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The principal–agent problem and its mitigation: a critical historical analysis

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Recommended Citation

Yan T and Hyman MR. 2024. The principal–agent problem and its mitigation: a critical historical analysis. *Journal of Management History*, 30(4): 615-636. <https://doi.org/10.1108/JMH-07-2023-0068>

This is the Author's Accepted Manuscript. The official published version can be found in the *Journal of Management History* at <https://doi.org/10.1108/JMH-07-2023-0068>.

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The Principal-Agent Problem and its Mitigation: A Critical Historical Analysis

Journal:	<i>Journal of Management History</i>
Manuscript ID	JMH-07-2023-0068.R1
Manuscript Type:	Research Paper
Keywords:	principal-agent problem, Chinese compradors, foreign market entry, building social bonds in business, formal and informal institutions

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The Principal-Agent Problem and its Mitigation: A Critical Historical

Analysis

Abstract

Purpose: The goals here are (1) to provide a critical historical analysis of the business (mis)behaviors and influencing factors that discourage enduring cooperation between principals and agents, (2) to introduce strategies that embrace the social values, economic motivation, and institutional designs historically adopted to curtail dishonest acts in international business, and (3) to inform an improved principal-agent theory that reflects principal-agent reciprocity as shaped by social, political, cultural, economic, strategic, and ideological forces.

Design/methodology/approach: The critical historical research method is used to analyze Chinese compradors and the foreign companies they served in pre-1949 China.

Findings: Business practitioners can extend orthodox principal-agent theory by scrutinizing the complex interactions between local agents and foreign companies. Instead of agents pursuing their economic interests exclusively, as posited by principal-agent theory, they also may pursue principal-shared interests (as suggested by stewardship theory) due to social norms and cultural values that can affect business-related choices and the social bonds built between principals and agents.

Originality: A critical historical analysis of intermediary businesspeople's (mis)behavior in pre-1949 (1840 to 1949) China can inform the generalizability of principal-agent theory and contemporary business strategies for minimizing agents' dishonest acts.

Research implications: The behaviors of compradors and foreign companies in pre-1949 China suggest international business practices for shaping social bonds between principals and agents and foreign principals' creative efforts to enhance shared interests with local agents.

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3 **Practical implications:** Understanding principal-agent theory's limitations can help
4
5 international management scholars and practitioners mitigate transaction partners' dishonest acts.
6

7 **Keywords:** principal-agent problem; Chinese compradors; building social bonds in business;
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9 foreign market entry; formal and informal institutions
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12 **Type:** Research Paper
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14 **Word Count:** 10493
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19 **Summary Statement of Contribution**

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21 Based on the critical historical analysis of extensive historical data, this study informs the social
22
23 construction of solutions to the principal-agent problem in non-Western marketplaces. Many
24
25 contemporary strategies related to synergistic relationship building, formal and informal
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27 institutional constraints or motivations, and economic measures to minimize agents' dishonest
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29 acts, have historical parallels. Conventional principal-agent and stewardship theories are
30
31 extended to examine agents' dishonest acts, principals behaving dishonestly toward agents, and
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33 agents and principals colluding to behave dishonestly at a third party's expense.
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Introduction

Management scholars, economists, sociologists, and political scientists have long studied the principal-agent problem (PAP) (Bolton and Dewatripont, 2005; Eisenhardt, 1989; Jensen and Meckling, 1976; Kiser, 1999; Laffont and Martimort, 2002; Pratt and Zeckhauser, 1991; Sappington, 1991; Tran *et al.*, 2023). Typically, *principals* are property owners or parties legally authorized to dispose of property, and *agents* are company managers, employees, or parties delegated to represent ownership. The PAP occurs when agents use information asymmetry dishonestly to advance their interests at the expense of principals' interests (Akerlof, 1970). It pervades transactions characterized by the separate ownership and management of property, influences strategy and communication efficacy when owners' and agents' perceptions, interests, and preferences diverge, and often is worse in cross-cultural than domestic contexts due to exacerbated cultural, religious, economic, and political ignorance (Ekanayake, 2004; Hewege, 2012; Johnson and Droege, 2004).

Principal-agent relationships exist under one of two orders. First-order principal-agent relationships arise between company managers and property owners, and second-order relationships exist between company managers and employees such as secretaries, drivers, salespeople, engineers, and accountants. Information asymmetry can exist under either order. Monitoring concealed information and actions within this asymmetry, which complicates measuring and controlling agents' power abuses, can create PAP-intensifying economic, social, and psychological burdens (Arrow, 1971; Day and Montgomery, 1983; Jensen and Meckling, 1976).

The PAP and related mitigation efforts are context-sensitive. Despite the PAP's frequent adverse effects on international business, it is often examined in *socially stable* contexts. Few

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2
3 studies have related principal-agent theory to the historical managerial innovations that
4 encourage cross-culture cooperation and social bonds building between principals and agents in a
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6 *tumultuous context*; for example, pre-1949 China featured frequent civil wars, foreign political
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8 and economic pressures, divergent regional interests, regional inequality and conflicts, weak
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10 government leadership, frequent natural disasters, pervasive secret societies, and thriving
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12 nationalistic activisms (SASS, 1983; Spence, 1991; Yan, 2013; Yan and Hyman, 2020). As a
13
14 result, international business scholars have yet to vet the theory's completeness or develop
15
16 solutions to the PAP situated in irregular business contexts (Bergen *et al.*, 1992; Chohan, 2019;
17
18 Ekanayake, 2004; Hewege, 2012).

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21 To fill this theoretical gap, this historical study relies on critical historical research
22
23 method (CHRM), which combines ontological realism and interpretative relativism to explain
24
25 business phenomena that shape and are shaped by social context and human agency (Yan and
26
27 Hyman, 2018), to answer these research questions. What are the PAP's driving elements and
28
29 how can it be (re)defined and solved in a changing socio-historical context filled with many
30
31 social uncertainties? In which condition can the principal's and agent's interests be reconciled in
32
33 pursuit of collective interests, as suggested by stewardship theory (Davis, Schoorman, and
34
35 Donaldson, 1997)? In the pre-1949 Chinese context, do conventional principal-agent and
36
37 stewardship theories pertain to the PAP? What are its implications for contemporary managers
38
39 and marketers? Table 1 summarizes our subsequent argument.

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42 ----- Place Table 1 here -----
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46
47 CHRM is an analytic method that highlights historical contexts and can help scholars
48
49 critically scrutinize the mechanisms, structures, and other driving factors embedded in social
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51 contexts that shape business behaviors (Yan and Hyman, 2018). Researchers generally use
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3 CHRM to explore contextualized specificities rather than to seek regularities. Specifically,
4
5 CHRM allows researchers to merge disparate and scattered historical information into
6
7 comprehensive narratives about historical events. Here, CHRM helps revisit the principal-agent
8
9 theory's multiplicity by scrutinizing multilateral historical sources related to the principal-agent
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11 problem in pre-1949 China. This analysis reveals the socially embedded mechanisms and
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13 historical contexts that shaped foreign companies principals' and local intermediaries agents'
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15 intentions, perceptions, and behaviors in a historically germane non-Western and relatively free-
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17 market-viable from 1840 to 1949 (Spence, 1991; Qi, 2003, 2010; Yan and Hyman, 2018). The
18
19 conclusion: the contextualized economic measures, *institutionalized oversight and control*
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21 *systems*, and *social bonds* that enhanced mutual interests among foreign principals and Chinese
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23 compradors in pre-1949 China support principal-agent and stewardship theories.
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29 This analysis focuses on compradors—initially, a Portuguese term meaning ‘business
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31 middleman’ that evolved into *Maiban* in Chinese—who served as ‘low-status intermediary
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33 businessmen buying goods for foreign businessmen’. (Later, comprador status extended to
34
35 people offering information or selling products to foreign companies (Yan, 1986a,b)). It extends
36
37 principal-agent theory via a critical history-oriented exploration of managing international
38
39 business (mis)behaviors. By probing underlying mechanisms, cultural values, meanings, and
40
41 interactions in cross-cultural business management, it suggests scrutinizing certain texts (i.e., on
42
43 business behaviors, strategies, interactions, and the like) and context (i.e., socio-political,
44
45 economic, and cultural-historical milieus) together while complementing and enriching
46
47 mainstream management and international business theory (Muldoon, 2020).
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52 Multilevel primary and secondary historical sources—including corporate archives,
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54 government documents, newspapers, personal memoirs, narrative history, historical explorations,
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3 and other relevant historical records (often scattered in large volumes of national and local
4 *Literature and History Materials*) from China or elsewhere (e.g., the University of Chicago and
5 Stanford University East Asian Studies libraries)—provided diverse contextualized data. Such
6 data, often published before the early 1960s or reprinted after the Cultural Revolution to signify
7 the Chinese regime’s political liberalization, encouraged ‘data triangulation’ that minimized
8 biased (re)interpretation of historical traces while avoiding presentism (i.e., interpretation via
9 contemporary values and standards) and static interpretations (i.e., generalized interpretations
10 disregard of contexts) (Yan and Hyman, 2018, 2021).

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22 Historical analysis helps to explain “power relations, politics, institution building, and
23 wider discursive and non-discursive factors” (Tadajewski, 2023, p.744). Stressing the
24 ‘historicity’ of the principal-agent problem and its mitigation, this study’s main contributions are
25 fourfold. First, it enhances management knowledge by revealing the contextualized meanings of
26 business behaviors, strategies, interactions, and processes across interests and cultures.
27 Specifically, it broadens the PAP model to a non-Western context filled with many uncertainties
28 and highlights the formal and informal institutions that discouraged comprador disloyalty and
29 shaped the social bonds between principals and agents. Second, it encourages contemporary
30 business practitioners to mitigate the PAP by adapting ‘softer’ effective measures to address
31 imperfect market-related information. Third, it showcases the contingent managerial, behavioral,
32 and economic issues perpetuated by compradors as self-interested businessmen who might not
33 loyally serve their foreign principals. Fourth, it informs contemporary business practitioners and
34 researchers about context-sensitive business strategies, power relations, and behaviors in ‘Old
35 China’—a domain characterized by its idiosyncratic socio-political origins, intellectual tradition,
36 and multilateral historical traces—by considering socially embedded comprador behaviors and
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3 Chinese-foreign business interactions through *critical*, *historical*, and *ethnographic* lenses (Frost,
4
5 2022; Yan and Hyman, 2021).
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7 8 **Principal-agent Theory and the Principal-agent Problem** 9

10 Principal-agent theory examines the power relationship and strategic interactions between
11 principals and agents defined by ownership structures and the rational pursuit of self-interest
12 (Grossman and Hart, 1986; Hart, 1995; Hart and Moore, 1990). In modern companies (or similar
13 business organizations), company owners need not be company operators. Due to insufficient
14 information or personal expertise, principals may rely on agents to execute business transactions.
15 Hence, the theory posits that agents may behave dishonestly when business transactions separate
16 ownership from valid onsite transaction control (Pratt and Zeckhauser, 1991). Such behaviors,
17 which are difficult to observe or measure directly, create agency costs (e.g., adverse selection
18 and moral hazard problems) that reduce business efficiency (Alchian and Demsetz, 1972;
19 Donaldson, 1990; Jensen and Meckling, 1976).
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33 Under conventional principal-agent theory, the PAP's primary impetus is the divergent
34 interests, beliefs, and preferences between principals and agents, implying that agents may
35 behave dishonestly to enhance their interests at the expense of principals' interests. When such
36 divergence occurs, or when detecting, assessing, and monitoring agents' behaviors is infeasible
37 or cost-prohibitive, principals' and agents' inherently incomplete contracts may aggravate the
38 PAP (Hart and Moore, 1990; Grossman and Hart, 1986). Contracts inherently are incomplete
39 because principals cannot fully anticipate emergent *ex-ante* and *ex-post* contingencies and often
40 grant agents unchecked authority (Hart and Holmström, 1987; Maskin and Tirole, 1999; Tirole,
41 1999). Artifacts of this shortfall include embezzling the principal's funds, using the principal's
42 capacities to sell the agent's products, transferring risks or costs to the principal, cooperating
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3 with the principal's competitors at the principal's expense, shirking assigned tasks, dealing
4 passively with business opportunities, taking unnecessary risks, and misinforming the principal
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6 (Akerlof, 1970; Cheung, 1969; Donaldson, 1990; Gailmard, 2009; Hart and Holmström, 1987;
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8 Laffont and Martimort, 2002; Pendergast, 1999; Stiglitz, 1974). The costliness and challenges of
9
10 detecting and assessing agents' dishonest acts may discourage principals from addressing hidden
11
12 actions and hidden information problems (Arrow, 1971; Jensen and Meckling, 1976).
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17 Conventional principal-agent theory assumes agents are self-interest maximizers who
18
19 may pursue their interests at principals' and other people's expense. Although this assumption
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21 explains many transactional (mis)behaviors, further scrutiny suggests expanding the principal-
22
23 agent theory's interpretive scope for five reasons. First, the theory focuses on material interests
24
25 (e.g., profit, promotion, and personal welfare) that agents may not pursue exclusively. However,
26
27 agents' social interests (e.g., social prestige or nationalistic goals) may dominate their personal
28
29 interests (Yan and Hyman, 2019, 2020). Second, several strategies can align agents' and
30
31 principals' interests; for example, well-designed and implemented reward systems and
32
33 participatory management can spur agents' productivity (Becker, 1974, 1976; Bolton and
34
35 Dewatripont, 2005; Dahl, 1985). Third, the theory is grounded in static models that ignore shifts
36
37 in agency relationships related to changes in socioeconomic conditions, cultural dispositions,
38
39 values, norms, or the power balance between principals and agents (Bergen et al., 1992).
40
41 Because these shifts may modify the PAP, agents are likelier to behave honestly if they
42
43 anticipate lucrative repeated transactions and behave dishonestly if they believe a principal is
44
45 unlikely to discover their misbehaviors. Fourth, scholars have focused on agents' dishonest acts
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47 rather than principals' or principals' and agents' dishonest acts at a third party's expense. Any
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49 party to a transaction may behave dishonestly. Fifth, scholars have recommended using formal
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3 contracts but ignored ineffective contractual regulation and informal or unconventional measures
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5 for curbing the PAP.
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8 Due to difficulties identifying the ‘right’ agents or business partners and accurately
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10 defining the ‘right’ contractual terms (i.e., *ex-ante* contractual contingencies), contracts may be
11
12 inefficient in protecting foreign companies from losses (Grossman and Hart, 1986; Hart, 1995;
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14 Hart and Holmström, 1987; Hart and John, 1990). Local agents’ undetected dishonest behaviors
15
16 may impede *ex-post*-contract enforceability in foreign contexts (Pratt and Zeckhauser, 1991).
17
18 High switching costs—shaped by resource mobility, strategy flexibility, and cost recoverability
19
20—to alternate channels may intensify the PAP by increasing principals’ dependence on agents
21
22 (Shin et al., 2020). However, formal and informal institutions are more than the background
23
24 entities shaping business entry strategies (Meyer et al., 2009; North, 1990). For example,
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26 fostering long-term social and psychological bonds between agents and principals and enhancing
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28 agents’ self-control can dampen agents’ dishonest acts.
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33 In pre-1949 China, *formal institutions* (e.g., contracts, laws, official monitoring systems,
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35 and other formal oversight arrangements) and *informal institutions* (i.e., social norms, religious
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37 dogma, and socio-cultural values such as *Zhong* [loyalty], *Yi* [allegiance to other societal
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39 members], *Xin* [faithful to one’s promise], *Lian* [personal integrity], *He* [amicability], and *Ren*
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41 [benevolence]) (1) discouraged dishonest acts by molding agents’ interests, perceptions,
42
43 preferences, and behaviors, and (2) encouraged positive *Guanxi* building between principals and
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45 agents (Confucius and his disciples, 1960; Sima, 2009; White, 1991; Yan, 2013; Yang *et al.*,
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47 1993; Zhu, 1983). Although neither formal rules nor laws, these values, when internalized via
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49 formal education or social learning, functioned as implicitly accepted codes that regulated
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51 businesspeople’s social behaviors, determined the social appropriateness of business strategies,
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3 connoted consumer values and cultures, signified managers' social reputations, and shaped
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5 personal relationships (Arnould *et al.*, 2021; Grace, 2021). People resisted 'doing business with'
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7 anyone who violated these values. For example, *Xin-* or *Yi-*deficient businesspeople rarely
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9 received long-run contracts, and companies rarely hired job applicants judged as *Bu-Zhong* (i.e.,
10
11 disloyalty to others, especially leaders).
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14
15 The PAP may arise in international markets when compradors' interests differ or conflict
16
17 with principals' interests. Moreover, cross-cultural differences in values, norms, and language
18
19 barriers may intensify the PAP by widening the principal-agent information or interest gap.
20
21 However, the PAP was muted in pre-1949 China because principals innovated strategies—such
22
23 as building mutual trust, institutionalizing bonding costs, and indoctrinating specific cultural
24
25 values—to mitigate it. Thus, orthodox principal-agent theory partly captures disloyal behavior
26
27 among business parties and urges scrutinizing the underlying mechanisms, influencing elements,
28
29 and dynamic interactions of principals and agents in international markets.
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34 In summary, principal-agent theory highlights the role of personal interest-seeking in
35
36 conditioning business parties' behaviors. It acknowledges challenges in detecting and measuring
37
38 hidden information and hidden actions. Principals' beliefs about the problem's type or severity
39
40 and agents' beliefs about the seriousness or effects of those responses may condition effective
41
42 responses to a PAP. Although contracts often define punishment and reward systems,
43
44 definitional and enforcement uncertainties may cause principals to adopt complementary
45
46 strategies (i.e., interpreting, justifying, dismissing, and regulating behaviors based on cultural
47
48 values, social norms, meanings, and relational ties) to minimize the PAP (Arnould *et al.*, 2021;
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50 Aulakh and Gencturk, 2000; Grace, 2021). The ethnographic specificities of non-Western socio-
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52 historical contexts demand an in-depth examination of the underlying socio-cultural mechanisms
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3 and dynamic processes that shape the PAP. The strategies that sustained the symbiotic
4
5 relationship between compradors and foreign companies in pre-1949 China show the PAP's
6
7 contextualized connotations and suggest ways to sustain cross-cultural cooperation.
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9

10 **Embedding Compradors in Pre-1949 China**

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12 This review of Chinese compradors and foreign companies in pre-1949 China (i.e., 1840
13
14 to 1949, an era characterized by extensive cross-border business transactions consummated in a
15
16 relatively free market) relies on scrutinizing multilevel historical materials such as old
17
18 newspapers (e.g., *Shen Bao* and *Xinwen Bao*) and magazines published before 1949, national and
19
20 local archives, businessmen's oral historical records, compradors' memoirs, and in-house
21
22 journals from Chinese and non-Chinese sources (e.g., *Chinese Literature and History Materials*,
23
24 *Economic History Materials of Wuhan Industry and Commerce*, *Materials of Shanghai Local*
25
26 *History*, *Library of Historical Materials of Shanghai in the 21st Century*, and *Anhui Literature*
27
28 *and History Materials*, various issues; SASS, 1983; *Shen Bao*, various issues; SHERI, 1960;
29
30 *Xinwen Bao*, various issues). These under-utilized multilateral materials by non-Eastern scholars
31
32 were mainly published before the early 1960s or (re)generated after the Cultural Revolution, two
33
34 relatively open periods (Yan and Hyman, 2021). Although generally trustworthy, they may be
35
36 incomplete or ambiguous due to social or political pressures on information providers (e.g.,
37
38 withholding negative information about elders, respected societal members, and family
39
40 members). Ensuring these materials' correct interpretation entails (1) identifying and
41
42 understanding their historical context, (2) assessing their authenticity and creators'
43
44 trustworthiness, and (3) triangulating data by scrutinizing multiple sources (Qi, 2003, 2010; Yan
45
46 and Hyman, 2018, 2021). Given compradors' differing socio-historically anchored connotations,
47
48 data triangulation, and contextualization enhanced interpretative validity (Muldoon, 2020).
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3 Chinese compradors' connotations and social influences shifted in pre-1949 China as the
4 sociopolitical and economic environment evolved (Huang et al, 1982; Yan, 2013). Scrutinizing
5 such shifts broadens insights into the PAP. Compradors' ever-increasing wealth and close
6 relationships with government officials and foreign companies steadily boosted their social
7 standing. Although occasionally criticized by Chinese nationalists, compradors were adored in
8 coastal cities such as Shanghai or Tianjin, and their conspicuous consumption behaviors were
9 widely envied and imitated (*Shen Bao*, various issues; *Xinwen Bao*, various issues).

10
11 Chinese compradors first appeared in the 15th century as official brokers for the Ming
12 government (1368 to 1644) (Hao, 1970). However, they did not become an influential socio-
13 economic institution until the East and West initiated extensive contact in the early 1840s (Hao,
14 1970). Previously, the Chinese government limited international trade to the *Shisanhang* (or the
15 'thirteen factories'), and Canton (or Guangzhou) was the only international trading port (Abe,
16 2017). Minimal and highly regulated international trade meant compradors were less essential.

17
18 After the First Opium War (1839 to 1842), when the Treaty of Nanking forced China to
19 welcome other countries, foreign companies entered China (Hao, 1970; Spence, 1991). Due to
20 ignorance about China, local business competition, and intensifying nationalistic resistance,
21 these companies solicited aid from local intermediaries. Compradors emerged to help foreign
22 companies break into major Chinese coastal and inland cities (Du, 1984; Yan, 1986a,b). Some
23 Chinese, often from wealthy local families, received a Western education from Western schools
24 or churches in cities such as Hankou, Shanghai, and Tianjin. Their familiarity with Chinese
25 norms, Western values, and Western lifestyles enabled them to excel as compradors (Dong,
26 1965; Huang et al, 1982; Yong, 1965).

27
28 Most compradors were Chinese nationals (Yamafuji, 2017; Yan, 1986a,b). Many foreign
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3 companies' former employees (e.g., translators, secretaries, house stewards, janitors, and
4
5 bodyguards), intermediaries who provided necessities, local businessmen (e.g., old-style bankers
6
7 or grocery store owners), and former business partners (e.g., contractors, agents, brokers, and
8
9 dealers) with close ties to foreign companies, become compradors (Cochran, 1980, 2000; Du,
10
11 1984; Hao, 1970; Li and Zhu, 1983; Ruan, 1964; Yan, 1964; Yan, 1986a,b). Foreign companies
12
13 retained former Chinese officials as compradors to lower government-imposed competitive
14
15 barriers or secure government purchasing contracts (Cochran, 1980, 2000; Gao, 1963; Jiang and
16
17 Chen, 1964; Lu, 1999; Ruan, 1964).

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21 Partly because traditional Chinese culture was family- and community-focused, and
22
23 partly because soon-to-retire compradors wanted to extend their influence, they often suggested
24
25 family members, relatives, and friends as replacements (Huang, 2007; Yang et al., 1993; Yan,
26
27 1986 a,b). Both recommenders and foreign companies took these suggestions seriously, as a
28
29 rejection or acceptance affected a recommender's social reputation and related societal members'
30
31 attitudes toward the foreign company. Thus, companies such as Asiatic Oil, BAT, Butterfield
32
33 and Swire, Gibb Livingston, HSBC, Melchers, Mobil, and Texaco often followed these
34
35 suggestions (Cochran, 1980, 2000; Huang, 1963; Jin, 1963; Li, 1999; Liu, 1984; Miao, 1999;
36
37 SASS, 1984; SHERI, 1960). Conversely, some compradors could become high-ranking
38
39 employees of foreign companies due to their profound social influence or well-entrenched social
40
41 networks (Cochran, 1980; Yamafuji, 2017).

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45 Whether relying on employees or local agents to initiate or expand their Chinese
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47 business, foreign companies chose between corporate hierarchies and the market to allocate
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49 resources (Cochran, 2000). To ease market entry and support foreign companies' value-creation
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51 efforts (e.g., collecting relevant information, identifying suitable partners, buying raw materials,
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3 and selling products), compradors promoted novel consumption styles or tastes, new consumer
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5 cultures, select social values, and their business networks (Bi, 1963; Chua, 2020; Hao, 1970; Xu
6
7 and Lin, 1964; Yan, 1986a,b). In long-time-experience-based ‘know-how’ intensive business,
8
9 where special skills are needed to identify the actual quality of products or services, compradors
10
11 helped foreign companies to procure or sell products such as tea, seafood, tobacco leaves, or tung
12
13 oil (Li, 1962; Wu, 1984). For example, compradors were vital to BAT collecting tobacco leaves
14
15 and selling cigarettes throughout China, Asiatic (U.K.) marketing oil lamps and kerosene oil to
16
17 millions of Chinese families, Melchers (Germany) securing tung oil, soldiers obtaining food
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19 rations, and Arnhold Brothers (U.K.) acquiring raw hides, herbs, silk, tung oil, sesame, and eggs
20
21 in remote rural areas (Chen, 1964; Jin, 1963; Liu, 1984; SASS, 1983; SHERI, 1960; Xu and Lin,
22
23 1964). In addition to securing local selling networks with Chinese compradors’ help, Dollar
24
25 (U.S.) hired local informants to collect and transmit local business information, via its telegraph
26
27 offices in Shanghai and Tianjin, to its U.S. headquarters (Ruan, 1964). Before and during WWI,
28
29 compradors helped Russian buyers import tea from the Hubei province (Guo, 1984; Jin, 1963).

35 **Principal-Agent Problem in Pre-1949 China**

36
37 Discrepant (shared) interests and goals among international business parties can
38
39 exacerbate (mitigate) the PAP. Although principals generally expect agents to be disinterested in
40
41 the strategies that best serve principals’ interests, agents’ preferences can distort strategy
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43 implementation (Clark, 1991).
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47 Principals and agents, especially in cross-cultural settings, may rely on different codes of
48
49 conduct to evaluate personal interests and goals, leading to divergent behaviors and their
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51 interpretations. Hence, insufficient or ineffective communication may undermine mutual trust,
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53 complicating cooperation between principals and agents. Long-term cooperation fostered by ad
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3 hoc contracts or partnerships that passed small-scale transaction tests can restrain principals' and
4 agents' dishonest behaviors (Cochran, 1980, 2000; Samiee *et al.*, 2015; Sappington, 1991).
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7
8 Multiple mechanisms and factors shaped power relations between foreign companies and
9 local compradors in pre-1949 China. Under orthodox principal-agent theory, asymmetric
10 information between a principal and an agent may encourage dishonest acts by the more
11 informed party (Akerlof, 1970). Relative to foreign companies, compradors with well-
12 established social networks better understood local norms, transaction rules, managerial styles,
13 and marketing channels (SASS, 1984; SHERI, 1960; Yan, 1986a,b). According to former
14 compradors' memoirs, compradors' shared knowledge helped foreign companies circumvent
15 government controls, yet the information gap between foreign companies and compradors
16 obscured the latter's dishonest acts (Lu, 1984; local *Literature and History Materials*, various
17 issues).
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31 Principals' and agents' strategic options can shape the PAP. *Bandwagoning compradors*
32 (i.e., affiliated with foreign companies to enhance long-term personal interests) were less likely
33 to behave dishonestly (Lu, 1999). In contrast, *distancing compradors* working for shunned
34 foreign companies, especially when nationalistic movements and related foreign brand boycotts
35 peaked from 1904 to 1949, imposed social pressures to erode open rapprochement between
36 foreign companies and local agents (SASS, 1983; SHERI, 1960; Spence, 1991; Tian and Dong,
37 2013; Wang, 2002; Wang, 1981, Yan and Hyman, 2020).
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47 Traditional Chinese society often deprecated businesspeople as greedy, snobbish,
48 incompetent, and immoral servants of personal interests (Huang, 2007; Yang et al., 1993).
49 Hence, the first few foreign companies might suffer from *adverse selection* (i.e., initially
50 retaining less competent local agents) (Hart and Holmström, 1987; Laffont and Martimort,
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2002). To attract more competent Chinese as compradors, foreign companies gave the first few Chinese willing to serve as compradors relatively high commissions (Huang, 2007). Once compradors' rags-to-riches stories circulated widely, more talented Chinese aspired to become compradors, improving foreign companies' candidate pools (Chua, 2020). Subsequently, intense competition among potential compradors discouraged them from behaving dishonestly toward foreign principals. Formal and informal social networks were essential in smoothing business in pre-1949 China (Kong and Ploeckl, 2020; Yan and Hyman, 2021). Many compradors formed guild-like associations (industry- or hometown-based) to share resources (e.g., marketing channels, business information, financial services, and salesforce) and regulate members' business behaviors (Xu, 2000; Yan, 1964).

Sustaining Stewardship Relationships in pre-1949 China

Stewardship theory contends principals' and agents' interests are alignable (Davis, Schoorman, and Donaldson, 1997). The multilevel historical analysis described here supports this contention. Despite the PAP's extent in international markets, historical data indicate its absence from pre-1949 China. Nationally, many loyal Chinese compradors served foreign principals earnestly, including Li Rui (for a U.S. tung oil company), Gao Xingqiao (for German coal mines and weaponry companies), Zheng Bozhao and Wu Tingsheng (for BAT), and Wang Huaishan (for HSBC) (Cao, 1999; Chen, 1999; Gao, 1963; SASS, 1983; *Shen Bao*, various issues; SHERI, 1960; *Xinwen Bao*, various issues; Xu, 1984). Although imperialistic privilege and political pressure partly explain compradors' cooperation with foreign firms, these factors only weakly encouraged compradors' sustained loyalty. Although foreign companies occasionally asked the pre-1949 Chinese government to intervene when a PAP arose, such actions typically elicited nationalistic resistance (Yan and Hyman, 2020). Thus, factors such as

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3 economic incentives, institutionalizing social constraints, and social bonds adopted by foreign
4 companies better explain this loyalty and reflexive agency (Zincir, 2022).

7 ***Instilling Economic Motivations and Restraints***

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10 Incentive structure—mainly the expected cost and payoff of specific behaviors—shapes
11 people’s decision-making (Becker, 1974, 1976). Increasing a behavior’s bonding cost or
12 reducing its expected payoff will minimize its adoption likelihood (Becker, 1974, 1976; Jensen
13 and Meckling, 1976). Compradors’ loyalty to foreign companies in pre-1949 China largely
14 stemmed from generous sales commissions and companies’ willingness to absorb losses caused
15 by *force majeure*s or unpredictable price vacillations (Chen, 1999; Gao, 1963; Li, 1962; Liu,
16 1984; Lu, 1999; Miao, 1999; Yan, 1986a,b; Yang, 1984; Yong, 1965; Zhou and Huang, 1984).
17 Former compradors indicated these companies also offered subsidies, financial rewards,
18 pensions, and informal monetary rewards (e.g., processing fees, kickbacks, and secret
19 allowances) (Yu and Wang, 1984; Zhou and Huang, 1984). Preferring one outstanding
20 representative to several mediocre representatives, foreign companies often paid handsomely for
21 compradors able to increase sales, befriend local officials, and expand the business into inland
22 markets (Yan, 1964). Whether compradors received a fixed or flexible share of net profits, as
23 determined by a sharecropping-like system that defined relative profit share, depended on ad hoc
24 arrangements with foreign companies (Cheung, 1968).

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27 To align principals’ and compradors’ interests, or to build a mutual steward relationship
28 between principals and agents (Davis, Schoorman, and Donaldson, 1997), foreign companies
29 built a symbiotic business relationship to penetrate the Chinese market and secure long-term
30 local assistance (Abe, 2017; Huang et al, 1982). Under a mutual-exclusivity arrangement,
31 compradors were a foreign company’s sole agent within a local market and were limited to
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3 selling only its products (Ding, 1984; Li, 1962; Zhou and Huang, 1984). This arrangement
4
5 avoided the multi-principal problem (i.e., competing principals overwhelming a shared agent)
6
7 while reinforcing economic interdependency between compradors and foreign companies,
8
9 discouraging compradors' dishonest acts (Gailmard, 2009).
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12 To discourage comprador disloyalty, foreign companies required compradors to deposit
13
14 non-transferrable and non-withdrawable funds into assigned bank accounts before any
15
16 transaction, which functioned as an exit cost for behaving dishonestly (Jiang and Chen, 1964).
17
18 These funds would reimburse companies for losses caused by compradors' dishonest behaviors.
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21 ***Discouraging Dishonest Acts with Institutionalized Oversight and Control Systems***

22
23 Market and economic control cannot provide adequate deterrence (Clark, 1991).
24
25 Although pure economic measures worked in many cases, they were ineffective in curbing
26
27 dishonest acts by agents with non-monetary interests. Thus, additional formal oversight and
28
29 control institutions that boosted disloyalty costs or shrunk disloyalty payoffs were needed when
30
31 the interests and goals of principals and agents diverged and agent performance was difficult to
32
33 assess (Aulakh and Gencturk, 2000; Becker, 1974, 1976; Jensen and Meckling, 1976). By
34
35 institutionalizing strategies for regulating their social relationships with compradors, foreign
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37 companies identified the 'right' comprador, fostered competition among compradors, and
38
39 disciplined dishonest acts.
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44 As prophylactic entities, foreign companies often set strict criteria for screening
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46 compradors (Hao, 1970; Yan, 1986a,b). These criteria included social measures to influence
47
48 social selling within targeted markets and well-entrenched social networks, an ability to sell
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50 foreign brands to potential customers, personal integrity, and a favorable social reputation (Lu,
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52 1984; Zhou and Huang, 1984). Foreign companies especially appreciated compradors with close
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3 government ties; for example, BAT chose Wu Tingsheng, and HSBC chose Wu Youling and Wu
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5 Maoding, to develop their northern Chinese markets (Abe, 2017; SASS, 1983; Xu, 1984).

6
7 Potential compradors competed based on their social reputation and ability to earn a partnership
8
9 with foreign companies (Dong, 1984; Lu, 1999). Foreign companies initially engaged new
10
11 compradors in trial low-value transactions to control losses, with successful compradors
12
13 graduating to increasingly higher-value transactions.
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17 Economic, psychological, and social ‘bonding costs’ can curb dishonest acts by
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19 increasing their expense (Donaldson, 1990; Jensen and Meckling, 1976). In pre-1949 China,
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21 foreign companies adopted measures meant to increase such costs. Notarization as a comprador
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23 required sponsorship by a wealthy person (*Ren Bao*) or a successful Chinese retailer (*Pu Bao*).
24
25 Widely adopted as collateral in ‘Old China’, the *Ren Bao* or *Pu Bao* was liable for losses caused
26
27 by disloyalty or mismanagement (Chen, 1999; Du, 1984; Lu, 1999). Because pre-1949 Chinese
28
29 society was family and community-centric and preferred supporting friends or relatives via social
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31 obligation (Huang, 2007; Yang *et al.*, 1993; Zheng and Wan, 2020), compradors refrained from
32
33 disloyal behavior to avoid undermining friends or relatives. *Ren Bao* and *Pu Bao* systems
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35 typically set high social barriers to discourage comprador disloyalty.
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41 Historical records show that foreign companies such as BAT, Asiatic Oil, Riqing
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43 Steamship, Texaco, and Mobil Oil divided China into many regional markets. These companies
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45 avoided monopolistic compradors through ‘divide and control’, with a unique agent responsible
46
47 for each region and any cross-regional collusion prohibited (Chen, 1984; Ding, 1984; Liu, 1984;
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49 Yu and Wang, 1984; Zhou and Huang, 1984). They created decentralized monitoring systems by
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51 hiring a central comprador to coordinate—but not lead—branch compradors (Jiang and Chen,
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53 1964; Lu, 1999). These systems helped foreign companies cut administrative costs while
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3 restricting compradors from exchanging information and building business alliances among
4 themselves, constraining their collective disloyalty (SDNCA, 1999; Yu and Wang, 1984).
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8 Foreign companies developed independent accounting and auditing systems to monitor
9 comprador transactions (Cochran, 2000; Yang, 1984; Zou and Huang, 1984). Companies
10 immediately and severely punished compradors believed guilty of dishonest acts or ineffective
11 business performance. For example, the Swire Group (U.K.) stipulated misbehaving compradors
12 must reimburse companies for resulting losses (Yang, 1984). Likewise, Asiatic Oil and Dollar
13 (U.S.) sued or expelled immoral or incompetent compradors (Liu, 1984; Ruan, 1964).
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21 ***Mitigating the PAP with Social Bonds***

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23 Informal institutions may shape corporate strategy-making in international markets when
24 formal rules inaccurately or insufficiently reflect transaction complexity (Meyer et al., 2009;
25 Samiee et al., 2015; Tran et al., 2023). Influenced by China's informal institutions (e.g., norms
26 and values), foreign companies in pre-1949 China built social bonds to control Chinese
27 compradors' discretionary power and secure comprador loyalty, thus minimizing the PAP
28 (Aulakh and Gencturk, 2000). Embedded in a Chinese cultural context, the values that shaped
29 Chinese compradors' interactions with foreign companies also shaped foreign companies'
30 business strategies and social bonds with Chinese partners. Instead of regulating people's
31 behaviors with formal rules or contracts, business strategies can rely on internalized values that
32 shape preferences, identification, and strategic choices (Yan, 2013; Yan and Hyman, 2019). For
33 example, relationship building can help retain and satisfy customers by building personal trust,
34 mutual understanding, and long-term cooperation (Gillett, 2016). Some values enshrined in
35 consumer cultures may also define meanings and influence managers' strategic choices (Arnould
36 et al., 2021; Grace, 2021). Akin to 'strategic ignorance', a foreign principal might intentionally
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3 forgive some compradors' (especially those with strong capabilities or local networks)
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5 misbehaviors or relax their obligations to contractual terms, which in pre-1949 China meant to
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7 give them a face in exchange for their future loyalty or flexible but more productive performance
8
9 (SASS, 1983; SHLHMC, 1986; Xu, 1984).

12 Although thoroughly assessing transaction processes and performance may reduce the
13
14 PAP (Pratt and Zeckhauser, 1991), it also creates negative externalities. For example, monitoring
15
16 can disillusion the overseen, and performance assessments often neglect compromises to social
17
18 reputation induced by pursuing performance goals. However, social control can minimize the
19
20 PAP without incurring costs attendant to economic incentives, formal contracts, and accounting
21
22 rules. Thus, the social bonds built by foreign companies encouraged compradors to internalize
23
24 traditional Chinese values such as *Zhong* (loyalty), *He* (amicability), *Ren* (benevolence), *Li*
25
26 (politeness and personal integrity), *Yi* (allegiance), and *Xin* (faithful to one's promise) as
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28 behavioral guidelines (Chen, 1999; Yan *et al.*, 2023). These values discourage dishonest
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30 behavior by reinforcing loyalty to authorities, family members, friends, community members,
31
32 and business partners. Companies also borrowed religious values from Buddhism, Taoism, and
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34 Christianity that encouraged honesty, abstinence, diligence, and self-sacrifice. Hence,
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36 compradors were inculcated to behave honestly regardless of external monitoring (Dong, 1984;
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38 Li, 1962; Yong, 1965).

44 In pre-1949 China, personal friendships between foreign managers and compradors partly
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46 bridged cross-culture divides (Chen, 1999; Gao, 1963; Hao, 1970; Ruan, 1964). A close
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48 relationship with a foreign company signaled a local manager's political privilege, economic
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50 power, and social capital, which tended to induce interpersonal admiration and discourage
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52 government harassment (Lu, 1984; Yan, 1986a,b). As attested by former compradors, long-term
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3 friendships with foreign managers encouraged compradors' loyalty to these managers and their
4 companies (Huang, 1963; Li, 1962). BAT archives also reveal that when foreign managers were
5 dismissed or retired, compradors would also quit out of loyalty to them and distrust of new
6 managers (SASS, 1983).
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12 Embedded in a social context curious about foreign elements, compradors promoted their
13 business interests and enhanced their social prestige by identifying with a foreign company's
14 brand (Abe, 2017; Hao, 1970; Ruan, 1964; Yan, 1964). Foreign companies often provided social
15 support to compradors, which helped them avoid government harassment while boosting their
16 future business prospects. For example, the German government during WWI knighted Gao
17 Xingqiao to reward his loyalty, furthering Gao's business and social prestige (Gao, 1963).
18
19 Similarly, U.S. and U.K. companies helped some Chinese compradors obtain political positions
20 in Shanghai and Jiangsu, enhancing these compradors' business power and socio-political status
21 while smoothing these companies' market entry (*Shen Bao*, various issues; Yan, 1986a,b). Some
22 foreign companies created joint ventures with compradors that eased market entry and curbed
23 their members' dishonest or fraudulent activities (Hao, 1970; Yan, 1986a,b).
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38 The symbiotic relationship between agents and principals helped to build their amicable
39 interactions. For example, many compradors and foreign principals deemed their long-term
40 cooperation requisite to maintaining their economic, political, and other interests (Gao, 1963;
41 Wang, 1984), which mitigated the PAP.
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47 **Market and Business Efficacy of Mitigating the PAP in Pre-1949 China**

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49 A strong sense of nationalistic resentment toward foreign elements existed in pre-1949
50 China (Spence, 1991). However, historical records show the formal institutional arrangements
51 and social bonds in pre-1949 China pertain to current business practices globally (Hao, 1970;
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3 Yan, 1986a,b; Yan, 2013). These strategies allowed foreign companies to enter industries
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5 strongly regulated by the Chinese government (e.g., inland shipping, coal mining, banking, and
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7 real estate) (Chen, 1999; Miao, 1999; Yang, 1984). Besides building conventional personal
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9 friendships, foreign companies focused on building political relationships. Hence, compradors
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11 who maintained close relationships with Chinese government officials were employed to help
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13 foreign companies acquire otherwise unobtainable insider information about tax policy changes,
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15 shape exchange rate adjustments, and secure preferential international commercial treaty terms
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17 for foreign principals (Huang et al, 1982; SASS, 1983; Yan, 1986a,b; Zhou and Huang, 1984).
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19 To enter remote markets filled with many social uncertainties (e.g., turf wars between local
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21 warlords or different local customs) and flexibilities (e.g. many types of socio-economic
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23 organizations, including Tongxianghui [village clan associations], Tongyegonghui [guild],
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25 Huiguan [guid hall], Shangbang [business cliques], Shanghui [the chamber of commerce], and
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27 local cooperatives), compradors often relied on compatriots or village clans with strong families
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29 and local connections to facilitate and sustain foreign companies' long-term business
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31 transactions (SASS, 1983; SHERI, 1960; Xu, 2000; Yang, 1984). Often an unintended byproduct
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33 of their business activities in pre-1949 China, compradors generally secured political and
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35 economic privileges for foreign companies (e.g., lower taxes, police protection against
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37 nationalistic attacks, government contracts, local market information, professional advice, and
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39 elimination of government-set foreign trade barriers) (SASS, 1983; SDNCA, 1999; *Shen Bao*,
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41 various issues; SHERI, 1960; Yan, 1986a,b).
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49 Evidence from former compradors and their family members reveals that inculcated
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51 traditional values (e.g., allegiance and loyalty), friendship with foreign managers, and previous
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53 help from those companies primarily drove compradors' loyalty to foreign companies. Chinese
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3 society has long criticized *Guohe Chaiqiao* (dismantling the bridge after crossing the river)
4 behavior as highly immoral. Thus, positive reciprocity from Chinese compradors often helped
5 foreign businessmen in China out of economic distress. For example, Gao Xingqiao relied on his
6 social connections with Chinese government officials to help German-owned coal and weaponry
7 companies register as Chinese companies during WWI, thus avoiding government reprisals.
8
9 After WWI, Gao donated extensively to the family of a German manager in financial distress
10 (Gao, 1963). Gao's efforts reciprocated assistance he once received from German businessman
11 Constantin von Hanneken, suggesting personal relationships and reciprocity can mitigate the
12 PAP. Li Rui, who partnered with a U.S. company to purchase tung oil, returned excess profits to
13 his U.S. principal—which he was permitted to retain—caused by a sudden decline in tung oil
14 price (Li, 1962). Li's friendship with a company manager and belief that sustained cooperation
15 with U.S. principals mandated long-term contracts motivated his actions. Yong Jianqiu, who
16 worked for German companies and was motivated by his deep gratitude for favors he once
17 received from foreign companies, assisted foreign principals in seeking political and economic
18 assistance from the Chinese government (Yong, 1965). Wu Tingsheng, a U.S.-sponsored-college
19 graduate, and Zheng Bozhao, a Cantonese deeply influenced by traditional Chinese values (e.g.,
20 *Zhong* (loyalty), *Xin* (faithfulness), *Jian* (frugality), and *Qing* (diligence)) helped BAT develop
21 distribution channels throughout China (Chen, 1999; Cochran, 2000; Cox, 1997; SASS, 1983).
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44 Historical records (e.g., personal memoirs, local gazetteers, newspapers, and oral history
45 records) show these values' adoption encouraged local luminaries to help foreign principals
46 extend foreign business into remote Chinese rural markets (Jiang and Chen, 1964; Jin, 1964; Li
47 and Zhu, 1983), an act often castigated by Chinese leftists as traitorous (Huang et al, 1982; Yan,
48 1986a,b).
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3 Secret gangs such as Paoge (Brother Pao), San Hehui (the Triad), or Qing Bang (the
4 Green Gang) thrived and deeply affected daily lives in pre-1949 China (SHLHMC, 1986).
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6 Because gang members were especially influenced by values such as *Zhong*, *Yi*, and *Xin*, foreign
7
8 principals would ask these members to serve as compradors focused on inland Chinese market
9
10 entry (SHLHMC, 1986; Zhao, 1990). Although some influential members opposed becoming
11
12 compradors, foreign principals sought their help to disband boycotts or address disputes between
13
14 compradors, foreign principals sought their help to disband boycotts or address disputes between
15
16 foreign companies and Chinese workers (SHLHMC, 1986). Foreign principals joined these
17
18 underground entities to smooth operations in a context filled with intense nationalistic resistance
19
20 against foreign business (Yan and Hyman, 2020; Zhao, 1990).
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24 However, formal institutional arrangements and social bonds asymmetrically curbed
25
26 compradors' but not principals' dishonest acts. As depicted by stewardship theory, principals
27
28 may behave opportunistically toward compradors (Davis, Schoorman, and Donaldson, 1997).
29
30 Foreign companies often dismissed compradors after entering the pre-1949 Chinese market. For
31
32 example, despite its moral behavior and excellent performance, Mobil Oil fired its compradors
33
34 once it dominated a local market (Zhou and Huang, 1984). BAT behaved similarly once its local
35
36 business networks became well-entrenched (Cochran, 2000; SASS, 1983). Some foreign
37
38 companies stole or speculated with compradors' deposits (Yan, 1964).
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42 Although certain Chinese values served as normative benchmarks for guiding business
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44 behaviors, they did not guarantee ethical commercial cultures in pre-1949 China, especially
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46 when some compradors predominantly pursued selfish economic interests. For example,
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48 compradors occasionally disregarded a principal's interests to extend their own business (Hao,
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50 1970). Foreign principals and Chinese compradors might collude to market socially unacceptable
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52 products such as opium, gambling, dog or horse racing, prostitution, and contraband (*Shenbao*,
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3 various issues; SHLHMC, 1986; Zhao, 1990).

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5 Moreover, principals and compradors occasionally developed a special mutual
6
7 stewardship relationship by behaving dishonestly to undermine third parties' interests (Davis,
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9 Schoorman, and Donaldson, 1997). Mobile Oil used compradors to recruit Chinese employees
10
11 (not compradors) working for Texaco and Asiatic Oil to reveal proprietary information, and
12
13 Asiatic Oil acted similarly toward Mobil Oil and Texaco (Liu, 1984; Zhou and Huang, 1984).
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15 With its Chinese compradors' assistance, BAT snatched market share from its main rival Lopato
16
17 (Russian) in Manchuria and destroyed the reputation of its main Chinese competitor, Nanyang
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19 Brothers (Cox, 1997; Ding, 1984; SASS, 1983). BAT exploited Chinese peasants in Henan and
20
21 Anhui by giving them Virginia tobacco seeds in the spring and collecting harvested tobacco
22
23 leaves later through Chinese compradors' local networks that avoided local government
24
25 regulation. Because BAT was the primary buyer and local peasants had minimal facilities for
26
27 storing tobacco leaves, BAT artificially depressed these leaves' price (Jiang and Chen, 1964; Jin,
28
29 1963; Li, 1962; SASS, 1983; SHERI, 1960; SDNCA, 1999). To pressure tea farmers to cut
30
31 prices, foreign companies collecting tea in Shanghai asked *Chashi* (tea inspectors) to
32
33 intentionally slow inspection efforts, as such procrastination would lower tea quality (SDNCA,
34
35 1999).

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38 Foreign companies did not limit themselves to building social bonds. Instead, they relied
39
40 on alternate intermediaries to suppress compradors' dishonest acts. For example, BAT and the
41
42 Swire Group relied on compradors and employees to preclude either group from monopolizing
43
44 business procedures (Cochran, 1980, 2000; SHERI, 1960; Yang, 1984). After establishing their
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46 Chinese business, foreign companies pressured compradors to work honestly and effectively via
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48 more formalized controls. Hence, adopting formal institutional arrangements or building social
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3 bonds also relies on the perceived power balance between foreign companies and local agents.
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5 Foreign companies believing local agents could work with local businesses more effectively
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7 tended to build social bonds. In contrast, foreign companies well-entrenched in China tended to
8
9 adopt formal institutional arrangements like rigid corporate hierarchies or formal contracts
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11 (Cochran, 2000).
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15 The PAP could extend past China when foreign managers acted as their home company's
16
17 agents. For example, U.S. and U.K. companies' managers colluded with Chinese compradors to
18
19 smuggle opium and other contraband into China without concern about undermining their
20
21 companies' reputations (Haddad, 2014; Yan, 1986a,b). The Hankou-based branch managers of a
22
23 Japanese company colluded with its compradors to embezzle Japanese government funds
24
25 (Zheng, 1984).
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28 **Discussion**

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30 A historically sensitive (re)examination of business events embedded in past contexts can
31
32 inform theory and methodology development in management (Van Lent and Durepos, 2019).
33
34 This study contemplates Western-based principal-agent theory's applicability to a non-Western
35
36 context by examining the PAP and trust-building between compradors and foreign companies in
37
38 pre-1949 China, a context characterized by wars, regional conflicts, and foreign economic
39
40 pressures and political invasions (SASS, 1983; Spence, 1991). Although traditional principal-
41
42 agent theory helps explain many cross-cultural business behaviors, the proposed extension
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44 indicates how certain contextualized strategies shape the PAP, its solutions, and principals' and
45
46 agents' strategic business behaviors in socio-politically chaotic marketplaces. As this historical
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48 study shows, principals and agents can align their interests. Thus, scrutinizing principal-agent
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50 relationships in non-Western socio-historical contexts can elucidate business (mis)behaviors
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3 across borders and boost conventional principal-agent theory's generalizability.
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5 This study supersedes conventional principal-agent theory's focus on agents' dishonest
6 acts by considering principal dishonesty toward agents, mutual principal-agent stewardship, and
7 principal-agent collusion to enrich themselves at a third party's expense. Rather than debunk
8 conventional principal-agent theory, it shows that principals' and agents' interests can be
9 aligned, conforming to stewardship theory (Davis, Schoorman, and Donaldson, 1997). For
10 example, conventional principal-agent theory maintains that PAP-related measurement and
11 implementation costs are challenging to minimize. In contrast, historical data shows that
12 principals in pre-1949 China circumvented direct measurement of agents' behaviors by
13 examining compradors' overall performance (e.g., market share, cash inflow, and net profit).
14 Capping transaction costs helped to minimize implementation costs. Moreover, managers can
15 sustain fruitful partnerships or coalitions by internalizing values such as compliance, loyalty,
16 allegiance, and rapprochement (Zheng and Wan, 2020).
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33 Historical insight into strategies adopted by foreign companies in pre-1949 China may
34 inform contemporary companies' business entry strategies. The main managerial implication
35 entails securing successful international market entry by shrinking the information, interest, and
36 interpretive gaps between local agents and foreign companies. Formal contracts cannot guarantee
37 the effective implementation of contractual obligations when one party cannot detect or assess
38 the other party's behaviors (Bolton and Dewatripont, 2005; Hart, 1995). Hence, in addition to
39 adopting well-known measures such as creating personal trust, Guanxi, and monetary incentives,
40 foreign companies should augment conventional approaches by espousing specific cultural
41 values or offering political or social rewards to sustain long-term symbiotic relationships
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3 between principals and agents. That is, institutionalizing formal or informal constraints or
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5 incentives can counter misbehaviors.
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7 ***Limitations and Future Research***

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9
10 This historical study is limited in four ways. First, it applied CHRM to the elements and
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12 mechanisms shaping strategic interactions between principals and agents. Foreign principals'
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14 differing cultural backgrounds were ignored. Hence, future research could probe for varying
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16 interactions between Chinese compradors and Russian, American, British, Japanese, and
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18 overseas Chinese principals.
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22 Second, the nonlinear relationship between local agents' preferences and economic
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24 changes was ignored. Although this study assumed stable principal-agent relationships, they may
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26 shift after agents accumulate sufficient economic and social power. Hence, future research could
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28 (1) explore how foreign companies can avoid powerful future competitors by constraining local
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30 agency development, or (2) identify complementary or replacement strategies to a share-
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32 cropping-like commission system when local agents' monetary pursuits subside.
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36 Third, focusing on pre-1949 (1840-1949) China limited this study's external validity.
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38 Hence, a comparative historical analysis of the PAP in other socio-economic contexts is needed.
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41 Fourth, positing that structural, cultural, and personal emergent properties in international
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43 business are best understood collectively (Zincir, 2022), efforts to broaden principal-agent theory
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45 and deepen related insights into business strategies and managerial styles could examine these
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47 research questions through a socio-historical lens:
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- 49 • How can dynamic interactions and changing power structures between foreign companies
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51 and local agencies (e.g., for retailing, franchising, procuring, or advertising) sustain entry
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3 into international markets and enhance stakeholders' welfare? How do such interactions
4
5 relate to business ethics and consumer culture?
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7

- 8 • If values discouraging agents' dishonest behavior in pre-1949 China fail in other
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10 political, cultural, and economic business contexts, how can adaptive and ecological
11
12 rationality evolve for future foreign principals and local partners?
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14
- 15 • How do principal-agent and stewardship theory apply to B2C and B2B strategies,
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17 advertising agency-client relationships, and co-branding across borders and cultures
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19 (Bergen *et al.*, 1992; Lee and Decker, 2016; Paswan and Panda, 2000)?
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21

22 **Conclusions and Implications**

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24 What are the PAP's driving elements and participants in changing socio-historical
25
26 contexts? How the PAP is (re) defined and how can it be solved? What are its implications for
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28 contemporary managers and marketers? Drawing on the critical historical analysis of multilateral
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30 historical data, this study answers these questions by showing economic, cultural, and
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32 psychological elements can shape the PAP. It indicates principal-agent interests can be
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34 reconciled, as suggested by stewardship theory, which extends insights into the PAP's interactive
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36 elements, underlying mechanisms, and mitigating measures.
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42 **Declarations:**

- 43
44 • Funding: No external funding was required.
- 45
46 • Conflicts of interest/Competing interests: The authors report no competing interests to
47
48 declare.
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- 50
51 • Availability of data and material: Multilevel data were collected.
- 52
53 • Code availability: No special software or custom code was required.
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Table 1. Curbing Compradors' Disloyalty in Pre-1949 China

Three Groups of Strategies	Main Measures	Business and Market Efficacy
Economic Motivations and Restraints	Subsidies, financial rewards, pensions, formal business contracts, and informal monetary rewards (e.g., processing fees, kickbacks, and secret allowances)	Partly effective but still could not control many hidden actions by compradors with non-monetary interests
Discourage Dishonest Acts with Additional 'Oversight and Control' Institutions	<ul style="list-style-type: none"> • Low-value transactions to control losses and find competent and loyal compradors • Compradors required sponsorship by wealthy persons (<i>Ren Bao</i>) or successful Chinese retailers (<i>Pu Bao</i>) • A central comprador to coordinate branch compradors • Independent accounting and auditing systems to monitor comprador transactions • Filing lawsuit 	Effective in curbing agency disloyalties by increasing disloyalty costs
Mitigate the PAP by Building Social Bonds	<ul style="list-style-type: none"> • Compradors internalizing traditional Chinese values such as <i>Zhong</i> (loyalty), <i>He</i> (amicability), <i>Ren</i> (benevolence), <i>Li</i> (politeness and personal integrity), <i>Yi</i> (allegiance), and <i>Xin</i> (faithful to one's promise) as behavioral guidelines • Social prestige and friendships • Compradors seek economic interests or obtain political positions • Forgiving some compradors' misbehaviors or relaxing their obligations to contractual terms in exchange for their future loyalty or flexible but more productive performance 	Discouraged compradors' disloyalty by building symbiotic relationships between agents and principals

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