The Theory and Application of Multinational Corporate Governance

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CHAPTER 1

Introduction

Multinational corporations (MNEs) originated from the seaborne trade in the colonial period before the Industrial Revolution. The Dutch East India Company, founded in 1602, can be considered the world's first MNE. As their operation and management span two or more countries, MNEs are also known as transnational enterprises, international firms, supernational enterprises, and cosmo-corporations.

MNEs are a telling sign of trade globalisation. Recent centuries have witnessed the rise of MNEs successively in Europe and America, Japan and South Korea, and China. European and American MNEs dominated the global market until the 1950s when Japanese companies started to globalise. In the 1970s and 1980s, many South Korean companies also began to grow their global presence. After 2000, MNEs from emerging markets appeared on the global stage, and there was exceptionally robust growth in companies from emerging markets, represented by China, after the 2008 global financial crisis. These companies continued to expand their global reach and scale up their operations, and 124 companies based in mainland China and Hong Kong recorded the enviable achievement of being listed in the 2020 Fortune Global 500, exceeding the 121 companies from the US. The rise of Chinese MNEs has become a major driving force of global economic growth and technological advances.

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As globalisation has accelerated, MNEs, born during the early evolution of the modern economy, have become the main engine of the global economy, technical advancement, and product innovation, playing a pivotal role in the world economy and the global technological revolution. However, MNEs are also often embroiled in financial fraud and corporate scandals. The Enron financial fraud scandal and the BP oil spill left the world in deep shock. Such scandals not only taint the reputation of the home country but also cause economic or environmental loss to the host country and ultimately impede globalisation. Therefore, MNEs should improve corporate governance and organisational innovation from the inside as regulatory systems are enhanced from the outside. As increasing numbers of MNEs from emerging markets, such as China, India, and Brazil, step into the spotlight, the new industrial revolution led by informatisation closes the gap between developed and emerging countries, thus intensifying their competition. Meanwhile, as COVID-19 runs rampant globally, populism and deglobalisation have resurged, and protectionism and unilateralism exert negative impacts on the world economy. The world is facing a period of major change unlike anything seen since World War II. Achieving sustainable development in this context is a test of a company's management and governance abilities.

We argue that corporate governance is a major challenge that many MNEs face due to the sophistication of MNEs and the complexity and significance of this issue in an overseas context. Compared to typical domestic companies, MNEs feature a greater diversity of cultures, shareholders, and employees. Institutions are nested and isomorphic with each other at multiple levels. Diverse institutions and cultures, a broader range of stakeholders, and more severe information asymmetry make governing MNEs more complex than general companies. Sound multinational governance is therefore of great importance for MNEs. Multinational corporate governance has been extensively studied from the perspectives of institutional theory (DiMaggio & Powell, 1983; Scott, 1995), stakeholder theory (Freeman, 2010), upper echelons theory (Hambrick & Mason, 1984), and signal theory (Spence, 1973). These studies have laid a good foundation regarding the object, level, and content of study; however, they are fragmented and lack a systematic outlook. To benefit MNE governance, we call for theoretical innovation to break free of the limitations of business globalisation theories and enhance governance analysis and studies, which is also this book's purpose.

This book is divided into nine chapters. This chapter introduces the development and governance framework of MNEs and presents the book's structure. Chapter 2 reviews the generation and development of MNEs, outlines the system of concepts and theoretical framework for multinational corporate governance studies, and lists the field's connotations, research progress, and main research questions. Chapter 3 presents the theoretical framework for multinational corporate governance. We review the principal-agent theory, stewardship theory, stakeholder theory, and corporate system theory in relation to the multinational corporate governance and arrive at the characteristics of the multinational corporate governance and the theoretical basis and research framework for studying the topic. Chapter 4 introduces the network governance framework for MNEs. In summarising the literature on multinational corporate governance, we find that most studies ignore that an MNE exists as a network organisation. From the perspective of network governance, this chapter elaborates on the governance of network nodes (parent company and foreign subsidiaries), governance of network relationship (parent-subsidiary and subsidiary-subsidiary relationship), and governance of external factors (host and home country institutions, international organisations, and other external stakeholders), thus forming a comprehensive MNE network governance framework. Chapter 5 covers the governance of foreign subsidiaries of MNEs. This chapter reviews and comments on the internal and external governance of foreign subsidiaries and the governance of the relationship between foreign subsidiaries and the parent company. Chapter 6 investigates the relevance of institutional and cultural distance to MNE governance. This chapter first establishes a three-level (macro-meso-micro) framework to describe factors affecting MNE governance, discusses the relationship between institutional and cultural distance and multinational corporate governance, and further discusses the relationship between institutional and cultural distance and the governance of Chinese MNEs. Chapter 7 addresses institutional gaps and Chinese MNEs. This chapter first discusses the influence of institutional deficit and institutional surplus on the selection of outward foreign direct investment (OFDI) location, host country, and equity entry mode in multinational corporate governance. It then analyses the relationships between the gaps in formal and informal institutions, the overseas equity governance of Chinese MNEs, and the performance of Chinese overseas listed companies. Chapter 8 covers the governance structure and mechanism of Chinese MNEs. This chapter first discusses and analyses the governance structure of Chinese MNEs, including shareholder governance, board governance, TMT governance, and stakeholder governance, and then discusses and analyses internal and external aspects of the governance mechanism of Chinese MNEs. Chapter 9 identifies the approach to and characteristics of the multinational governance of Chinese MNEs. This chapter tracks the history of and research developments in Chinese corporate multinational governance and analyses five aspects of the evolution of the Chinese corporate multinational governance approach: multinational motivation, host country selection, entry mode selection, parent-subsidiary governance model, and governance structure. The end of the chapter summarises the theoretical framework for MNE governance proposed in this book.

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CHAPTER 2

MNEs and Multinational Corporate Governance

In the wake of the major geographical discoveries of the fifteenth century, the world became more connected. Cultural and trade exchanges multiplied, colonialism and trade liberalism appeared in succession, and a unified global market finally took shape. All countries and regions became part of an international system for the division of labour.

Today, as economic globalisation deepens, economies around the world are becoming more mutually dependent. MNEs have accelerated economic globalisation, which has allowed the MNEs to expand their global reach and improve their competitive edge by creating favourable conditions for the release of market forces. MNEs have undergone different stages of development during the process of economic globalisation. MNE governance theory, the study of applying corporate governance theory to MNEs, has also taken shape. Its theoretical bases are mainly MNE and corporate governance theories. This chapter tracks the history of MNEs against the backdrop of economic globalisation, elaborates on MNE theory developments, and proposes new priorities for MNE research.

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2.1 MNE Development and Theoretical Research

2.1.1 The Emergence and Development of MNEs

Globalisation is one of the most important features and trends of the world economy today. Economic globalisation, which accelerated in the 1990s, is primarily an economic process of interaction and integration, and it involves how countries and people correlate with, influence, and restrict each other in politics, culture, technology, military endeavours, security, ideology, lifestyle, and values. There are ten general aspects of globalisation: technology, economics, politics, law, management, organisations, culture, ideology, interpersonal communications, and international relations. Economic globalisation facilitates the allocation of resources and production factors across the globe, the flow of capital and products, the spread of technology, and the economic development of less-developed regions. It represents progress in human development and is an irresistible trend of the global economy.

As technology advances and countries become more interdependent, MNEs play an increasingly important role in the global economy. Economic globalisation presents an excellent opportunity for MNEs, driving economic growth as vital entities in international trade, finance, economic, and technical cooperation and competition. As a new corporate form emerging against the background of globalisation, MNEs coordinate resources across the globe to create maximum value. It is fair to say that they are an inevitable result of globalisation.

Any change in their development, especially strategic adjustments and restructuring, dramatically influences the international market or the global economy. Since the 1990s, MNEs have been shifting from capital-intensive businesses to knowledge- and technology-intensive businesses, from manufacturing to services, and from hardware to software, which has induced the adjustment and cross-border transfer of industries worldwide. While giving full play to the core business, they also intervene in upstream and downstream businesses to secure control over core technologies. MNEs transfer or localise downstream technologies to restructure their business. By setting up foreign subsidiaries, they are able to bypass many barriers and rapidly identify local market needs. They can make full use of local resources and reduce production and trade costs through internal transactions, facilitating production, circulation, and consumption on a global scale and thus bringing about economic globalisation of practical significance. Therefore, MNEs are the carriers and driving force of economic globalisation.

Globalisation started in the fifteenth century when advanced capitalist countries in Europe sought to expand sea trade routes. Emerging in the age of discovery, MNEs have come a long way since the advent of the East India Company in 1600. Generally, their history can be divided into three stages: chartered companies, modern MNEs, and new-era MNEs.

2.1.1.1 Chartered Companies

A chartered company is a type of corporation that emerged during the mercantilist period in the seventeenth and eighteenth centuries. It enjoyed a trading monopoly granted by the sovereign authority of a state in an overseas colony of the state. After discovering the 'New World' of the Americas, Western European countries started colonial trade, and chartered companies replaced individual traders. A chartered company was often incorporated under a royal charter that granted it an exclusive monopoly in a trade destination. Such companies also assumed certain administrative functions and could even make war. For example, the East India Company was founded by Queen Elizabeth I of England to compete with the Netherlands for superiority in international trade. The company started the Battle of Plassey in India in 1757 and gradually encroached into India's territory. By 1820, India had been entirely colonised by Great Britain. Several other chartered companies were also famous at this time, including the Royal African Company, Hudson's Bay Company, and the Dutch East India Company. Chartered companies primarily engaged in trading and shipping, and although they gradually expanded into finance, most focused on transporting raw materials, which suggests that they were trade organisations in essence. Manufacturing was generally limited to small workshops in Western Europe, and the absence of the factory system and mass production made it impossible to build a multinational manufacturing chain. The theory of comparative advantage developed by David Ricardo explains why chartered companies emerged. According to this theory, even when a country has an absolute disadvantage in all goods, it still can benefit from exporting to another country as long as it has a relative cost advantage.