Chapter

Agency Theory and Internationalization: A Critical Assessment of Literature

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Abstract

This study consolidates the state of academic research using agency theory to explain the various phenomena's in the multinational firm's (MNCs) context. Based on the systematic review of the literature, the author finds that agency theory is used to examine the degree of internationalization, international diversification, born global internationalization, and governance issues in various modes of foreign entries. The author classifies the literature in three broad themes: corporate governance, firm ownership, and born global firms. Agency theory is also used to examine the impact of top management characteristics, board structure, ownership by domestic investors, foreign investors, business group firms, family ownership, and state ownership on the firm internationalization decisions. The study concludes with the research gaps and future research directions.

Keywords: Agency Theory, Internationalization, Systematic Review, Ownership, Top Management Team, Board of Directors

1. Introduction

The last three decades have witnessed explosive research on the corporate governance of multinational firms (MNCs). The performance of MNCs is based on four commonly held arguments in the literature. First, MNCs can achieve economies of scale with their knowledge of specific asset exploitation at a larger scale [1]. Second, the internalization of the activities within the firm reduces the agency problem in the MNCs [2, 3]. Third, MNCs can get financial resources at the lowest possible cost in the international market [4, 5]. Finally, MNCs have strong corporate governance mechanisms to maximize the firm value [6, 7]. Earlier studies in the international business literature have been more concerned with the internalization theory to efficiently control the resource allocation to minimize the transaction cost [8]. Buckley and Strange [8] called for use of the agency theory to understanding the governance issue in the MNCs with the inclusion of the strategic and behavioral aspects of the various stakeholders in the different country contexts.

This study reviews the literature on MNCs using the agency theory. The author finds that agency theory is used to examine the degree of internationalization, international diversification, born global internationalization, and governance issues in various modes of foreign entries. Agency theory is used to analyze the impact of top management characteristics, board structure, ownership by domestic investors, foreign investors, business group firms, family ownership, and state ownership on the firm internationalization decision. Board internationalization and diversity impact the internationalization decision of the firms. TMT internationalization is positively related to the accounting quality of the MNCs. High competition in the international context mitigates the agency cost incurred by reducing the CEO's opportunistic actions and the CEO pay structure is also used to mitigate the agency cost in MNCs. The ownership structure of the MNCs has a strong impact on MNCs strategic actions. Ownership by institutional owners is positively related to firm internationalization due to their active monitoring and international experience. Foreign corporate and institutional ownership was also found to be positively associated with firm internationalization. State ownership has an interesting set of two agency conflicts and has scope for empirical examination.

Further section discusses the article's selection and review strategy. Descriptive analysis of the articles provides information regarding the year-wise, context-wise, journal wise and methodology-wise description of the reviewed articles. Further, the author synthesizes the finding from the literature review and provides an integrated discussion. The final section of the paper discusses the research gaps and future research agenda.

2. Literature review strategy and sample selection

2.1 Review method

This study uses a systematic literature review to integrate the existing literature on agency theory advancement in the context of international business. The systematic method of the literature review was proposed by Tranfield et al. [9] in medical science literature, to overcome the criticism of the traditional literature review. A traditional literature review involves the subjectivity and bias of the researcher. The main objective of the systematic literature review is to identify research key contributions in a field and descriptively present and discuss them.

There are two important steps in the systematic literature review:

- Define the inclusion criterion of the primary studies
- Identify data sources and selection of studies

2.1.1 The inclusion criteria

This study uses the following criteria to include review articles:

- The study should use agency theory to explain the internationalization phenomenon
- This study only includes peer-review journal articles to ensure the quality of literature
- This study includes articles published in "B" or above category journals according to ABDC journal ranking. This ensures the quality publications toward the theoretical advancement of the phenomenon.

2.1.2 Study selection and data source

This study uses Business Source Ultimate of the EBSCO database to find the relevant articles. The focus of the study was on top ranked international business journals. EBSCO includes all the top ranked journals in the field of international business which includes top international business journals indexed in Web of Science or Scopus databases. The author uses a combination of the keywords: agency and internationalization to find the relevant articles. The search using these keywords in title, abstract, and author keyword in the database yielded a total of 132 articles. Further, the author removes duplicate and below B category journal articles (as per ABDC ranking) and finds 59 articles for further use in the study. The author read the abstract and the introduction of these 59 articles whenever required to find relevant studies. Finally, the author finds 24 relevant articles that meet the objective of the study. **Table 1** lists all the review studies with journal name, the theory used, country or context, method (qualitative/ quantitative), and analytical techniques.

3. Findings and discussion

3.1 Descriptive analysis

This section discusses various descriptive characteristics of the review articles. There is an increasing trend of publication of studies using agency theory to study MNCs. **Figure 1** shows an increasing trend of using agency theory in the context of firm internationalization after 2010. **Figure 2** shows that review studies are published in various management journals. The highest number of publications from the sample studies are from the International Business Review and Journal of Business Research. Most of the sample studies have integrated agency theory with the resource-based view, resource dependency theory, and institutional theory (see **Table 2**). Firm internationalization is a complex process and requires more than one theory to explain the underlying phenomenon. Most of the articles are based on a single institutional or country context (see **Figure 3**). Most of the articles are empirical and primarily use a diverse set of quantitative techniques (see **Table 3**).

3.2 Corporate governance and agency theory

As per the agency perspective, the divergence of interest between the principal and agent causes opportunistic behavior by agents to maximize their utility and reduces the shareholders' value [34]. Firms use several governance mechanisms to mitigate agency costs such as monitoring by the board of directors [35], and high ownership by outsiders [36]. There exist internal as well as external mechanisms to control the agency problem [25]. Internal governance mechanism is such as CEO compensation alignment with the shareholders' value maximization [37]. The external mechanism is market control such as the threat of takeover, and competition in the labor and product market [38]. Further, this study divides the literature into various themes.

3.2.1 Board of Directors (BOD)

BOD has the roles of managing the top management's hiring to firing, providing information and network resources, and assisting top management to decide

Author	Publication Title	Theory	Context	Quantitative/ Qualitative	Analytical Method
Chen et al. [10]	International Business Review	Agency Theory, RDP	Taiwan	Quantitative	Panel Fixed Effect
Toledo et al. [11]	Journal of Business Research	Agency Theory, RBV	Mexico	Quantitative	Partial correlation
LiPuma [12]	Journal of Business Research	Agency Theory	USA	Quantitative	OLS
Singla et al. [13]	Journal of Business Research	Agency Theory, RBV	India	Quantitative	GLS Random Effect
Mersland et al. [14]	International Business Review	Agency Theory, RBV	73 developing countries	Quantitative	SUR
Dauth et al. [15]	International Business Review	Agency Theory, UEP, Human capital theory	Germany	Quantitative	Pooled OLS
Elosge et al. [16]	International Business Review	Agency Theory, IBV, and UEP	Germany	Quantitative	3SLS-GLS
Hooghiemstra et al. [17]	International Business Review	Agency Theory	Denmark, Finland, Norway, and Sweden	Quantitative	OLS
Doherty and Alexander [18]	European Journal of Marketing	Agency Theory	UK	Qualitative	Case Study
Saeed et al. [19]	Cross Cultural & Strategic Management	Agency Theory, RDP	China and India	Quantitative	Tobit
Zhou et al. [20]	Management Decision	Agency Theory, IBV	China	Quantitative	Logit
Sanders and Carpenter [21]	The Academy of Management Journal	Agency Theory, Information-processing theory	USA	Quantitative	OLS, Logit, Poisson
Zahra [22]	Corporate Governance: An International Review	Agency Theory		Conceptual	
V. Z. Chen [23]	Corporate Governance: An International Review	Agency Theory, RDP	USA	Quantitative	Probit
Cuervo-Cazurra et al. [24]	Journal of International Business Studies	Agency Theory		Conceptual	
Filatotchev and Wright [25]	Journal of Management Studies	Agency Theory, Internationalization theory		Review	

Author	Publication Title	Theory	Context	Quantitative/ Qualitative	Analytical Method
Tihanyi et al. [26]	Academy of Management Journal	Agency Theory, FDI theory	USA	Quantitative	Hierarchical linear
Chang et al. [27]	European Financial Management	Agency Theory	USA	Quantitative	OLS, Poisson, Negative Binomial
Gaur and Delios [28]	Management International Review	Agency Theory, IBV	India	Quantitative	GLS Random Effect
Ray et al. [29]	Global Strategy Journal	Agency Theory, SEW	India	Quantitative	GLS Random Effect
Benito et al. [30]	Journal of Management Studies	Agency Theory, RBV, and IBV	Norway	Quantitative	GLS Random Effect
Shi et al. [31]	Journal of International Business Studies	Agency Theory, IBV, and Bonding theory	USA	Quantitative	Probit
Tsao and Chen [32]	Asia Pacific Journal of Management	Agency Theory	Taiwan	Quantitative	GLS Random Effect
Tsao and Lien [33]	Management International Review	Agency Theory	Taiwan	Quantitative	GLS Random Effect

Note: RDP (resource dependence perspective), RBV (resource-based view), IBV (institution-based view), UEP (upper echelon perspective), FDI (foreign direct investment), SEW (socioemotional wealth), GLE (generalized least square), OLD (ordinary least square), SUR (seemingly unrelated regression), 3SLS (three stage least square).

Table 1.
Review articles description.

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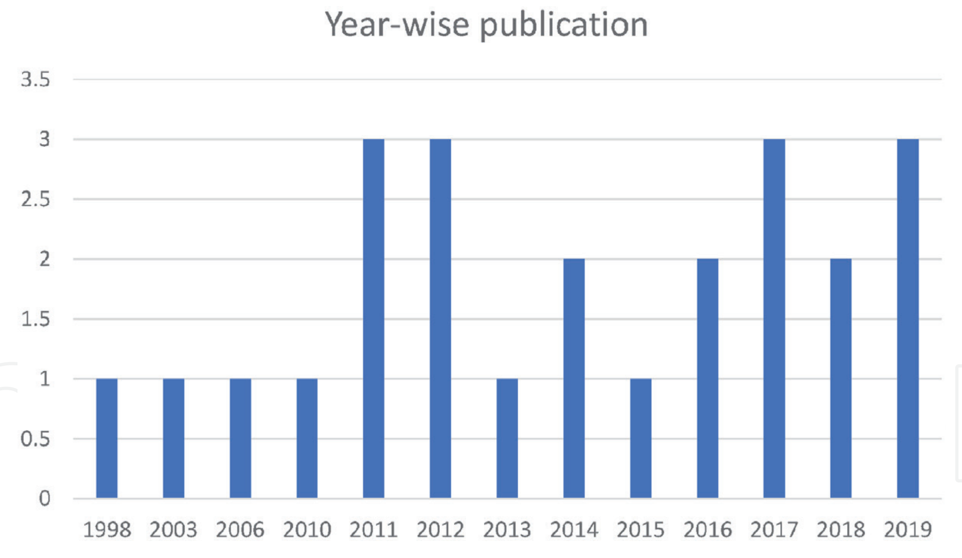

Figure 1.
Year-wise publication trend in sample studies.

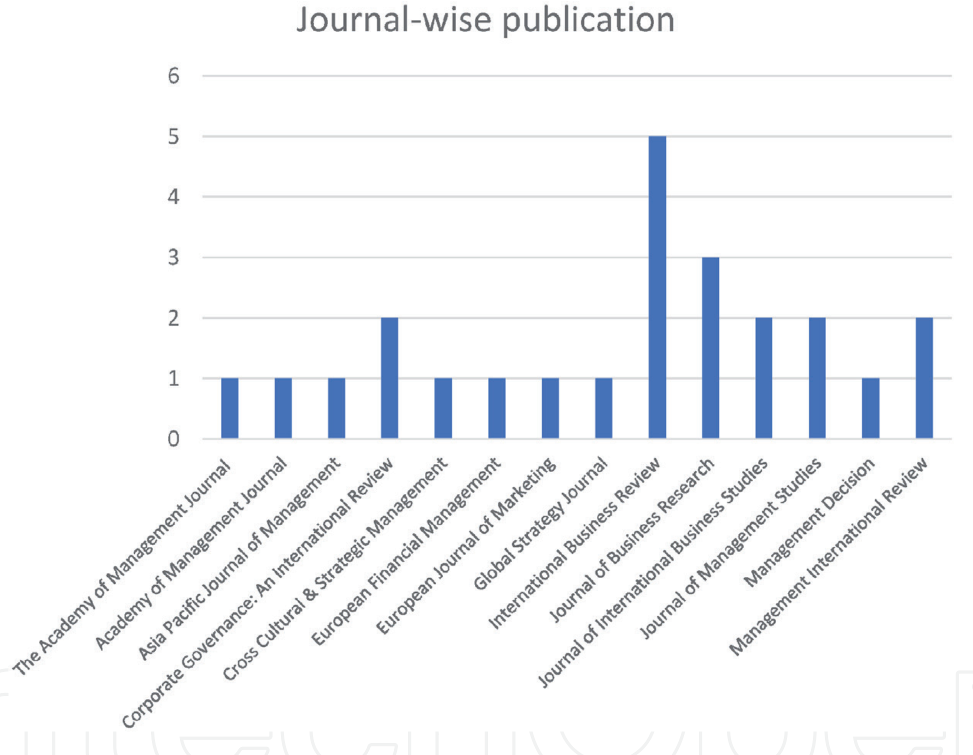

Figure 2.
Journal-wise publication trend in sample studies.

the firm strategy [17]. Various studies have found the link between the board composition and characteristics with firm internationalization decisions such as diversification, innovation, and acquisition [25]. Hooghiemstra et al. [17] studied the impact of board internationalization on the monitoring quality of the board. They proposed that the internationalization of the board make communication difficulties due to language and culture difference. This impacts the perception of the individual director toward earning management. Board internationalization cause difficulties in the understanding of accounting laws of the host nation and reduce the quality of monitoring. Foreign directors are found to be less influenced by management. The lack of country-specific accounting knowledge and a language barrier in the board meeting causes less effective monitoring which causes high earning management.

Theory Used	No of Articles
Agency theory	8
Agency theory, RBV	3
Agency theory, RDP	3
Agency theory, SEW	1
Agency theory, Internalization theory	1
Agency theory, FDI theory	1
Agency theory, Information-processing theory	1
Agency theory, IBV	1
Agency theory, IBV	1
Agency theory, IBV, and Bonding theory	1
Agency theory, IBV, and UEP	1
Agency theory, RBV, and IBV	1
Agency theory, UEP, Human capital theory	1
Grand Total	24

Table 2.
Theory used in the sample studies.

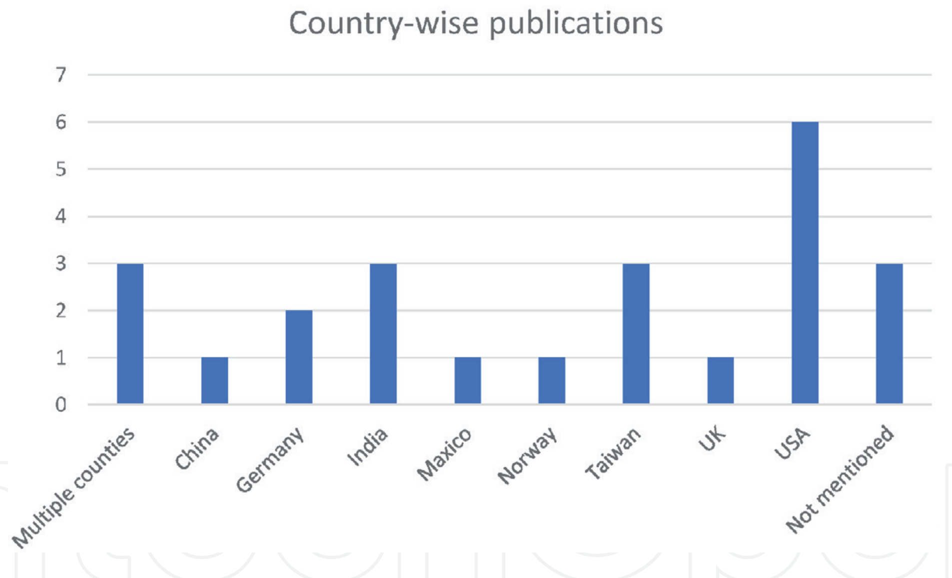

Figure 3.
Context-wise publication trend in sample studies.

Board diversity is also an emerging issue in the governance literature. Saeed et al. [19] studied the impact of ownership on women's presence on the board in the emerging economies context of India and China. They found that women's presence on the board is negatively related to the family and state ownership in the firm. Firm internationalization has a positive impact on the independence of the female BOD. As per the resource dependence theory [39], the presence of female directors motivates the female employee in the firm and increases the legitimacy of the firm in the international context. The diverse board provides a pool of skills and knowledge to make a better decision [19]. In the emerging economies context, board diversity has different implications as compared to developed economies. Emerging economies have weak legal protection, less defined property rights, and

Research Method	No of Articles
Qualitative	1
Quantitative	20
Conceptual and Review	3
Analytical Technique	**No of Articles**
3SLS-GLS Regression	1
Case Study	1
GLS Random Effect Regression	4
Hierarchical Regression	1
Logit Regression	1
OLS Regression	4
Panel Fixed Effect	1
Panel Random Effect	2
Partial correlation	1
pooled OLS	1
Probit Regression	2
SUR Regression	1
Tobit Regression	1

Table 3.
Research method used in the sample studies.

the infrastructure is also not well developed. State-owned firms have high government influence due to top management appointed by the state. The politics in the male-dominated arena of the emerging economies hurt the selection of the female members on the board [19].

The independence of the directors from the top management team reduces the cost of an agency. The independent director has the human and social skills to influence the firm internationalization decisions [26]. Chen et al. [10] examine a sample of US manufacturing firms and find that directors' independence provides appropriate resources and information's in multinational firms. Integrating agency theory with the resource dependence view, they argue that independent directors possess international experience in the specific industries with the interlocking ties which increase firm willingness to internationalize.

3.2.2 Top management team (TMT)

The agency theory is used to explain the divergence of interest between the top management team (as agent) and shareholders (as principals). Agency theory literature is well developed to explain the actions and behavior of the TMT and the opportunistic decision by the managers to maximize their benefits [16]. Internationalization increases competition in the industry from the domestic as well as foreign multinational firms. This increased competition increases the TMT focus on the decision to improve the firm value and reduce the agency conflict [27].

CEO (chief executive officer) pay structure is used to mitigate the agency problem by aligning the owner-managers interest. In the international business context, a contingent pay structure of the CEO can increase her/his effort in managing the complexity and get the rewards [25]. Higher and Long term based CEO pay can reduce the agency cost and increase information processing in the multinational context [21]. Elosge et al. [16] examined the role of CEO succession on the German firm's internationalization. They combine agency theory, institutional theory and upper echelons approach to identify CEO succession influence on internationalization decisions. They find that CEO succession leads to higher firm internationalization. The new CEO tries to peruse the legitimacy and try to maximize the personal benefit by international diversification. This positive impact is reduced after a threshold of the CEO changes due to the disturbance caused in the firm's management. Finally, they found an inverted-U-shaped relationship between CEO succession and internationalization.

Dauth et al. [15] integrated upper echelons perspective, agency theory, and human capital theory to examine the impact of TMT internationalization on accounting quality. They found that TMT internationalization improves the accounting quality and the effect size is small in the case of CFO (chief financial officer) internationalization compare to CEO. TMT internationalization help in coping with the complex accounting standards and reduce the incentive to exert earning discretion.

3.3 Ownership and agency

Existing studies show that the ownership structure of the firms influences the firm's decision-making and behavior of risk-taking [40]. Emerging economies firms also face the principal-principal agency issue [41, 42]. Heterogeneity of the strategic preferences among the institutional investors is established in the existing studies [26, 40, 43]. This section reviews the studies using agency theory to establish the link between the ownership structure and internationalization decisions.

3.3.1 Domestic ownership

Domestic ownership includes ownership by domestic individuals, corporates, and institutions. Singla et al. [13] examined the role of domestic corporate ownership on internationalization. This corporate invest in the other firms and form a cross-holding and pyramidal ownership structure. This improves the relative competitiveness of the firm in the home market by reducing the supply and demand uncertainty and providing access to resources. Tihanyi et al. [26] study the impact of institutional ownership on the US firm's international diversification. They find that institutional investors (professional investment funds and pension funds) have a long-term interest in the firm and they effectively monitor the manager's action due to their large ownership. The long-time horizon and risk-taking behavior of the institutional investors increase the focal firm's international diversification.

Zhou et al. [20] integrated agency theory with the institution-based view to understanding the relationship between institutional ownership and cross-border acquisition success in Chinese firms. They find that institutional ownership improves firms' governance quality and acquisition success. They are more informed to evaluate the cross-border acquisitions decisions by the firms and their large shareholding incentives to monitors the other shareholders and managers active in the acquiring firms.

3.3.2 Foreign ownership

It includes ownership by foreign corporations and institutional investors. Ray et al. [29] argued that the high foreign institutional ownership reduces the fear of complex unknown practices in the international market by improving understanding of the foreign market based on their international experience. They found that foreign corporate and institutional ownership is positively associated with firm internationalization. Foreign corporate investors are not only motivated by financial goals but also want to enter into the new market and develop organizational capabilities [13]. In the emerging market multinational firms the foreign institutional help in building credibility and reputation in the foreign market. Institutional investors are active monitors and sent a positive signal of good governance in the focal firms. In sum, institutional ownership is positively associated with firm internationalization [13]. Foreign investors are also associated with the high commitment entry modes selection by the firms [25]. Mersland et al. [14] examined the influence of microbanks internationalization on their social and financial performance. Internationalization of the microbanks helps in getting international BOD, international debt access, international network access which improves their social performance.

3.3.3 Business group ownership

Business group ownership is very dominant in the emerging economies context such as India. Gaur and Delios [28] integrated agency theory with institutional theory to examine the impact of international diversification on firm performance. They examined a sample of Indian multinationals and found that high domestic and foreign ownership is positively associated with the firm international diversification. They found a negative impact on firms' international diversification of financial performance. Business group affiliation positively moderated the relation between the firm international diversification and financial performance. The group affiliated firms have a less negative impact of international diversification of the firm's performance due to the resource availability support in the affiliated firms.

3.3.4 Family ownership

There are various definitions of family firms in the literature. Ray et al. [29] defined family firms as "firms given founding business have a shareholding of 20% or more with a director position by founding family members and at least a member from the founding firm is managing director/CEO/board chairperson". Tsao and Lien [33] defined family firms as "firms in which the founders or their family members hold the key management positions, sit on the board, or are the block-holders of the firm". Singla et al. [13] examined the impact of family ownership on firms' internationalization. Based on the principal-principal (PP) agency theory and the resource-based view they argue that the various shareholders have different preferences and favor firm internationalization differently. They find that a lower level of family ownership is positively associated with firms' internationalization while a higher level does not favor internationalization.

Ray et al. [29] investigated the influence of family management and ownership on firm internationalization decisions in emerging economies (India). They integrated the "socioemotional wealth perspective and agency theory" to examine the relationship. They adopted the willingness and ability perspective [44] to establish the relationship. Where the willingness is related to "disposition to act" and ability is related to "discretion to act". The family firms have less willingness to take the risk and lower internationalization. The risk aversion of the family firms is more strong with the control of the increase as they have ownership as well as management position in the affiliated firms. The family members can influence the manager's actions. The negative impact of family ownership on internationalization is reduced with higher foreign institutional ownership.

Tsao and Lien [33] examined the moderating role of family ownership on firm internationalization and innovation/performance. They took a sample of Taiwan's publicly listed firms and find that family firm's experience positively moderate the relationship between internationalization and innovation/performance. The presence of the family management mitigates the agency due to high family firm control over firm strategic actions. The family firm has principal-principal agency conflict with the minority shareholders.

3.3.5 State ownership

In the case of state-owned firms, the two-agency relationship exists [24]. Cuervo-Cazurra et al. [24] listed triple agency conflict in state-owned enterprises internationalization as follow:

- First, these firms are having the owners as the citizen of the nation who appoints the politicians as the agent. The firms have certain social and economic goals. In these settings, the citizens as the principals do not have contractual control mechanism overs the politician as the agent. The politician once selected are replaced after the next election only. The conflict arises when politician maximize own utility to remain in power and citizens want a better return for their investment

- The second agency issue is between the politician and the appointed firm's managers. Agency conflict occurs when politician want to achieve their personal goals while the managers maximize their benefits [45]

- A third agency relationship exists between the managers of the state-owned enterprises and the managers of their foreign subsidiary [46]

All three principals have different objectives:

- citizens have the objective of the country development

- Politician wants to remain in the power

- Foreign subsidiary managers want to advance their carrier

Cuervo-Cazurra et al. [24] proposed that the state-owned multinationals firms invest and enter into the countries where their project value is less than the private multinational with less agency cost. Benito et al. [30] have examined the impact of state ownership on the headquarter reallocation by the multinationals outside the home market. Integrating agency theory, resource-based view, and institutional perspectives, they argued that location decisions about the multinational headquarters are based on the efficiency and the legitimacy factors. They find that state ownership along with concentrated ownership is negatively related to the headquarters location outside the home country. They proposed that the location of the headquarters outside the home country negatively impacts the image of the home country and causes a loss in employment and R&D.

3.4 Born global and agency issues

The early-stage internationalization of the new ventures provides them growth and profitability opportunity. The governance challenges are serious in the born global firms [22]. Zahra [22] examined the impact of public and corporate governance on the global entrepreneurial firms as the early internationalizes. These governance systems decide the success and survival of the born global in the international market. The born global firm faces issues regarding the management of intellectual property rights and free-riding by the established players. Public and corporate governance resolve cross-border conflicts. Corporate governance effectively monitors the manager's actions as well as supports the decision-making in the complex global context.

LiPuma [12] examined the performance of the IPO performance by born global. Using a sample of the technology-based international new ventures he argued that the agency risk is higher due to the difficult monitoring and the communication in the born global. Born global have high liabilities of the foreignness due to less experience in the international context. He found that the timing of IPO is later in born global firms in comparison to the domestic firms.

4. Conclusion

This study consolidates the state of academic research on using agency theory to explain the various phenomena's in the MNCs context. Based on the systematic review of the literature, author finds that agency theory is used to examine the degree of internationalization, international diversification, born global internationalization, and governance issues in various modes of foreign entries.

4.1 Future research directions

A large number of opportunities exist in future research to examine various aspects of agency in the different contexts of MNCs. First, the impact of business group affiliation on the MNCs performance is inconclusive [28]. These studies suggest heterogeneity among the business group in different institutional contexts and require separate attention. Second, several studies emphasized the board characteristics impact on the agency issues and firm internationalization. But, the black box of what happens inside the board room is not well understood and requires attention to understand it using methods such as video recording of board room activities [17]. Third, future research needs to identify the heterogeneity among the family firms based on the composition of the family members team, knowledge resource and networks difference with family members, dynamics in the family, and intergenerational issues in the context of the emerging economies family firms. Forth, current studies have considered principal-principal conflict based on the financial goals of the various owners. Future studies need to consider the multidimensional nature of the principal-principal conflict with multiple sources of conflict other than the financial returns interest. Fifth, future studies need to go beyond the board composition and structure to resolve agency issues and need to look into the influence of the director's social and human capital on firm internationalization decisions [10]. Sixth, agency issue needs to re-examine in the born global firms in various institutional contexts. Lastly, state ownership proposes an interesting agency issue with two different principal-agent relationships and has different dynamics in comparison to the other owners.

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