majority shareholders in Chinese firms often fail to link pay to performance, thus failing to maximize shareholder value that would benefit all shareholders—including minority shareholders. Linking pay to performance targets seems especially important in state-owned enterprises (SOEs) in emerging economies (Adithipyangkul et al., 2011).

The identity of the controlling shareholder also affects executive compensation. Concentrated family ownership, for example, influences PP conflicts both positively and negatively. Gomez-Mejia et al. (2003) report that family CEOs earn less than non-family CEOs in firms with concentrated family ownership. They reason that family CEOs value intangible benefits from running a business firm. This stewardship orientation of owner-managers has positive effects for the firm as a whole—assuming the family managers are competent.

These positive effects are conditioned on several aspects. First, the family itself can be a source of PP conflicts when they appoint owner-managers who are not qualified to run the business enterprise (Faccio et al., 2001; Gilson, 2006). Stewardship behavior and good intentions cannot compensate for lack of managerial talent. Second, the presence of other family members as large shareholders in the firm can result in mutual monitoring (Combs et al., 2010). Firms with a controlling owner often lack an effective board

and other monitoring devices (Young et al., 2008) so that strategic control by other family members becomes important. Combs et al. (2010) find that family CEOs monitored by multiple family members receive less compensation than CEOs of non-family firms, whereas lone-family-member CEOs typically receive more cash compensation than CEOs of non-family firms. This suggests that, in the absence of mutual monitoring among family owners (an internal governance mechanism), family CEOs extract more firm value, thus potentially creating PP conflicts.

## TUNNELING AND SELF-DEALING

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Tunneling refers to inter-company transfers that favor the company in which the controlling shareholder has a larger equity stake (Johnson et al., 2000; Liu and Magnan, 2011). In the US context, tunneling is typically referred to as self-dealing and must adhere to the highest standard of legal scrutiny (Gilson, 2006). The transfer of resources that benefit the controlling shareholder puts minority shareholders at a disadvantage and is especially severe in times of crisis (Jiang and Peng, 2011b; Johnson et al., 2000). As a result, in the absence of effective minority shareholder protection, corporate valuation suffers (La Porta et al., 2002).

Institutional constraints such as anti-self-dealing regulations not only affect firm performance and valuation, but also country-level equity market developments (Djankov et al., 2008). At the firm level, formal protection through public and private control mechanisms of self-dealing is important to curb opportunistic behavior of controlling shareholders. Private control of self-dealing highlights disclosure requirements and shareholder approval, thus decreasing the risk of expropriation and cost of capital (Liu and Magnan, 2011). In countries with stronger private control of self-dealing regulation, firm value is generally higher. However, the more control and cash-flow rights diverge, the less effective the anti-self-dealing regulations are. These dynamics potentially create PP conflicts (Liu and Magnan, 2011).

## ADDRESSING PRINCIPAL–PRINCIPAL CONFLICTS

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The previous sections have outlined causes and consequences of PP conflicts. In this section we propose two ways to address PP conflicts by focusing on the effects of external and internal governance mechanisms. Investor protection laws and regulations may act as external governance mechanisms to protect minority shareholders (Jiang and Peng, 2011a; La Porta et al., 1998). Additionally, multiple blockholders may act as internal governance mechanisms that help to address PP conflicts (Jiang and Peng, 2011b).



## External Governance Mechanisms

Controlling shareholders are typically considered a *root cause* of PP conflicts (Faccio et al., 2001; Young et al., 2008). This finding is conditioned on external governance mechanisms such as protection by laws and regulations (Jiang and Peng, 2011a; Peng and Jiang, 2010). The incentives for the controlling shareholder to extract private benefits of control are tightly coupled with the corporate governance system in place (Gedajlovic et al., 2004; Gedajlovic and Shapiro, 1998). Institutions can directly affect organizational structure by prescribing a certain organizational form or by providing necessary support for effective internal control structures. For instance, formal institutions may prescribe one-share-one-vote ownership structures and so effectively reduce the ability of the controlling shareholder to expropriate minority shareholders (Faccio et al., 2001; La Porta et al., 1998), thus directly affecting organizational structure. Additionally, the institutional environment is also important in supporting complex internal structures such as an effective board of directors that protects investor rights (Aguilera and Jackson, 2003).

Strong external governance mechanisms (e.g. effective laws and regulations) coupled with effective internal control mechanisms (e.g. low divergence of control and cash flow rights) are consistent with the notion of low private benefits of control and respect for minority shareholder rights. Hence, the level of shareholder protection embedded in the legal and regulatory institutions affects the scale and scope of private benefits of control (Dyck and Zingales, 2004; Jiang and Peng, 2011b). Serious PP conflicts emerge when external and internal governance mechanisms are weak, thus providing the controlling shareholders with ample opportunities to expropriate minority shareholders. The incentives for minority shareholder expropriation may always exist, but these incentives may be particularly high in times of crisis (Jiang and Peng, 2011b).

Given the widely known economic benefits of improving external governance mechanisms (La Porta et al., 1997), one may ask the question why effective external governance mechanisms are not implemented in countries that currently lack effective investor protection. In many countries with currently weak external governance mechanisms, controlling owners often have little interest in improving investor protection laws—a situation known as economic entrenchment (Morck et al., 2005). These controlling owners, often very wealthy families, use their powerful position to influence not only their own private firm, but also public policy. Hence, effective external governance mechanisms may not develop if large parts of a country's economic sector are controlled by an elite of corporate owners who want to preserve the status quo (Morck et al., 2005).

## Internal Governance Mechanisms

Although external governance mechanisms such as laws and regulations are important, they do not work perfectly and often must be supplemented by internal mechanisms. An important internal governance constraint is the presence of multiple blockholders rather than just one controlling shareholder and numerous small shareholders (Faccio

et al., 2001; Jiang and Peng, 2011b). Multiple blockholders are in a position to form coalitions to take actions against the controlling shareholder (Jiang and Peng, 2011b), thus effectively providing internal safeguards. Firth et al. (2006) provide supporting evidence for this claim by showing that private blockholders in Chinese firms link CEO pay to shareholder wealth or increases in profitability, thus better aligning management and shareholder interests.

The most effective internal mechanism to credibly protect shareholder rights seems to be low divergence of voting rights from cash-flow rights. This intuitive argument directly relates to the incentives of the controlling shareholder to expropriate minority shareholders. For instance, the typical controlling shareholder in Europe owns 34.6 percent of shares versus 15.7 percent in Asia, suggesting that controlling shareholders in European firms have fewer incentives to expropriate minority shareholders than controlling shareholders in Asian firms (Faccio et al., 2001: 59).

In systems characterized by weak external but strong internal constraints (e.g. low divergence between control and cash-flow rights), controlling shareholders have a “great incentive to increase firm value” because “one does not steal his own money” (Peng and Jiang, 2010: 255). It is especially in these contexts that firms with a controlling shareholder can build a reputation for respecting minority shareholder rights. For instance, firms can list their shares on a stock exchange with higher formal minority shareholder protection or build a reputation for good firm governance over time (Young et al., 2008). It should be noted, however, that these mechanisms are imperfect and often abandoned in times of crisis (Jiang and Peng, 2011b). More credible signals constitute “groups of firms whose businesses do not lend themselves to intragroup supply transactions” (Gilson, 2006: 1658).

The lack of effective internal governance mechanisms can have several reasons. One often cited reason is managerial entrenchment (Gompers et al., 2003; Morck et al., 1988). Managerial entrenchment generally refers to organizational arrangements that effectively protect company insiders from the market for corporate control or other shareholder interventions (Gompers et al., 2003) and is often caused by large equity holdings by company insiders (Morck et al., 1988). Company insiders with a controlling stake have the necessary means to stay in control even if performance does not meet expectations. Hence, managers with large equity holdings enjoy the private benefits of continued employment while outside shareholders suffer lower shareholder wealth.

## FUTURE RESEARCH DIRECTIONS

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While PP conflicts have received some attention in the management literature, clearly more work needs to be done (Young et al., 2008). In this section, we highlight three key areas that offer promising research opportunities. First, recent corporate governance scholarship calls for more attention to the institutional environment (Aguilera et al.,

2008; Aguilera and Jackson, 2003). Some studies in the tradition of the institution-based view of corporate governance show how *formal* institutions such as laws and regulations affect PP conflicts and minority shareholder expropriation (Jiang and Peng, 2011a). Future studies may turn their attention to how *informal* institutions such as social norms affect PP conflicts (Coffee, 2001).

Second, future research may also deepen our understanding of how the identity of the controlling shareholder affects PP conflicts. A natural starting point in this endeavor is family ownership and control as the dominant ownership form in many parts of the world. Two family firm issues warrant closer attention: (1) making the transition from family to professional management and (2) informal inheritance rules.

The transition of family firms to non-family or professionalized firms is a critical period in the life of family firms (Gedajlovic et al., 2004; Zahra and Filatotchev, 2004). From a PP perspective, outside investors may benefit from professional managers since managerial talent in the family is limited. However, several factors seem to impede the transition to professional firms in many parts of the world. Most prominent among these factors are institutional conditions (e.g. lack of formal institutions to establish arm's-length contracts with professional managers) and cultural values (e.g. trust toward outsiders). Future studies may investigate how governance mechanisms can support professional outside management even if formal institutions are weak (Young et al., 2008) and trust toward outsiders is lacking (Zhang and Ma, 2009).

Future research may also pay attention to the informal rules that influence succession in family firms cross-nationally. The two primary ways to handle family firm successions around the world are *coparcenary*—defined as an inheritance system that divides the business equally among successors—and *primogeniture*—defined as inheritance by one (often male) successor (Chau, 1991). We have a relatively underdeveloped understanding of how these informal rules affect PP conflicts. For instance, succession according to the coparcenary principle in (overseas) Chinese firms has been identified as a major source of intrafamily rivalry that increases the chances of break-up or diversification of the family firm (Chau, 1991; Fukuyama, 1995). More studies are needed to gain a better understanding of how governance arrangements can protect minority shareholders during the turbulent succession period.

Finally, research may also pay closer attention to potential collaboration among large shareholders (i.e. blockholders). Mutual monitoring associated with multiple blockholders prevents the controlling shareholder from diverting firm resources for private use (Young et al., 2008). This argument assumes that shareholders act independently. Some evidence, however, suggests that shareholders form coalitions to influence firm outcomes (Bennedsen and Wolfenzon, 2000; Zwiebel, 1995). Future research may investigate (1) the antecedents that lead to the formation of shareholder coalitions as well as (2) the effects that these shareholder coalitions have on PP conflicts.

## CONCLUSION

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This chapter contributes to the corporate governance literature by going beyond the usual “institutions matter” proposition and tackling the harder but also more interesting question of how institutions matter (Peng et al., 2009, 2008). Specifically, we have argued that weak institutions and concentrated firm ownership are a root cause of PP conflicts and shown how PP conflicts affect organizational outcomes in four management areas: (1) managerial talent, (2) mergers and acquisitions, (3) executive compensation, and (4) tunneling/self-dealing.

So why should researchers and practitioners turn their attention to the emerging view of PP conflicts? PP conflicts can help managers, investors, and policymakers to create better governance structures. Agency theory’s assumption that principals pursue a common goal—often defined as shareholder value maximization—leaves out findings showing that divergent principal interests can affect monitoring effectiveness and firm performance (Young et al., 2008). For policymakers, the PP perspective holds important implications during times of institutional transition (Peng, 2003). Corporate governance solutions for emerging and transition economies need to pay more attention to the institutional environment than the agency model can provide (Globerman et al., 2011; Lubatkin et al., 2007). Adopting policies designed for developed economies may be less effective and even counterproductive when this call is ignored (Young et al., 2008). For instance, abolishing concentrated firm ownership without reforming the institutional conditions, including effective law enforcement, is prone to create a “governance vacuum” that supports unchecked managerial opportunism (Filatotchev et al., 2003; Young et al., 2008). Therefore, the creation of effective institutions becomes a priority for policymakers in countries facing institutional transitions.

An institution-based view of corporate governance has emerged in the literature. The PP model is one of the frameworks used to understand how institutions influence the relative payoffs of powerful firm insiders such as controlling shareholders and affiliated managers. Compared with the traditional PA model, the PP model is relatively new in the corporate governance literature, but the phenomena of PP conflicts are certainly not new. In conclusion, if research is to keep up with practice, it seems imperative that corporate governance researchers pay more attention to PP conflicts in the 21st century.

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