

AN INTEGRATED ANCIENT CHINESE PHILOSOPHICAL PERSPECTIVE ON CORPORATE GOVERNANCE

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Abstract

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Although the concept of corporate governance began with the emergence of corporations, the concept of governance can be traced back to ancient China. Currently, discussions of this topic focus mainly on the differences between approaches to and theories about corporate governance and examine their effectiveness, an integrated view that draws on Chinese theories and cultures is missing. This paper attempts to address the gaps by conceptually synthesizing insights from ancient Chinese philosophies to construct an integrated framework; it further defines the legal and ethical constraints while incorporating both an ancient Chinese (i.e., Eastern) philosophical perspective and Western governance elements and both national-level and firm-level variables. Drawing on institutional theory (Scott, 1995, 2004, 2008a, 2008b) and considering the interaction of legal and ethical constraints, a model — the ethical-legal model — constructs and categorizes corporate governance approaches into four types driven by different types of institutions and compares how these approaches are related to different governance perspectives (agent, stewardship and stakeholder). An autonomous (*Wu Wei*) governance approach is triggered when the cognitive institution is formed as a result of high levels of both legal and ethical constraints and drives autonomous corporate governance with a shift in focus from compliance to commitments.

Keywords: Institutional theory, Corporate Governance, Legal Constraints, Ethical Constraints, Natural Dao, Human Dao, Wu Wei Autonomous

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1. INTRODUCTION

Although corporate governance is a recent issue, the concept has existed since the introduction of large-scale trade and the need for responsibility in the conduct of commercial activities. Corporate governance was first developed into a subject of academic research in the United States after

the Second World War and became prominent with the publication of the Committee on the Financial Aspects of Corporate Governance (1992). In the field of corporate governance, the discussion has been centered around the agent problems caused by the separation of ownership and control, such that managers may not always act in the interest of shareholders (Bhimani, 2008). La Porta et al. (1997;

1998; 2000; 2002) developed a “law and finance perspective” and extended their research beyond the firm level to the national level by including country-specific variables, namely the degree to which shareholders’ rights are defined and protected by law, thus specifically addressing another agency conflict between controlling and minority shareholders. Davis et al. (1997) introduced the stewardship perspective which contracts the agent view of corporate governance and stated that managers act as stewards of the resources entrusted to them by stakeholders and thus are responsible for acting in the stakeholders’ best interest. An institution-based perspective also has been developed in consideration of the institutional factors impacting corporate governance and the differences across markets and regimes (Haxhi & Aguilera, 2017; Meyer & Peng, 2016). Other research has focused on corporate governance and its correlation with stock price (Gompers et al., 2003), the roles of the board of directors, executive compensation and shareholder activism (Bebchuk et al., 2009), and stakeholders’ perspectives of corporate governance (Stout, 2012; Edmans, 2020). However, the majority of the research has focused on the debate over optimal theories, the effectiveness of different approaches, and governance elements in different contexts; no consensus has been reached, and an integrated view is missing.

In China, corporate governance has received increasing attention over the past few decades, along with the country’s economic development and transformation. As China has grown to become the second-largest economy in the world, the underlying mechanism of governance and issues faced by Chinese corporations have elicited significant interest among researchers. Currently, the research on corporate governance in China can be divided into two streams. The first stream of research has focused on identifying quantifiable measurements of the effectiveness of a Chinese firm’s corporate governance effectiveness and how these variables affect a firm’s financial and stock performance, and the second has attempted to identify how Chinese-specific institutions shape and improve the corporate governance system (Liu, 2006). However, many important issues remain unaddressed, and no available consolidated theoretical model can integrate the different constraints and promote effective corporate governance.

Additionally, China is undergoing a unique transition from a planned economy to a market-oriented economy and lacks a sound institutional infrastructure with a well-structured legal system, rigorous law enforcement, and well-functioning financial markets (Liu, 2006). These limitations have made it difficult to copy the Western governance structure in the context of an effective governance model for China. However, the majority of the studies on this topic have attempted to view Chinese empirical findings through the lens of Western theory and from a Western perspective (Jiang & Kim, 2015), whereas a framework and view that integrates Chinese theory and culture are lacking.

Accordingly, this paper attempts to address current gaps in research on corporate governance by conceptually synthesizing insights from ancient Chinese philosophy and constructing an integrated framework. It is one of the first attempts to employ

Chinese theory to propose a governance framework that explains corporate governance issues by asking “*How can managers be controlled and directed?*”, rather than the conventional perspective, which explains corporate governance by asking “*How can managers control or direct their subordinates?*”. An integrated model that considers the interaction of different approaches involving both national-level factors and firm-level variables is advocated. The model is rooted in ancient Chinese governance philosophy and incorporates Western governance elements. Drawing on institutional theory, this paper categorizes corporate governance approaches into four types under different types of institutions and reviews how it correlates with different corporate governance perspectives, including the agent, stewardship, and stakeholder perspectives. It shows that an autonomous governance approach can be triggered by situational features — namely high levels of both legal and ethical constraint — and thus form the cognitive institution and drive self-regulating corporate governance behavior with a shift in focus from compliance to commitments and a change in the role of a manager from agent to steward and, finally stakeholder.

The study is divided as follows. The paper proceeds with a review of the literature on governance, the uniqueness of Chinese corporate governance, and governance from the perspective of ancient Chinese philosophy in Section 2. Section 3 constructs the integrated framework, categorizes governance approaches, and makes propositions. Section 4 presents a discussion and theoretical and practical implications, and Section 5 concludes the paper and offers thoughts on future research.

2. LITERATURE REVIEW

2.1. Corporate governance and governing approaches

Corporate governance is not clearly defined, different definitions of the concept provide unique perspectives. Shleifer and Vishny (1997) defined corporate governance as the ways through which suppliers of finance (i.e., shareholders) assured that they would receive a return on their investment, while Gillan and Starks (1998) took a broad perspective and defined corporate governance as a system of laws, rules, and factors that control a firm’s operations. According to the Organization for Economic Cooperation and Development (OECD), “Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders, and other stakeholders, and spells out the rules and procedures for making decisions in corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance are set as well” (1999, as cited in Arjoon, 2005, p. 343). Based on the definitions, direction, and control together form the two cornerstones of a governance system (Hopt, 2011).

Leaving aside the complexities of the definition of corporate governance, theoretically, the definition of a firm serves as the fundamental aspect of

corporate governance, resulting in the use of different approaches to support the governance cornerstones of direction and control. Should a firm be viewed as a “nexus of contracts” negotiated among self-interested individuals, or as a “legal entity” with the same rights and responsibilities as a natural person (Bradley et al., 1999)? Differences in the understanding of the nature of a firm have fostered two corporate governance theories: contractarianism, which focuses on a legal approach, and communitarianism, which emphasizes an ethical approach. From the perspective of contractarianism, contractual relationships among different stakeholders of the firm are emphasized and the purpose of the firm is to minimize the cost of trading through a nexus of contracts that govern trade activities involving the contracting parties (Coase, 1937). Under contractarianism, managers act to maximize the shareholders’ interests and thus maximize their own compensation. Nevertheless, contractual incompleteness is inevitable and often considered to be caused by language ambiguity, inadvertence, uncertainties, disputes, precontracting intentions, measurability issues, and the verifiability of contract terms and outcomes (Schwartz, 1992; Bradley et al., 1999). Additionally, a contract signed by two parties might result in negative effects on a third party. Furthermore, as contractarianism places too much emphasis on economic efficiency, achievements in terms of social welfare may be neglected (Kuttner, 1999). In contrast to contractarianism, communitarianism is rooted in humanism (Wagner, 1995). From this perspective, organizations are considered with their social identifications such that their social responsibility outweighs economic efficiency (Kuttner, 1999). Communitarians consider corporate activities to be justified by the fulfillment of societal needs rather than by pure economic productivity (Etzioni, 1996). In a corporate setting, communitarians believe that corporate managers, beyond their responsibility to the primary shareholder group (Clarkson, 1995), play a social role: the managers are accountable for all the firm’s stakeholders, including its employees and business partners, such that commitments are enhanced through trust and an ethical climate, in contrast, contracts yield only compliant behaviors (Kelman, 2017).

For centuries, studies have placed too much emphasis on comparing these theories to identify differences between them and produce endless “either-or” debates. Iwai (1999) was the first to make a fresh attempt to end this debate by claiming that corporations are real entities with their own will and purpose to fulfill in society, Iwai further claimed that a corporation bears a dual role in the legal system as both a “person” who owns corporate assets and enjoys certain rights and responsibilities, and a “thing” that is owned by the shareholders through a nexus of contracts. As a result, corporations not only exist in the province of law but also play an ethical role in society. Coffee (2001) discovered that although Scandinavian countries have very low crime rates, their legal system is similar to a civil law system that protects the investor to a lesser degree than a common law system (La Porta et al., 2000). Consequently, he suggested that legal and social norms are intertwined such that the impact of social norms

may be strongest when the law is weakest (Coffee, 2001). The aim of this paper is also to end the debate between contractarianism and communitarianism by exploring the inner coherence of both approaches from the perspective of ancient Chinese philosophy. A return to the fundamentals indicates that the two approaches are simultaneously consistent and complementary. When contracts are illusory, clan and trust-based control is necessary. The legal approach never opposes the ethical approach, rather, the former can be adopted in the latter, serving as a vehicle to ensure distributive justice and equity from payoffs to contracts. By nature, both approaches serve as means of control and direction, the two cornerstones of corporate governance.

2.2. The unique corporate governance in China

Although there are different approaches to corporate governance, good governance employs certain mechanisms that ensure an adequate return on investments for finance suppliers and can be broadly separated into internal and external focuses (Liu, 2006). Generally, the internal mechanism includes the ownership structure, executive compensation, board of directors, and similar aspects, while the external mechanism is composed of the market and legal infrastructures. China, as a large, socialist, and market-oriented economy (Yang et al., 2011) is endowed with certain unique internal and external mechanisms, which have imposed certain challenges in attempts to adopt the Western corporate governance model. These main differences encompass three aspects, as described below.

First, China’s concentrated state ownership has led to an agency problem that differs from that in Western countries. In China, unity of ownership and control is not a problem, as government agencies contribute assets to state-owned enterprises, and thus, the government naturally has input into asset utilization and management operations (Clarke, 2003). Consequently, Chinese enterprises face a horizontal agency problem that lies mainly between controlling and minority shareholders, whereas the classical agency problems in Western corporations are vertical conflicts between managers and controlling shareholders (Zou et al., 2008; Jiang & Kim, 2020).

Second, state ownership and the transition from a planned economy to a market-oriented economy have set a strong political backdrop for Chinese corporate governance. Even after decades of privatization and reforms, approximately one-third of the shares of listed firms are still owned by the central or local governments (Yang et al., 2011). This percentage was as high as 84% at the end of 2001 (Qiang, 2003) and around 50% at the end of 2009 (Yang et al., 2011). Regarding internal governance, Liao et al. (2009) reported that 13.9% of the independent directors of listed firms were politically connected. In a contemporaneous sample of approximately 790 newly partially privatized firms, 27% of the chief executive officers (CEOs) previously or currently were government officials (Fan et al., 2007), and even the managers were government agents whose appointments were controlled by administrative and communist party bureaucrats (Firth et al., 2006). Regarding external

governance, Chi et al. (2011) discovered a strong political connection between acquiring and target firms in merger and acquisition activities. In addition, large banks in China are state-owned, which makes it difficult for them to provide effective governance to borrowers, and to sacrifice financial interests for social and political interests (Tian & Estrin, 2007).

Third, the legal environment is improving overall but remains weak (Liu, 2006) and lacks a truly independent judicial system (Allen et al., 2005). According to La Porta et al. (1998), China's shareholder rights protection indicator score is only 3, compared with an average of 3.61 for all transition economies. The Chinese market has been widely criticized for lacking a sound legal framework and effective law enforcement (Allen et al., 2005; Pistor & Xu, 2005; Liu, 2006; Kato & Long, 2006; Zou et al., 2008). Specifically, in China, intermediary institutions such as law firms and accounting firms normally operate only with permission from the government instead of responding to market demands (Clarke, 2003), legal institutions such as courts tend to hear very limited securities-related claims (Supreme People's Court of the People's Republic of China, 2003), and enforcement of the Chinese Securities Regulatory Commission's (CSRC) rules regarding corporate governance are often challenged as insufficiently grounded in legislation (Sheng, 2001; Tang, 2001). In addition, the corporate governance code in China, like some other regulations such as company law, contains broad and vague language, describes only guiding principles (such as the duty of loyalty, *zhongshi*), and lacks explicit regulations (Clarke, 2003; Jiang & Kim, 2015). As a result, the capacity of Chinese institutions goes beyond the legal aspect and includes other dimensions to ensure the effectiveness of corporate governance.

Empirically, research has demonstrated that certain features mentioned above have hampered effective corporate governance in China. Chen et al. (2004) discovered that politically connected firms underperformed in the 3-year post-IPO (initial public offering) stock return by 30% compared with the average, while politically connected CEOs focused more on political goals than on enhancing shareholders' values. Similarly, Fan et al. (2007) discovered that the 3-year post-IPO stock returns of newly partially privatized firms with politically connected CEOs were 18% lower than those of firms without political connections. Liang et al. (2016) suggested that the relationship-based culture of China makes outside directors ineffective. Other factors such as strong political connections between governments and listed firms and the lack of truly independent judicial systems also have affected the effectiveness of corporate governance instruments in China (Yang et al., 2011). As Liu (2006) commented, "When the legal system is incomplete and law enforcement is weak, and when business is closely connected to politics, the effectiveness of the conventional governance mechanisms, even though they are squarely in place, might also be greatly compromised" (p. 431). Consequently, it is crucial to consider China's uniqueness and develop an appropriate governance model that reflects its culture and leverages Chinese theories.

2.3. Governance from the perspective of integrated ancient Chinese philosophies

China, a country with over 5,000 years of civilization, is endowed with rich governance philosophies ranging from Confucianism, which focuses on governing with benevolence, virtue, and rites, to Legalism, which emphasizes governing by the rules of law, and Daoism, which advocates the idea of "do nothing", i.e., allowing the natural unity of humanity and heaven. Over more than 2,000 years of development, the Chinese traditional culture has yielded rich connotations that provide insights into the study of modern governance. Accordingly, the past must be made to serve the present, and Chinese wisdom must be made to serve the world, to enhance the development of the theoretical literature on governance.

Daoism, a philosophy indigenous to China, arose as a secular school of thought around 500 BC when fundamental spiritual ideas started to emerge in both the East and West. The primary concepts focus simply on *Dao*, which refers to the "way", and *Wu Wei*, which is understood to mean "no deemed action". In terms of governance, *Dao* offers the tool, while *Wu Wei* indicates how to use it.

Daoism integrates Confucianism and Legalism from the perspective of "*Dao-Way*" governance; it shares the same origin as ancient Confucianism and serves as the origin of Legalism. Confucianism has inherited dialectical thought from Daoism and forms its ideology, from which the governance concepts of benevolence, virtue, and rite were developed. Ban Gu described in the *Yi Wen Zhi* in the *Book of Han* that Confucianism was initiated by the officers of Situ (a key government position in ancient China), who helped the ruler to govern and educate the people to behave according to natural law and is also venerated in six scriptures that focus on benevolence and justice, following the *Dao* from ancient Rao and Shun (1955, as cited in Zhu, 2010). From this perspective, Confucianism and Daoism can be easily understood as being integrated such that the *Dao* serves as the inner essence of governance, while benevolence (*Ren*), virtue (*De*), and rites (*Li*) are the outer manifestations.

Similarly, as Legalism concretizes the governing concept of Daoism, the law can be viewed as a manifestation of *Dao*. When introducing Ming Law, Guan Zhong clearly demonstrated in *Guan Zi Ren Fa* that a ruler's major responsibility is to ensure an open, wise, and just *Dao* (2004, as cited in Chen, 2021). Later, Han Fei emphasized in *Han Feizi* that wise ruler should select talents according to *Fa*, the concretized *Way* as indicated in Daoism, instead of self-recommendation and should measure contribution according to *Fa* instead of self-estimation (Fei, 2019). *Han Feizi* epitomized the central thought, focusing on *Fa* as the core and integrating *Fa-Law*, *Shu-Techniques*, and *Shi-Power* to achieve governance (1997, as cited in Denecke, 2010). At the beginning of the Four Classics of Huangdi, *Dao* is clearly described as having given birth to *Fa*. *Fa Zhe* (the ruler) utilizes *Fa* to regulate people's behavior and to guide them in discerning right from wrong (2007, as cited in Xiaohui, 2021).

3. RESEARCH FRAMEWORK AND PROPOSITIONS

3.1. Defining good governance

Firms are situated in a business community that involves all relevant participants in the corporate structure, including employees, suppliers, and customers. As a result, the corporation does not only involve shareholders, and the purpose of a corporation should involve protecting not only the shareholders' interests but also the stakeholders' interests to achieve sustainable development. The stakeholder perspective of corporate governance incorporates business communities, the political environment, laws and regulations, and the market (Gillan, 2006). Consequently, effective corporate governance goes beyond a firm's balance sheet and moves towards a broad perspective that seeks the best outcomes for stakeholders and is never content to merely avoid trouble. This perspective includes identifying a vision, developing a strategy, selecting and supporting leadership to deliver the strategy, and assuring corresponding progress, stewardship of resources, and guardianship of safety and quality. All of these steps are completed to the highest standards of probity and transparency, resulting in good financial and social performance.

3.2. Different *Dao* in corporate governance

"The *Dao* gives birth to the One. The One gives birth to the Two. The Two give birth to the Three. The Three gives birth to the ten thousand things. The ten thousand things are bolstered by *Yin* and weird *Yang*. Together they harmonize as Breath" (Laozi, 2014, Chapter 42). *Dao* is the basis and origin of everything and forms an expanse that constitutes the realm in which humans live, work, and play. Good governance can be achieved by leveraging all types of *Dao* (e.g., human *Dao* and natural *Dao*) and different types of *Dao* can complement each other. Confucianism is infused with human *Dao* (i.e., ethical constraints) as the ethical way of living, while natural *Dao* (i.e., legal constraints) is akin to the constancy of sciences, institutions, and regulations.

Legal constraints are rooted in the philosophy of Legalism and mainly serve to minimize agent problems via a viable socio-political system that allows individuals to pursue selfish interests exclusively in ways that benefit the state. As a result, a proper governance system allows officials to benefit from their ranks and emoluments while effectively preventing them from exploiting the resources or subverting the power of rulers by using governance tools such as laws and institutions, rather than morality (Pines, 2014). In the context of corporate governance, national legal protections and corporate regulations serve as *Fa* to guide overall cooperate behavior; governance structures, including certain capital structures, board composition, and managerial compensation, serve as *Shu* and can be leveraged to manage controls; and *Shi* defines the ownership and hierarchical power that is determined by the distribution of the share-holding percentage of the firm. Together, these factors aim to prevent unlawful conduct, emphasize rules, and apply increased monitoring and penalties to enforce these

rules. They focus on preventing people from doing bad things by manipulating the costs of misconduct.

Ethical constraints share concepts with Confucianism, focusing on *Ren*, *De*, and *Li* as the cornerstones of the ethical system that supports the governance philosophy of the ethical governance approach. *De* serves as the core of ethical governance and describes the basic character of a governor only if he or she has cardinal virtues and can contribute to the development of the society (Cheng, 2004). From this perspective, *De* is a crucial characteristic of corporate leaders. *Ren*, an internal moral quality, contributes directly to behaviors that can benefit others and form a personality full of power, attraction, and cohesion (Lu, 2021). As a result, *Ren* reflects an individual's morality level. *Li*, which has a literal definition of "propriety", refers to the proper context in which the order and sequence of a relationship are carried out (Lu, 2021). Hence, at the national level, *Li* reflects the overall level of education, while at the organizational level, it reveals the ethical climate. Both of these contexts jointly influence the level of ethical awareness, which forms an integral part of human *Dao* governance. The better understanding of *Li*, the higher the level of ethical awareness. Together, *Ren*, *De*, and *Li* are directed toward the achievement of responsible conduct and the infusion of ethics in business practice. They focus on internalized commitments and are rooted in individual and communal values.

Confucianism indicates endogenous prerequisites to a reliance on ethical constraints (human *Dao*) for effective governance: namely, each individual must behave properly accordingly to *De*, which sounds ideal but explains why *Qin* relied on Legalism, rather than Confucianism, to unify China. As recorded in the *Book of Lord Shang* humane people can treat others with kindness but cannot make people kind to others; just people can share love with others but cannot make people love others (Shang, 2019). Termes (1995) concludes that the imposition of codes of ethical conduct cannot guarantee the ethical functioning of a financial institution; rather, companies can be ethical if people are ethical (Treviño et al., 1999). Without a common understanding of etiquette and a certain climate of organizational ethics, it is difficult to leverage an ethical approach to achieve effective governance. Hence, with pure humanity, it is not sufficient to govern with only an ethical approach. As a result, the imposition of legal constraints (natural *Dao*) to ensure effective corporate governance is the first step towards regulating corporate behavior and correspondingly improving compliance. Empirical studies have shown that the law and its enforcement together are essential for corporate governance and finance (La Porta et al., 1997, 1998; Shleifer & Vishny, 1997). When investors' rights are enforced, investors tend to finance firms; however, when the legal system fails to protect investors' rights in contracts, corporate governance, and external finance are unsatisfying (La Porta et al., 2000). Hence, *Proposition 1* is as follows:

Proposition 1: Legal constraints (natural Dao) which are formed by Fa, Shu, and Shi have a positive impact on effective corporate governance, which is reflected in both financial and social performance.

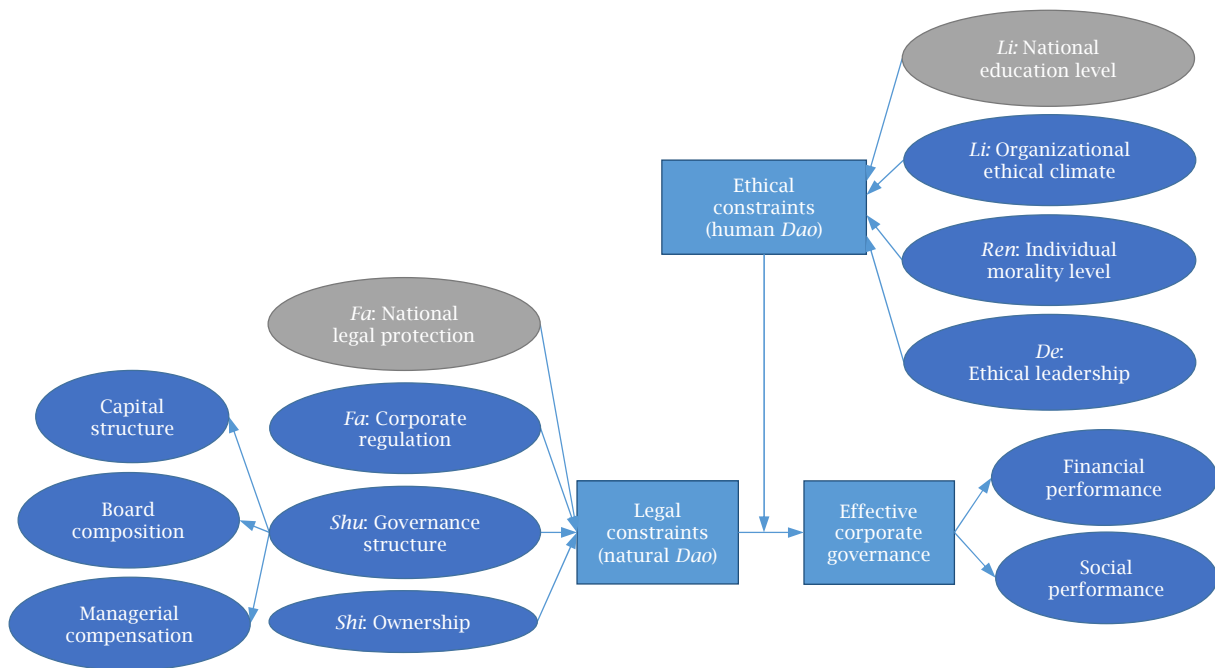
3.3. An integrated framework: The interaction and complementation of different forms of *Dao*

Confucius once said, if people are led by laws and governed by punishment, they will try to avoid the punishment but have no sense of shame; if they are led by morals and affected by rules of propriety, they will have a sense of shame and will become good (Yang, 1980). From the legal perspective, researchers have established that companies can file misleading accounting statements in a completely compliant manner without violating generally accepted accounting principles, a situation that makes it difficult to rely on legal compliance mechanisms to achieve corporate governance (Arjoon, 2005). France et al. (2002) also discovered several reasons why the leveraging of laws to regulate companies is difficult and ambiguous, such as the sophisticated nature of financial concepts, which are difficult for juries to follow; the many tricks used by executives to avoid taking responsibilities; and the applicability of criminal law only to extreme cases, whereas in practice, the majority of cases of violation are difficult to

prosecute. As a result, the mechanism of legal compliance is far from adequate as it lacks moral strength and the ability to build trust inside the organization (Arjoon, 2005). Accordingly, ethical constraints (human *Dao*) are needed to directly address concerns about relationships and build trust within and outside the company at the fundamental level. The legal and ethical constraints interact with each other to ensure effective corporate governance. At the national level, legal protection and education pave the road for good governance. At the firm level, good governance can be achieved through either legal constraints (natural *Dao*) or ethical constraints (human *Dao*). As a result, the study proposes the framework shown in Figure 1, which incorporates both legal constraints and ethical constraints and involves national and firm-level factors that predict effective corporate governance. *Proposition 2* is also presented as follows:

Proposition 2: Ethical constraints strengthen the legal constraints on effective corporate governance, which are reflected in both financial and social performance.

Figure 1. Framework to predict effective corporate governance, which incorporates legal constraints and ethical constraints



3.4. Different institutions, different perspectives, and different governance approaches

Drawing on institutional theory, institutional elements include legal regulations, rules, norms, and even beliefs, and institutions can be classified into three types: regulative, normative, and cultural cognitive (Scott, 1995, 2004, 2008a). Regulative institutions “stress rule-setting, monitoring, and sanctioning activities” (Scott, 2008b, p. 428), while normative institutions “introduce a prescriptive, evaluative, and obligatory dimension into social life” (Scott, 2008a, p. 54) and cognitive institutions emphasize the “shared conceptions that constitute the nature of social reality and the frames through

which meaning is made” (Scott, 2008a, p. 57). From this perspective, these institutions are different forms of *Dao*: legal constraints are regulative institutions, while ethical constraints are normative institutions. The three types of institutions “differ in the bases of order, motives for compliance, logics of actions, mechanism, and indicators employed” (Scott, 2008b, p. 429). When the level of legal constraints is high, the rationale for claiming legitimacy is to be legally confirmative to avoid punishment, and individuals’ behavior follows a “have-to” motivation; when the level of ethical constraints is high, an individual feels morally obliged to be compliant and has an “ought-to” motivation. High levels of both legal and ethical

constraints lead to the formation of cognitive institutions, which are built upon deeper beliefs and driven by a “want-to” motivation. This circumstance triggers autonomy, enabling the different types of *Dao* to be internalized and proactively followed; accordingly, the autonomous governance approach, *Wu Wei* develops, and little or no external reinforcement, monitoring, or interference is needed to ensure effective governance. Therefore, this study considers the interaction of legal constraints with ethical constraints and proposes the ethical-legal (E-L) model (Figure 2), which enables the categorization of corporate governance approaches into four types, and presents Proposition 3.

- Type 1 refers to poor governance, characterized by low levels of both legal and ethical constraints. This category includes firms such as Enron, Satyam, Cadbury, Walmart, and Xerox, which tend to exploit investors’ interests and harm society by engaging in non-compliant corporate behaviors. Poor corporate governance can lead to issues such as corruption, negligence, fraud, and lack of accountability.

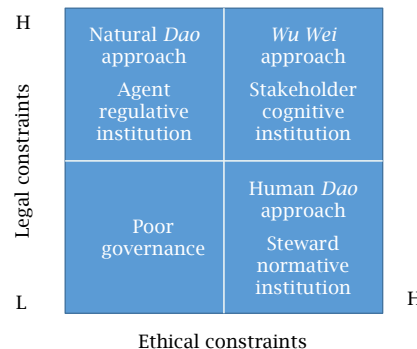
- Type 2 refers to firms that take a natural *Dao* approach, emphasizing legal but not ethical constraints. This is consistent with the agent theory approach to corporate governance, which targets the reduction of agent costs by imposing internal controls via regulative institutions and extrinsic motivations to regulate agents’ opportunistic behavior (Jensen & Meckling, 1976; Davis et al., 1997). Hence, the natural *Dao* approach views managers as “agents” for principals and regulates the managers’ behaviors when their motivations for individualistic utility cause principal-agent interest divergence. The main drawback of this approach is the lack of attention given to external sociological and psychological factors; it emphasizes compliance only in terms of corporate governance while neglecting commitment. However, these external factors affect the organization and the effectiveness of governance in subtle ways that have strong impacts.

- Type 3 includes firms that leverage a high level of ethical constraints and a low level of legal constraints to drive effective governance, this is known as the human *Dao* approach. As discussed above in subsection 3.2, this approach requires pre-conditions to function effectively. Alone, the human *Dao* approach may not bring effective corporate governance. Francis (2000) described the connection between governance and ethics: “Corporate governance, as a term, has come to imply good, in the non-moral as well as the moral sense. Its non-moral applications include efficient decision-making, appropriate resource allocation, strategic planning, and so on. In its moral sense, good corporate governance has come to be seen as promoting an ethical climate that is both morally appropriate in itself, and consequentially appropriate in that ethical behavior in business reflected in desirable commercial outcomes” (p. 9). From this perspective, the human *Dao* approach is consistent with the stewardship perspective of corporate governance, which views managers as stewards who are motivated to act in the best interest of shareholders (Donaldson & Davis, 1991) via structures or elements that direct, facilitate and empower rather than monitor and control (Davis et al., 1997). Given that individuals are so diverse, there are different perceptions regarding how individuals’ and

shareholders’ needs are met. The stewardship perspective relies on normative institutions and intrinsic motivations in a way that “utilities gained from pro-organizational behavior is higher than the unity that can be gained through individualistic, self-serving behavior” (Davis et al., 1997, p. 25). It also fills a gap in corporate governance issues beyond the economic perspective, which cannot be resolved using the agent perspective if alignment cannot be achieved through regulative institutions. When the natural *Dao* approach (agent perspective) and human *Dao* approach (stewardship perspective) complement each other with high levels of both legal and ethical constraints, the Type 4 approach is born.

- Type 4 refers to firms that adopt the *Wu Wei* approach, characterized by high levels of both ethical and legal constraints. *Wu Wei* is another key concept used to explain how to govern from a Daoism perspective. The *Wu Wei* approach leverages both intrinsic and extrinsic motivations and relies on cognitive institutions to govern the behavior of the management team; as it helps to achieve deeper levels of cognition and belief, firms can self-regulate their behavior to minimize misconduct while maximizing benefits to both the firm and society. *Wu Wei* does not mean “doing nothing”; rather, it implies that *Dao* is embedded subtly in 10 thousand things in the universe, and thus there is no need to interfere. Because *Dao* exists in everything at an unconscious level but cannot be fully known, it is crucially important to follow *Dao* and adjust actions accordingly. As Sun Yat-Sen remarked: “The world’s great trend is vast and turbulent, and those who follow the trend will prosper, those who go against the trend will die” (1916, as cited in Wang, 2003, p. 10). Applying *Wu Wei* to corporate governance provides a route to autonomous governance driven by the “flow”, which is also known as the internalized *Dao*. The *Wu Wei* approach shares the insights indicated in the stakeholder perspective, such that the individuals in an organization can affect or be affected by the achievements of the organization’s objectives (Freeman, 2010). Under this circumstance, shared value is created among different stakeholders, including managers, controlling shareholders, minority shareholders, and even society, their interests are fully aligned, and their motivations for autonomous governance and self-leadership behavior are empowered by a belief that “one’s work extends beyond the formal reward system and relates to the importance of shared organizational vision” (Davis et al., 1997, p. 28).

Figure 2. E-L model to corporate governance



Proposition 3: When the levels of both legal and ethical constraints are high, the Wu Wei approach fosters autonomous corporate governance, with lower costs of governing and better governance effects than those afforded by other approaches, resulting in enhanced financial and social performance.

4. DISCUSSION

The trend towards the convergence of corporate governance approaches has been developing with little notice. Globalization brings new perspectives on corporate governance because it directs corporations to homogenize their governance standards globally rather than solely focusing on national performance criteria in their country of origin (Ping & Andy, 2011). Additionally, in the digital age, data are being transformed into a value-generating; consequently, data governance and data management have become part of the scope of corporate governance and are of crucial importance to both firms and their boards of directors in terms of improved decision-making and strategic positioning (Karger, 2023). From this perspective, theoretically, it is essential to consider a general guideline and focus on the underlying commonalities instead of differences; practically, the development of an autonomous governance mechanism by leveraging ethical constraints to complement legal constraints is necessary.

Theoretically, this paper makes several contributions to the literature on corporate governance and other aspects. First, it is one of the first papers to apply Chinese theories to corporate governance in consideration of the idiosyncrasies of corporate governance in China. Second, it is one of the first works to create a consolidated view of corporate governance that integrates Chinese theories and Western governance elements. It proposes an integrated framework to drive effective corporate governance by utilizing both legal constraints formed by *Fa* (legal protection), *Shu* (techniques and governance structure), and *Shi* (ownership) and the ethical constraints formed by *Li* (national education level and organizational ethical climate), *Ren* (individual morality level), and *De* (ethical leadership). Third, this paper extends the literature on the institutional theory of corporate governance and categorizes corporate governance approaches into four types with consideration of the types of institutions involved. When the levels of both legal and ethical constraints are high, a cognitive institution is formed and individuals in corporations can self-regulate their behavior and move towards autonomous governance, which is characterized by high compliance and high commitment. Finally, this paper enriches the body of research on corporate governance from the agent, stewardship, and stakeholder perspective by linking these perspectives with different corporate governance approaches and types of institutions. With the development of an autonomous governance approach under cognitive institutions with strong ethical and legal constraints, a manager's role shifts from that of an agent to that of a true stakeholder for shareholders when agency costs are minimized.

Practically, this paper, first of all, offers implications that to ensure effective governance in China, it is necessary to leverage ethical constraints

where the legal infrastructure is weak, and the institutional capacity in China goes beyond legal aspects to cover social and economic dimensions. Second, this paper provides a theoretically sound framework for firms and policymakers to integrate different levels of corporate governance practices as they contribute to better firm performance (Mutlu et al., 2018).

First, improving investor protection is crucial for corporate governance. As proposed in Figure 1, policymakers at the national level must enhance investor protection by perfecting the law (*Fa*) to a desired standard (Coffee, 1999; Gilson, 2001). At the firm level, the management team can rely on functional convergences resulting from decentralized, market-based activities (e.g., mergers and acquisitions) to adopt strict investor protection regulations as new corporate standards (La Porta et al., 2000; Coffee, 1999; Gilson, 2001). From this perspective, overseas investors in Chinese firms, instead of merely seeking the advantage of ownership, location, and internalization (OLI), may consider the adoption of stricter investor protection practices to be equally important.

Additionally, few studies have explored the importance of adequate education for both policymakers and business practitioners as a means to ensure effective corporate governance. First, according to Cadbury (2002), "corporate governance is a process" instead of a state, therefore, it must also change in response to new demands and challenges in the modern business environment. As a result, continuous, appropriate education for stakeholders in this process (including employees, management, shareholders, auditors, or even members of firms' audit committees) is essential to enable learning from the best practices in corporate governance and the acquisition of new skills and knowledge to improve management. Second, as indicated in the first chapter of *Doctrine of the Mean* that what heaven confers is called nature; accordance with nature is called the way; cultivating the way is called education (2007, as cited in Qi, 2014). Education is an important way to enhance common awareness and thus avoid misconduct and enhance the common understanding of *Li* in society, a crucial aspect of fostering internalized accountability and intrapreneurship for corporate governance.

Furthermore, at firm levels, a focus on the dimensions of the organization's ethical climate, ethical leadership, fair treatment of employees, and open discussion of ethics may be most useful in terms of corporate governance (Treviño et al., 1999). On the individual level, enhancing employees' role in corporate governance is of crucial importance because corporations are formed by individuals, and each individual's behavior affects corporate behavior. Corporate leaders can work with organizations to foster a solid ethics system wherein employees can increase their involvement and learn about ethical values and socially responsible behavior, rather than simply learning the required job skills (Nguyen & Yeh, 2022). In such a case, employees would be increasingly willing to provide valuable advice and even to make concessions during periods of economic or financial distress (Bradley et al., 1999). Armed with necessary ethical values and awareness, employees can participate in mutual monitoring (i.e., cross-checking between

teams) to deter opportunism, impel managerial action, and facilitate power-sharing instead of domination (Fukao, 1995) with the goal of improving the effectiveness of governance.

Last but not least, humans are not only rooted in economic rationality (Davis et al., 1997) but are also “self-actualizing”, in other words, humans are also endowed with self-fulfilling desires, while the economic view suppresses their aspirations (Argyris, 1973). Both the basic and higher-order needs listed in Maslow’s (1970) hierarchy should be considered. Practitioners must focus on both legal and ethical constraints regarding corporate governance issues within an organization. Strengthening ethical constraints is instinctive. Hence, it can mitigate weak aspects of legal constraints while activating self-regulating behavior in the context of strong legal constraints, allowing movement toward autonomous governance and the discovery of genuine commitment. Under this circumstance when firms start to self-regulate their behavior, governance and agency costs may decrease and profits may increase.

5. CONCLUSION

Despite the above-listed contributions, this paper is not without limitations. First, empirical studies will require further identification and development of the measures of governance elements, as proposed in Figure 1. Second, survey methodology, a case study, and even second-hand data could be used to further explore and verify the proposed mechanism, framework, and propositions. Third, it would be

interesting to use longitudinal data to uncover how different governance approaches impact firm performance and whether a shift to autonomous governance would positively impact firm performance. Additionally, further testing of the framework in different cultures and economies would expand the generalizability of the study and thus add value. Last but not least, family-owned businesses are unique and involve informal family constitutions that bypass legal institutions; therefore, further study is needed to integrate these informal family constitutions (Ulrich, 2023) into the proposed framework to predict effective governance.

Corporate governance relies on a balance between the number of regulations, the cost of implementation, and social responsibility. It also serves as a pathway for companies to achieve sustainability (Agbata et al., 2022). Governing a firm is like flying a kite, the string should be held neither too loosely nor too tightly. If the string is held too loosely, the kite will fly away; if it is held too tightly, it will break more easily. Similarly, corporate regulations that are too loose foster adverse effects and governance issues, whereas regulations that are too tight can affect business activities (Ping & Andy, 2011) by imposing extra unnecessary costs. Holmstrom and Kaplan (2003) stated that “the greatest risk facing the U.S. corporate governance system is the possibility of overregulation” (p. 8). Therefore, moving towards a proactive, autonomous, and stakeholder agenda for corporate governance is necessary, and the discussion here is just the beginning.

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