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Culture, Law, and Corporate Governance

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Abstract

This article advances a new framework for investigating a simple yet fundamental question: in what ways does the law on the books reflect cultural values? We analyze relations between indices of investors' legal rights—as coded by La Porta et al. (LLSV)—and national cultural profiles. These indices correlate with cultural priorities that are consistent with societal acceptance of litigation. Indices of formalism in civil procedure exhibit similar correlations. Such societal stance may be related to a heritage of British rule. Grouping countries according to legal families—the cornerstone of LLSV's legal approach—provides only a partial depiction of the universe of corporate governance regimes. Our findings cast doubt on the alleged general supremacy of statutes in common law countries. These findings have implications for understanding diversity and convergence in corporate governance systems and for a systematic analysis of the interface between law and social institutions.

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1. Introduction

This article advances a new framework for investigating a simple yet fundamental question: in what ways does the law on the books reflect cultural values? While the notion that it could might appear to be a truism, analysis of this question in law and economics is lacking.

In 1996, La Porta, Lopez-de-Silanes, Shleifer, and Vishny (LLSV) redefined the analytical framework for comparative research on corporate governance by introducing an

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integrated approach to law and finance.¹ LLSV's operationalization of investors' legal rights and legal origins enabled statistical tools to be implemented.² These constructs have been shown to correlate with important economic factors, thus suggesting the desirability of enhancing investors' rights through legislative reform.³ LLSV later advanced what they called 'the legal approach' as the preferred way to understand corporate governance. This approach focused on classification by legal origins more than on particular index scores.⁴ Later works by LLSV and others treat the legal origin variable as a proxy for colonial impact on social institutions, with a common law origin generally predicting a beneficial impact.⁵

Several countries formerly under communist regimes implemented legal reforms during the 1990s with a view to enhancing investor protection. With few exceptions, these reforms produced outcomes that varied from disappointing to ruinous.⁶ At the turn of the millennium, commentators came to share the view that simply writing investor rights into the law is not enough; more fundamental issues must be confronted. Pistor and co-workers thus highlighted the importance of the mode of legal transplantation and the level of law enforcement (legality).⁷

The insight that changing the law on the books does not guarantee corporate governance improvement encouraged researchers to consider additional factors. Rajan and Zingales refer to history and politics to call LLSV's results into question.⁸ Pagano and Volpin advance a political economy model and evidence that associates minority shareholder protection with the prevalence of coalition governments in countries.⁹ Relatedly, Roe links social-

¹ Rafael La Porta et al., *Law and Finance*, 106 *J. Pol. Econ.* 1113 (1998), originally appeared as NBER Working Paper No. 5661 (1996).

² The indices have become a standard reference. Early implementations include Ross Levine, *Law, Finance, and Economic Growth*, 8 *J. Fin. Intermediation* 36 (1999); Ross Levine, *The Legal Environment, Banks, and Long-Run Economic Growth*, 30 *J. Money, Credit & Bank.* 596 (1998); Asli Demircug-Kunt & Vojislav Maksimovic, *Law, Finance, and Firm Growth*, 53 *J. Fin.* 2107 (1998).

³ See La Porta et al., *supra* note 1; Rafael La Porta et al., *Legal Determinants of External Finance*, 52 *J. Fin.* 1131 (1997) (hereinafter *Legal Determinants*); Rafael La Porta et al., *Agency Problems and Dividend Policies Around the World*, 55 *J. Fin.* 1 (2000). See also Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, *Corporate Ownership around the World*, 54 *J. Fin.* 471 (1999); Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, *Tunneling*, 90 *Am. Econ. Rev. Papers & Proceedings* 22 (2000).

⁴ Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 *J. Fin. Econ.* 3 (2000).

⁵ See, e.g. Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer, & Robert W. Vishny, *The Quality of Government*, 15 *J. L. Econ. & Org.* 222 (1999); Thorsten Beck, Ross Levine, & Norman Loayza, *Finance and the Sources of Growth*, 58 *J. Fin. Econ.* 261 (2000); Ross Levine, *Law, Finance, and Economic Growth*, 8 *J. Fin. Intermediation* 36 (1999).

⁶ Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?* 52 *Stan. L. Rev.* 1739 (2000); Edward Glaeser, Simon Johnson, & Andrei Shleifer, *Coase versus the Coasians*, 116 *Q. J. Econ.* 853 (2001).

⁷ Daniel Berkowitz, Katharina Pistor, & Jean-Francois Richard, *Economic Development, Legality and the Transplant Effect*, 47 *Eur. Econ. Rev.* 165 (2003); Katharina Pistor, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 *Eur. Bus. Org. L. Rev.* 59 (2000); Katharina Pistor, Martin Raiser, & Stanislaw Gelfer, *Law and Finance in Transition Economies*, EBRD Working Paper No. 48 (2000).

⁸ Raghuram Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the 20th Century*, 69 *J. Fin. Econ.* 5 (2003).

⁹ Marco Pagano & Paolo F. Volpin, *The Political Economy of Corporate Governance*, CSEF Working Paper No. 29 (2000).

democratic governments with the absence of dispersed shareholding in countries.¹⁰ Beck, Demirgüç-Kunt, and Levine present evidence consistent with the legal approach and with a theory of bio-geographic endowment—both of which are connected to the impact of colonial rulers.¹¹ In a remarkable development, Shleifer posited that the practice of justice and the ‘structure’ of society rather than the law itself are what matters for investor protection—that legal rules are just a reflection of a broader societal stance.¹²

Theorists, policy-makers, and practitioners share the intuition that corporate governance reflects national culture.¹³ Until recently, however, commentators treated culture either anecdotally or as a black box. The challenge for economic analysis is to operationalize culture in ways that permit developing and investigating testable hypotheses. Toward this end, Stulz and Rohan Williamson and Beck et al. used countries’ predominant religion as a proxy for their national culture.¹⁴

Religion is a convenient proxy for culture. Classifying countries by religion, however, fails to capture the richness of cultural differences. This is especially so for the commonly employed religious classification of countries as Protestant versus other. This misses both the complexity of religious variation around the world and the large differences in religious commitment within countries. Even more important, it leaves the substantive meaning of the cultural differences virtually undefined.

We propose an alternative cultural framework for addressing the fundamental question posed above: in what way do the laws on the books in different societies reflect the culture that prevails in those societies? Put another way: are meaningful, measurable elements of the culture found in different countries manifest in the statutory legal rules of those countries?

Like others, we operationalize legal rules by using the LLSV dataset. Notwithstanding its limitations as a measure of investor protection (see below), this dataset provides a unique snapshot of certain legal rules in the context of corporate governance. Narrowly interpreted, these indices specify sets of circumstances over which disputing corporate constituencies can resort to litigation. We derive testable hypotheses that link the LLSV scores of countries to specific aspects of the cultures of these countries. In doing so, we follow the view that protecting investors through statutory legal rights hinges on the practice of justice in the court system.

To conceptualize and measure culture in a richer manner, we draw upon the prevailing theories in cross-cultural psychology—a discipline heretofore untapped by law and economics. Analyzing cultural value dimensions and generating data that describe national

¹⁰ Mark J. Roe, *Political Determinants of Corporate Governance* (2003).

¹¹ Thorsten Beck, Asli Demirgüç-Kunt, & Ross Levine, *Law, Endowments, and Finance*, 70 *J. Fin. Econ.* 137 (2003).

¹² Andrei Shleifer, *Strategies for Protecting Investors*, David Horowitz Lectures, Jerusalem and Tel Aviv, Israel, February 2002 (on file with authors).

¹³ See, e.g. Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 *Stan. L. Rev.* 127, 168 (1999); OECD Ad Hoc Task Force on Corporate Governance, *OECD Principles of Corporate Governance*, Document SG/CG(99)5 3 (1999); CalPERS, *Global Corporate Governance Principles* (1999).

¹⁴ René M. Stulz & Rohan Williamson, *Culture, Openness, and Finance*, 70 *J. Fin. Econ.* 313 (2003); Beck et al., *supra* note 11. These works were inspired by David Landes, who argues that religious values may affect the development of institutions. David Landes, *Culture Makes Almost All of the Difference*, in *Culture Matters 2* (Lawrence E. Harrison & Samuel P. Huntington, Eds., 2000).

cultures is a central focus of this discipline. Models and datasets on cultural value dimensions allow, for the first time, to derive testable hypotheses without resorting to crude proxies like religion.

This study reveals correlations, predicted on the basis of theory, between national scores on cultural value dimensions and indices of shareholder voting rights and of creditor rights. These findings suggest that a national culture that promotes assertiveness in reconciling conflicting interests and that promotes tolerance for the uncertainty this creates is consistent with using litigation to deal with economic conflicts. The correlations between national culture and legal rules hold regardless of other major characteristics of countries. Moreover, these associations are not due to a reverse causal impact of legal rules on culture. In part, they may reflect a heritage of British rule. Further evidence suggests that cultural orientations persist in the face of formal legal reforms. Hence, national culture may impede reform and may induce path dependence in corporate governance systems.

The final inference from the current study concerns the classification of countries by legal origin—the cornerstone of LLSV’s legal approach. We find that this classification provides only a partial depiction of the universe of corporate governance regimes. Shareholder rights are higher in countries belonging to the English-speaking cultural region. However, these countries fare no better than others in protecting creditors. This casts doubt on the alleged general superiority of statutes in common law countries for protecting investors. We conclude that analyses of corporate governance regimes should combine the legal with the cultural approach.

2. Theory and hypotheses

2.1. *Relations between culture and legal rules*

The mechanisms that connect culture and law in national societies are mostly terra incognita in economic theory. Oliver Williamson advances a notional model distinguishing four levels of analysis.¹⁵ “Level 1” consists of informal institutions.¹⁶ This is where norms, customs, mores, and traditions are located and where religion plays a role. According to Williamson, “Level 1 is taken as given by most institutional economists.” Level 2, located below Level 1, consists of formal legal rules, comprising constitutions, law, property rights, etc. North has shown that the definition and enforcement of legal rights are important features of this level.¹⁷ In this model, higher levels impose constraints on the development of the levels immediately below. Williamson postulates that Level 1 informal institutions are pervasively linked with complementary institutions, both formal and informal. The resulting institutions “have a lasting grip on the way a society conducts itself.” Governance structures (e.g. of firms) and marginal analysis (e.g. of economic outcomes) belong to Levels 3 and

¹⁵ Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. Econ. Lit. 595 (2000).

¹⁶ Williamson identifies Level 1 with the notion of “embeddedness” proposed by Mark Granovetter, *Economic Action and Social Structure: The Problem of Embeddedness*, 91 Am. J. Sociol. 481 (1985). Both concepts must not be confused with the cultural orientation of Embeddedness.

¹⁷ Douglass C. North, *Institutions*, 5 J. Econ. Perspectives 97 (1991).

4, respectively, and therefore lie beyond the present scope. Although the system is fully interconnected, feedback among levels is neglected.

Viewing Level 1 informal institutions merely as constraints, that define transaction costs for alternative formal institutions, does not fully capture their role. The prevailing informal institutions in a society (e.g. beliefs, norms, and values) also serve as sources of motivation for and justification of alternative formal institutions.¹⁸ Culture—as we conceptualize and operationalize in the present study—encompasses both facets of Level 1 institutions, namely as constraints and as motivational factors. Culture operates as a constraint due to its nature as societies' "common knowledge" (see Section 2.2). It thus coordinates people's epistemics and expectations. This lowers the social costs for developing and sustaining institutions that are compatible with prevailing cultural values. Culture operates to motivate and justify action compatible with its values through its impact on organizational policies and on the values of individual decision-makers.¹⁹

The foregoing analysis points to the assumption that underlies our basic hypotheses: in the long run the content of formal legal rules should be compatible with and partly reflect the prevailing cultural orientations in a society. The present study considers legal rules that pertain to reconciling conflicting economic interests through the court system. Specifically, we focus on litigation-based enforcement of investor rights in corporations. To corroborate the analysis, we also look at enforcement of simpler contractual rights.

2.2. Value dimensions of culture

Definitions of culture abound. In order to distinguish culture from structural aspects of society that might influence corporate governance, we define culture in subjective terms. Culture refers to the complex of meanings, symbols, and assumptions about what is good or bad, legitimate or illegitimate that underlie the prevailing practices and norms in a society.²⁰ Value emphases are the essence of culture seen this way. They are the implicitly or explicitly shared, abstract ideas about what is good, right, and desirable in a society.²¹ They justify and guide the ways that social institutions (e.g. the family,

¹⁸ Avner Greif, *Cultural Beliefs and the Organization of Society: A Historical and Theoretical Reflection on Collectivist and Individualist Societies*, 102 *J. Pol. Econ.* 912 (1994); Victor Nee, *A New Institutional Approach to Economic Sociology*, in *The Handbook of Economic Sociology* 49 (Neil Smelser & Richard Swedberg, Eds., 2nd ed., 2005).

¹⁹ Lilach Sagiv & Shalom H. Schwartz, *A New Look at National Culture: Illustrative Applications to Role Stress and Managerial Behavior*, in *Handbook of Organizational Culture and Climate*. 417 (Neal M. Ashkanasy, Celeste P.M. Wilderom, & Mark F. Peterson, Eds., 2000); Peter B. Smith, M. F. Peterson, & Shalom H. Schwartz, with 49 co-authors, *Do Cultural Values Predict Managerial Behaviors? A 47 Nation Study*, 33 *J. Cross-Cultural Psychol.* 188 (2002); Shalom H. Schwartz, *Mapping and Interpreting Cultural Differences around the World*, in *Comparing Cultures* (Henk Vinken, Joseph Soeters, & Peter Ester, Eds., 2004).

²⁰ Pierre Bourdieu, *Outline of a Theory of Practice* (1972); Hazel R. Markus & Shinobu Kitayama, *A Collective Fear of the Collective: Implications for Selves and Theories of Selves*, 20 *Personality & Social Psychol. Bull.* 568 (1994).

²¹ Robin M. Williams, *American Society: A Sociological Interpretation* (3rd ed., 1970). This definition is similar to that adopted in studies of the effects of societal development (e.g. *Culture Matters: How Values Shape Human Progress* (Lawrence E. Harrison & Samuel P. Huntington, Eds., 2000)) and widespread in cross-cultural psychology (e.g. *Handbook of Cross-Cultural Psychology* (John W. Berry, Marshall H. Segall, & Cigdem Kagitcibasi, Eds., 2nd ed., 1997)).

education, economic, political, religious systems) function, their goals and modes of operation. Social actors (e.g. organizational leaders, policy-makers, individual persons) draw on these cultural value emphases to select actions, evaluate people and events, and explain or justify their actions and evaluations.²²

Many different value emphases could be chosen to characterize cultures. Rather than using arbitrary intuitions to select values relevant to corporate governance, we utilize the key dimensions of culture identified in the literature of cross-cultural psychology, the discipline that specializes in cross-national comparisons of culture. A common postulate in cross-cultural psychology is that all societies confront similar basic issues or problems when they come to regulate human activity.²³ The key dimensions of culture are derived from these issues, because the preferred ways of dealing with them are expressed in different societal value emphases. It is thus possible to characterize the culture of different societies by measuring the prevailing value emphases on these key dimensions. This yields unique cultural profiles.

Schwartz has provided the first set of cultural value dimensions we use.²⁴ He derived three bipolar, cultural value dimensions from three basic issues that confront all societies. In coping with these issues, societies exhibit greater or lesser emphasis on the values at one or the other pole of each dimension. Analysis of the dimensions yields seven value orientations on which cultures can be compared. [Table 1A](#) briefly describes these basic societal issues, the three value dimensions dealing with them, and the polar orientations. Hofstede advanced another pioneering dimensional framework for characterizing culture.²⁵ [Table 1B](#) sets forth Hofstede's value dimensions and the basic societal problems they address. Here too, each dimension describes a range of possible stances between two polar extremes.

2.3. *Cultural value orientations and investor rights*

Corporate governance is the framework that defines the division of wealth and power in the corporation. Legal rules that shape this division are scattered in various parts of countries' laws, including specific corporate laws, general commercial codes, bankruptcy codes, financial institutions regulation, etc.²⁶ Voting rights are a critical aspect of corporate governance, however, because they define the extent to which shareholders can exert power over corporate affairs. Voting rights are the essential characteristic of equity, valuable primarily

²² Clyde Kluckhohn, *Value and Value Orientations in the Theory of Action*, in *Toward a General Theory of Action* (Talcott Parsons & Edward Shils, Eds., 1951); Geert H. Hofstede, *Culture's Consequences: International Differences in Work-Related Values* (1980); Shalom H. Schwartz, *Cultural Value Differences: Some Implications for Work*, 48 *Appl'd Psychol. Int'l Rev.* 23 (1999).

²³ See Florence R. Kluckhohn & Fred L. Strodtbeck, *Variations in Value Orientations* (1961).

²⁴ Shalom H. Schwartz, *Cultural Dimensions of Values: Towards an Understanding of National Differences, in Individualism and Collectivism: Theoretical and Methodological Issues* 85 (Uichol Kim et al., Eds., 1994); Schwartz, *supra* note 19; Schwartz, *supra* note 22.

²⁵ Geert H. Hofstede, *Culture's Consequences: International Differences in Work-Related Values* (1980) (hereinafter "Culture's Consequences 1980"); Geert Hofstede, *Culture's Consequences: Comparing Values, Behaviors, Institutions, and Organizations Across Nations* (2nd ed., 2001) (hereinafter "Culture's Consequences"); Geert H. Hofstede, *Cultures and Organizations: Software of the Mind* (1991) (hereinafter "Software of the Mind").

²⁶ See Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (1994).

Table 1A

The Schwartz cultural value dimensions

Embeddedness/Autonomy

Concerns the desirable relationship between the individual and the group. Embeddedness represents a cultural emphasis on maintenance of the status quo, propriety, and restraint of actions or inclinations that might disrupt group solidarity or the traditional order. Autonomy describes cultures in which the person is viewed as an autonomous, bounded entity who finds meaning in his or her own uniqueness. Intellectual Autonomy refers to a cultural emphasis on the desirability of individuals independently pursuing their own ideas and intellectual directions; Affective Autonomy to a cultural emphasis on the desirability of individuals independently pursuing affectively positive experience.

Hierarchy/Egalitarianism

Concerns guaranteeing responsible behavior that will preserve the social fabric. Hierarchy refers to a cultural emphasis on obeying role obligations within a legitimately unequal distribution of power, roles, and resources. Egalitarianism refers to an emphasis on transcendence of selfish interests in favor of voluntary commitment to promoting the welfare of others.

Mastery/Harmony

Concerns the relation of humankind to the natural and social world. Mastery refers to a cultural emphasis on getting ahead through active self-assertion. Harmony refers to an emphasis on fitting harmoniously into the social and natural environment.

Table 1B

The Hofstede cultural value dimensions

Individualism/Collectivism

Valuing loosely knit social relations in which individuals are expected to care only for themselves and their immediate families versus tightly knit relations in which they can expect their wider in-group (e.g. extended family, clan) to look after them in exchange for unquestioning loyalty.

Power Distance

Accepting an unequal distribution of power in institutions as legitimate or illegitimate.

Uncertainty Avoidance

Feeling uncomfortable or comfortable with uncertainty and ambiguity, and therefore, valuing or devaluing beliefs and institutions that provide certainty and conformity.

Masculinity/Femininity

Valuing achievement, heroism, assertiveness, and material success versus relationships, modesty, caring for the weak, and interpersonal harmony.

for large minority shareholders.²⁷ These shareholders can exploit voting rights directly, in the general meeting, or indirectly, as a credible threat to stand up for their rights in court.

We focus on litigation over voting rights as a means for dealing with conflicting economic interests in the corporation.²⁸ Countries may differ in the extent to which they direct investors to resolve their grievances in court. If, as Shleifer proposes, what matters for investor protection is the practice of justice and the ‘structure’ of society, then these dif-

²⁷ Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. Fin. 737, 751–55 (1997).

²⁸ We do not view voting rights as an apparatus of corporate democracy, notwithstanding the use of the same label, since this is not a salient feature of shareholding in most countries.

ferences should be compatible with the way a society conducts itself in general, namely with cultural orientations. A similar analysis applies to legal rights granted to creditors, which become crucial during insolvency. The bankruptcy setting is highly confrontational as various constituencies try to take as much as they can from a limited pie. The element of confrontation implies that hypotheses about cultural values and enforcing creditors' rights should be similar to the ones advanced with regard to shareholders' rights.

Our first cultural hypothesis is that greater reliance on concrete legal rules enforceable in the courts is stronger in nations high on the Schwartz cultural orientation of Mastery and low on his Harmony orientation. These cultural emphases are compatible with giving power to investors and encouraging them to stand up and fight for their rights. Cultural Mastery emphasizes assertiveness, venturing, and active determination of one's destiny. In contrast, cultural Harmony opposes head-on confrontation, so it should discourage embodying economic interests in strict legal form and zealously enforcing them in court.

Our second cultural hypothesis is that investor legal rights are stronger in nations high on the Hofstede Individualism dimension and low on his Uncertainty Avoidance dimension. Individualism (versus Collectivism) legitimizes the vigorous pursuit of personal interests rather than deference to others' decisions and interests. Uncertainty Avoidance affects the way power in organizations is exercised. High Uncertainty Avoidance is consistent with giving power to authorities who control uncertainty and with perceiving conflict in the corporation as unnatural.²⁹ Low Uncertainty Avoidance is compatible with readiness on the part of corporate constituencies to challenge one another—in general meetings, in public media, and in the courts—with indeterminate outcomes.

3. Data

3.1. Cultural variables

3.1.1. The Schwartz data

Respondents from every inhabited continent completed a value survey anonymously in their native language.³⁰ They rated the importance of 56 single values as “guiding principles in MY life.” Each value was followed in parentheses by a short explanatory phrase (e.g. WEALTH [material possessions, money]). Responses ranged from 7 (of supreme importance) to 3 (important) to 0 (not important) to –1 (opposed to my values). Separate multidimensional scaling analyses of the 56 values within each of the different nations established that 45 of the values have near-equivalent meaning across cultures. Only these 45 values were, therefore, included in the analyses for testing cultural dimensions. A Similarity Structure Analysis (SSA) of these values across nations supports the use of the seven value orientations to represent national cultures.³¹

²⁹ Hofstede, *Culture's Consequences*, *supra* note 25, at 133, 166.

³⁰ The survey is described in Schwartz, *supra* note 22.

³¹ The SSA was performed on data from over 35,000 respondents from 122 samples in 49 nations, gathered between 1988 and 1993. See Schwartz, *supra* note 22. On the methods used see Ingwer Borg & James C. Lingoes, *Multidimensional Similarity Structure Analysis* (1987); Louis Guttman, *A General Nonmetric Technique for Finding The Smallest Coordinate Space for a Configuration of Points*, 33 *Psychometrika* 469 (1968).

Data for comparing nations might ideally be obtained from representative national samples. But inferences about national culture from such samples require caution. Differences in the demographic compositions of national populations (e.g. distributions of age, education, occupation) affect average value priorities. Consequently, even when comparing the values of representative national samples, it would be necessary to control for demographic differences between nations before we could confidently ascribe observed differences in value priorities to national culture alone. Moreover, many nations contain more than one sub-cultural group, so a single characterization based on a representative national sample is still misleading.

The approach taken instead was to obtain samples matched on critical characteristics, largely from the dominant cultural group in each nation.³² The focal type of sample was urban school teachers who teach the full range of subjects in grades 3–12 of the most common type of school system. No single occupational group represents a culture, but school teachers may have a number of advantages for characterizing national value priorities. As a group, they play an explicit role in value socialization, they are presumably key carriers of culture, and they probably reflect the mid-range of prevailing value priorities in most societies. By focusing on this single matched group, it was possible to obtain a relatively pure representation of national differences in value priorities, net of the influences of other national differences.³³

To compute the mean importance of a value orientation in a nation, the importance that members of the sample from that nation attributed to the set of values that represent that orientation was averaged. For cross-national comparisons, sample differences in scale use were eliminated by centering the mean importance of all seven orientations within each sample around the approximate international mean. The meaningfulness and validity of such subjective, societal-level measures as explanatory variables is supported by associations between national scores on them and a wide variety of social, economic, political, demographic, and other characteristics of nations.³⁴

Some of our analyses group nations into regions based on the similarity of their cultural profiles. These regions emerged when the similarities and differences among nations on the seven cultural orientations were represented graphically.³⁵ This representation revealed six distinct groups of nations: English-speaking, West European, East European, Far Eastern, Latin American, and African. Each cultural region exhibited a distinctive

³² In line with the vast majority of cross-cultural studies, this study compares nations as cultural groups. Where national boundaries encompassed heterogeneous groups with separate distinctive cultures, their data refer to the culture of the dominant group.

³³ To test the robustness of conclusions from the teacher samples, Schwartz, *supra* note 19, performed parallel analyses with data from samples of college students, from a wide variety of majors, in each of 40 nations. The results supported the value dimensions and the locations of the nations on these dimensions.

³⁴ See Marianne Bertrand & Sendhil Mullainathan, *Do People Mean What They Say? Implications for Subjective Survey Data*, 91 *Am. Econ. Rev.* 67 (2001); Hofstede, *Culture's Consequences*, *supra* note 25; Schwartz, *supra* note 19.

³⁵ See Yair Goldreich & Adi Raveh, *Coplot Display Technique as an Aid to Climatic Classification*, 25 *Geographical Analysis* 337 (1993) for the statistical technique employed.

value profile that differed significantly from all other regions on at least one dimension (see Appendix B).

3.1.2. *The Hofstede data*

Hofstede's study originated in an audit of company morale among IBM employees across the world around 1968 and around 1972. Factor analysis of country mean scores in 50 countries and three regions produced the four dimensions described above. Hofstede noted the criticism that "IBMers are very special people, not at all representative for our country." He argued, however, that the crucial requirement is that samples be well matched across countries, not that they be representative. He asserted that comparing IBM subsidiaries shows national culture differences with unusual clarity because the samples are so homogeneous in terms of employer, kind of work, and education level.³⁶

Hofstede used hierarchical cluster analysis to divide countries into culture groups. To obtain meaningful groupings, however, he had to use his own judgment to join several subgroups. This yielded the following culture regions: Anglo, Germanic, Nordic, More Developed Latin, Less Developed Latin, More Developed Asian (consisting only of Japan), Less Developed Asian, and Near Eastern (see Appendix B).³⁷

3.2. *Legal variables*

3.2.1. *The LLSV data*

Our main set of legal variables is LLSV's dataset covering 49 countries (but no socialist or transition economies). It includes only countries with at least five domestic, non-financial, publicly traded firms with no government ownership in 1993. LLSV constructed two indices, described below, intending them to capture the degree to which national laws protect outside investors from insiders.

3.2.2. *Anti-director rights*

LLSV's anti-director rights index (ATD) is based on six specific legal rights granted to shareholders. Scores indicate the number of rights that the company law or commercial code in a country recognizes. In addition to this overall index, we consider two aspects that ATD intermixes: control (voting) rights and cash flow (remedial) rights.³⁸ In order to separate these two aspects, we split ATD into sub-indices. The first sub-index, labeled ATD-Vote, includes the four voting-related rights. The other sub-index, labeled ATD-Remedial, includes the two remedial rights. The two sub-indices correlate positively but moderately ($r = .29$).

³⁶ Hofstede, *Software of the Mind*, *supra* note 25, at 252; *Culture's Consequences*, *supra* note 25, at 73.

³⁷ Hofstede, *Culture's Consequences* 1980, *supra* note 25, at 333–336. In the 2001 edition, *supra* note 25, Hofstede repeats the first step of hierarchical cluster analysis with an extended group of 50 nations and three regions but fails to repeat the second step of grouping. We, therefore, opted to adhere to Hofstede's original grouping except for consolidating the two Asian groups into one.

³⁸ Nonetheless, the ATD index does not include the most important protection against directors and control persons—namely anti-self-dealing rules. Devising a numerical representation for this aspect is a difficult challenge.

3.2.3. *Creditor rights*

LLSV specified four creditor rights in either reorganization or liquidation laws, as these may substitute for one another. Scores on the creditor rights index (CRD) indicate the number of rights recognized in the law of a country.³⁹

3.2.4. *Legal families*

LLSV's classification of countries into legal families draws on René David's taxonomy of legal systems according to their origin in common law, civil law (with a breakdown into French, German, and Scandinavian laws), and several other families of law.⁴⁰

Several researchers, including LLSV have used the indices and the legal family classification as independent, explanatory variables.⁴¹ Only recently have researchers begun to use these indices as dependent variables, as part of a larger trend that seeks to identify determinants of governance in general. Nonetheless, these indices are not free from criticism. LLSV acknowledge several problems with their indices: they do not cover merger and takeover rules, they cover disclosure rules only partially, and they do not cover stock exchange rules or regulations of financial institutions.⁴² One might also object to LLSV's choice of index components, to the assignment of equal weight to each, and to LLSV's reading of particular national laws. Finally, the relevance of legal rules hinges on a general infrastructure of legality, or rule of law, in each country and especially in transition economies.⁴³

These limitations imply that the LLSV indices may not reliably capture countries' levels of investor protection. These measures nonetheless provide a unique operationalization of statutory rules in the field of corporate governance for a particularly large number of nations. These indices can be viewed narrowly as specifying sets of circumstances over which disputing parties can resort to litigation. Hence, the LLSV indices essentially reflect the extent to which countries differ in directing investors to resolve their grievances in court. Accordingly, we hypothesize that investor rights scores for nations correlate positively with nations' Mastery scores and negatively with their Harmony scores in the Schwartz dataset, and positively with Individualism and negatively with Uncertainty Avoidance in the Hofstede dataset.

³⁹ LLSV, *supra* note 1, at 1134, state that the CRD index is based on the perspective of senior secured creditors. Of the components that comprise CRD, however, only two relate to secured creditors while the others apply to creditors in general.

⁴⁰ René David & John Brierly, *Major Legal Systems in the World Today* (1985); 2 Int'l Encyclopedia of Comp. L. (René David, Ed., 1972). David's taxonomy dates from the mid-1960s and has since been criticized, *inter alia*, as being "Euro-American-centric". Ugo Mattei, *Three Patterns of Law: Taxonomy and Change in the World's Legal Systems*, 45 Am. J. Comp. L. 5, 10 (1997). Nonetheless, leading authorities on comparative law generally adhere to this taxonomy. Konrad Zweigert & Hein Kötz, *An Introduction to Comparative Law* 63–75 (Tony Weir trans. 3rd ed., 1992); Mary Ann Glendon et al., *Comparative Legal Traditions* (2nd ed., 1994); Rudolph B. Schlesinger et al., *Comparative Law: Cases-Text-Materials* 1 (5th ed., 1988).

⁴¹ See, for example La Porta et al., *Legal Determinants*, *supra* note 3, and works cited *supra* note 2.

⁴² La Porta et al., *supra* note 1.

⁴³ Pistor, Raiser, & Gelfer, *supra* note 7; see also Pistor, *supra* note 7. It should be noted that LLSV do not neglect this aspect, as they include a measure for the rule of law in their analysis.

3.2.5. *The Djankov et al. data*

To corroborate the main analysis, we take advantage of recently available data to examine relations of national culture to the degree of formalism in the working of court systems in countries. Djankov, La Porta, Lopez-de-Silanes, and Shleifer capture this feature by constructing formalism indices for two basic legal procedures: (1) eviction of a residential tenant in default of rent payments and (2) collection of a check returned for non-payment.⁴⁴ The legal formalism indices aggregate several rules of procedure, each of which is coded for the degree of formalism it reflects.

4. Results

4.1. *Cultural value orientations and investor rights*

Table 2 presents the Pearson correlations between national scores on the cultural value dimensions and on ATD and ATD-Vote. These variables correlate negatively with Harmony and Uncertainty Avoidance, as hypothesized. We fail to find the hypothesized relations with Mastery, however. ATD-Remedial does not correlate with any cultural dimension from either cultural theory—a result not altogether surprising in light of the very narrow scope of this index. Thus, we conclude that the voting rights regimes in countries fit with certain cultural emphases with which they were expected to be compatible, but the (coded) remedial rights are not related to the surrounding national culture.

Below, we report an analysis of legal families and cultural regions suggesting that Asian countries with a common law heritage are an outlier sub-group. We, therefore, recomputed the correlations here after excluding these countries. Table 2 reports the results. The negative correlations with Harmony and Uncertainty Avoidance remain significant. In the Hofstede data, Individualism also correlates positively with ATD and ATD-Vote, as hypothesized, and Power Distance correlates negatively with ATD. The latter finding is consistent with Hofstede's argument that high Power Distance connotes a negative view of power and wealth,⁴⁵ the constitutive elements of corporate governance.

Table 2 further reports Pearson correlations of creditor rights for the full sample of nations and for a sample from which common-law Asian countries are excluded. The case for excluding these countries is at least as strong with regard to creditor rights as for ATD (see below). Indeed, we advocate considering only the sample excluding these countries, pending further research on the actual level of creditors' rights in them. Excluding these countries, the results for the Schwartz model confirm the hypothesis of a negative correlation with Harmony. The correlation with Uncertainty Avoidance is also negative (at 7%). A weak negative correlation between creditors' rights and Power Distance is consistent with Hofstede's argument.

4.2. *Robustness, consistency, and dynamic aspects*

The above results suggest that the content of statutory laws governing the way to reconcile competing interests in the corporation partly reflects the surrounding national culture.

⁴⁴ Simeon Djankov et al., *Courts: The Lex Mundi Project*, 118 Q. J. Econ. 453 (2003).

⁴⁵ See Hofstede, *Culture's Consequences* 1980, *supra* note 25, at 92.

Table 2
Pearson correlations between nations' standings on cultural value dimensions and on investors' rights

Model	Full sample			Excluding asian common law		
	ATD	ATD-Vote	CRD	ATD	ATD-Vote	CRD
<i>Schwartz</i>						
Harmony	−.338**	−.353**	−.360**	−.338**	−.402**	−.327**
Embeddedness	.168	.162	.308**	.056	.155	.161
Hierarchy	.206	.271	.414***	.004	.183	.263
Mastery	.022	−.059	.102	−.036	−.107	.031
Affective Autonomy	−.090	−.007	−.107	.021	.035	.053
Intellectual Autonomy	−.306**	−.306**	−.235	−.172	−.278	−.036
Egalitarianism	−.163	−.180	−.369**	−.009	−.110	−.198
<i>N</i>	35	35	34	31	31	30
<i>Hofstede</i>						
Uncertainty Avoidance	−.394***	−.403***	.364***	−.309**	−.405***	−.248
Individualism	.126	.226	−.111	.288**	.321**	.040
Power Distance	−.092	−.166	−.058	−.277**	−.261	−.313**
Masculinity	−.015	−.063	−.009	−.039	−.084	−.040
<i>N</i>	43	43	43	38	38	37

Significance levels are one-tailed.

** Significant at 5%.

*** Significant at 1%.

The content of these laws is compatible with the degree to which the national culture tolerates or even encourages confrontational processes with indeterminate outcomes. The present framework allows us rigorously to investigate some general propositions concerning these relations. This section first examines whether the correlations noted above may be spurious. In light of the centrality of litigation to our hypotheses, we then look briefly at the relations between cultural orientations and the degree of formalism in national court systems. We then address the causal dynamics that may underlie the observed associations.

4.2.1. *Relations with other national characteristics*

One might suspect that nations' cultural orientations, and the scores that represent them, may serve as proxies for the effects of major socio-economic factors. Such factors must be of sufficient scope and magnitude in order to be considered as "competing" with culture. We, therefore, consider legality (i.e. "law and order" or "rule of law"), the level of economic development, and religion. Some degree of mutual influence among these factors and culture is likely. Nonetheless, it is possible to examine the robustness of the relations of cultural orientations (here, Harmony) to investor rights by controlling possible effects of such variables.

Legality may play a role in the actual working of corporate governance systems.⁴⁶ Higher compliance with legal rules is likely to accompany higher scores on the LLSV indices because both are associated with greater reliance on the court system for conflict management. There is no point in writing more rights into the law if people disregard the law and do not settle their disputes in court.

In theory, the larger size of capital markets in developed economies might induce pressure on lawmakers to provide investor protection to facilitate the working of markets. LLSV, however, find no evidence that investor rights are a consequence of per capita income.⁴⁷ Moreover, researchers recently excluded GDP per capita from their analyses due to the endogeneity problems it may entail.⁴⁸ These limitations notwithstanding, it is still worth examining whether cultural Harmony predicts the LLSV indices when economic development is taken into account.

Lastly, we test whether the association of a country's dominant religion with investor rights might account for the latter's association with cultural Harmony. Stulz and Williamson reported a positive correlation of Protestantism (versus Catholicism) with creditor rights but not with shareholder rights. Treisman noted a negative correlation between Protestantism and perceived corruption.⁴⁹ It is not clear, however, which aspects of these religions underlie these findings.

Table 3 presents results of regressing ATD, ATD-Vote, and CRD scores on Harmony and, in turn, the level of legality, economic development, and Protestantism as a dominant

⁴⁶ See Pistor, Raiser, & Gelfer, *supra* note 7; Berkowitz, Pistor, & Richard, *supra* note 7.

⁴⁷ La Porta et al., *supra* note 1, at 1139.

⁴⁸ Beck et al., *supra* note 11, note that "GDP per capita is endogenous, which causes estimation problems, as shown by Acemoglu et al. [below note 54]."

⁴⁹ Daniel Treisman, *The Causes of Corruption: A Cross-National Study*, 76 *J. Pub. Econ.* 399 (2000).

Table 3
Regressions of investors' rights on cultural harmony and other national characteristics

Dependent variable	Harmony	Rule of law	GDP/cap	Protestant	R ²	F	N
ATD	−.39** (2.56)	.38** (2.48)			.26	5.53***	35
ATD-Vote	−.40** (2.57)	.33** (2.18)			.23	4.86**	35
CRD	−.37** (2.21)	.09 (.54)			.14	2.47*	34
ATD	−.35** (2.08)		.11 (.63)		.13	2.22	34
ATD-Vote	−.37** (2.19)		.11 (.68)		.14	2.46*	34
CRD	−.34** (2.00)		−.16 (.94)		.15	2.74*	33
ATD	.39** (2.44)			.16 (.97)	.17	3.34**	35
ATD-Vote	−.48*** (3.25)			.32** (2.19)	.32	7.35***	35
CRD	−.32* (1.87)			.03 (.19)	.10	1.76	34

Standardized beta coefficients. *t*-statistic absolute values are reported in parentheses.

* Significant at 10%.

** Significant at 5%.

*** Significant at 1%.

Table 4

Pearson correlations between nations' standings on cultural value dimensions and on legal procedure formalism

Model	Evicting non-paying tenants	Collecting returned checks
<i>Schwartz</i>		
Harmony	.346***	.393***
Embeddedness	.053	.088
Hierarchy	-.211	-.221
Mastery	-.111	-.157
Affective Autonomy	-.246**	-.267**
Intellectual Autonomy	.102	.086
Egalitarianism	.085	.063
N	49	49
<i>Hofstede</i>		
Uncertainty Avoidance	.569***	.590***
Individualism	-.598***	-.527***
Power Distance	.484***	.396***
Masculinity	-.052	.074
N	48	48

Significance levels are one-tailed.

** Significant at 5%.

*** Significant at 1%.

religion.⁵⁰ Consistent with the cultural hypotheses, Harmony robustly predicts all three measures of corporate governance in the presence of these controls. These potential competitors with culture failed to account for the relations of cultural Harmony to the LLSV indices across nations. This strengthens our confidence in the robustness of culture as a predictor of corporate governance-related laws.

4.2.2. Culture and legal formalism

If cultural value priorities indeed underlie national laws, then national cultural profiles should relate consistently to laws that govern a variety of subject matters. Particularly interesting are laws pertaining to litigation, because the LLSV measures relate so closely to it. Chase argues that the tightly controlled legal procedure in Germany serves the cultural value of Uncertainty Avoidance. This contrasts with the volatile and relatively unpredictable quality of the lawyer-dominated American trial.⁵¹ We, therefore, expect lower Harmony and Uncertainty Avoidance to correlate with open-ended, informal litigation processes as the latter are represented by Djankov et al. (inversely to LLSV's indices).

Table 4 presents correlations between the formalism indices and the cultural dimensions. Confirming the hypotheses, both formalism indices—for tenant eviction and check collection—exhibit the expected positive correlations with Harmony and Uncertainty

⁵⁰ *The Rule of Law index*, from Daniel Kaufmann, Aart Kraay, & Pablo Zoido-Lobaton, Governance Matters (Working Paper 1999), represents the level of perceived legality in countries. Economic development is represented by the log of GDP per capita in 1993 (the year for which LLSV's indices were constructed), taken from the World Bank's World Development Indicators.

⁵¹ Oscar G. Chase, *Legal Processes and National Culture*, 5 *Cardozo J. Int'l & Comp. L.* 1 (1997). See also Mirjan Damaska, *The Faces of Justice and State Authority: A Comparative Approach to the Legal Process* (1974–1975).

Avoidance. They also correlate negatively with Individualism—again, inversely to the LLSV ATD index and in line with our hypothesis. Finally, formalism correlates positively with Hofstede's Power Distance in line with Damaska's and Chase's views and in contrast with the result for ATD. Replicating the regression analyses reported in Table 3 for the formalism indices yielded consistent results—namely robust positive coefficients for Harmony in the presence of the control variables (not shown). These findings support the notion that laws on the books in two different fields—corporate governance and civil procedure—reflect similar cultural orientations for particular forms of conflict management.

4.2.3. *Reverse causality and the role of British heritage*

Culture can impact law-making in two different ways: first, cultural values may motivate lawmakers and interest groups to prefer certain legal arrangements to others; second, culture may constrain reforms that are not compatible with prevailing value priorities. Culture has thus been called “the mother of all path dependencies.”⁵² One might still hesitate to draw policy implications from the present evidence. If cultural emphases adjust rapidly to changes in the legal environment, culture may have little relevance to policy formation. Before addressing this issue formally, a preliminary note is in place.

In order for statutory provisions to affect widespread beliefs about what is right and desirable (culture), they must either be central and salient or, alternatively, they must influence people's day-to-day life even if they are unaware of them. Given the way we operationalize culture, only a negligible influence from LLSV's indices to cultural orientations seems plausible. The data on culture come from respondents unlikely to be familiar with these legal rules and whose daily practices are unlikely to be affected by them. Hence, there is little reason to fear reverse causality from the legal to the cultural variables in this study.

Addressing reverse causality between variables commonly relies on using an instrumental variable in two-stage least squares (2SLS) regressions. An ideal instrument would correlate with the predicting variable but not with the predicted one. Alternatively, lagged-period values may be used as instruments as they are not susceptible to feedback from the predicted variable. The now common practice of using legal family as an instrument in predicting economic outcomes reflects the latter approach, because many countries' legal origins were determined historically by colonial rulers.⁵³ However, the legal family classification cannot be considered exogenous when studying legal rules because it is a concise representation of just such rules. This classification also does not distinguish between what was imported and its evolution into current law.

Many of the variables commonly treated as exogenous are inadequate for controlling reverse causality in relations between cultural and legal variables. They may have had reciprocal causal relations with law and/or culture either directly or through economic factors. The menu of truly exogenous variables is thus limited largely to bio-geographical factors and to major historical events. Studies that take this approach point to the long-lasting

⁵² See Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 Delaware J. Corp. L. 147 (2001).

⁵³ See, e.g. Rafael La Porta, Florencio Lopez De Silanes, & Andrei Shleifer, *What Works in Securities Laws?* J. Fin. (forthcoming).

Table 5

Two-stage least squares regressions of investors' rights on cultural harmony across nations, using a heritage of British rule as an instrumental variable

Dependent variable	Harmony	Intercept	R ²	F	N
ATD	-3.25*** (-3.14)	16.95*** (3.86)	.23	9.87***	35
ATD-Vote	-20.91*** (-2.94)	10.91*** (3.61)	.21	8.62***	35
CRD	-2.23** (-2.50)	11.54*** (3.04)	.16	6.23***	34

t-statistic values are reported in parentheses.

** Significant at 5%.

*** Significant at 1%.

implications of episodes of British rule for social and economic outcomes.⁵⁴ Being ruled by Britain apparently affected many outcomes, including the law, but as an historical fact, it could not be affected by them. We, therefore, use episodes of British rule as an instrument to control for reverse causality in our analyses.

Table 5 reports 2SLS regressions of ATD, ATD-Vote, and CRD scores on Harmony. The instrumental variable is based on Treisman's dummy variable for whether a country had experienced a British rule of any kind.⁵⁵ These regressions assess the link between Level 1 and Level 2 institutions in Williamson's model while isolating potential feedback. Consistent with the results in Table 2, Harmony has a significant negative coefficient in all the regressions.

Countries in the English-speaking cultural region score lower on Harmony and higher on Mastery than other countries.⁵⁶ Hence, the above results might be due to the subgroup of English-speaking countries among those with a history of British rule. We, therefore, checked whether non-English-speaking countries with a history of British rule also score lower on Harmony than other countries. This was indeed the case. The Harmony scores of non-English-speaking countries with a history of British rule did not differ from those of English-speaking countries, and they were significantly (at 1%) lower than the Harmony scores of other countries.

Explanations for the strong emphasis on Mastery and de-emphasis of Harmony in English-speaking former British colonies call upon the frontier experience, active development, and the centrality of entrepreneurial business. This applies to the settlement colonies including Australia, Canada, New Zealand, and the United States. In non-settlement colonies too (and not without resistance), British rulers engaged in physical development, including land-use planning and major transportation infrastructures. They also made institutional reforms including, though not limited to, legal transplantation. Today, these countries share an enhanced cultural inclination toward venturing and confronting the unknown that, among other things, supports reliance on court litigation. The results are consistent with the idea that the experience of British rule left an imprint on the cultures of these countries in tandem with its influence on their written laws, over and above any reverse causality.

⁵⁴ See, e.g. Daron Acemoglu, Simon Johnson, & James A. Robinson, *The Colonial Origin of Comparative Development: An Empirical Investigation*, 91 *Am. Econ. Rev.* 1369 (2001).

⁵⁵ Countries not coded by Treisman were coded according to the CIA's World Factbook.

⁵⁶ Shalom H. Schwartz & Maria Ros, *Values in the West: A Theoretical and Empirical Challenge to the Individualism-Collectivism Cultural Dimension*, 1 *World Psychol.* 93 (1995).

4.3. Cultural regions and legal families

The cornerstone of LLSV's legal approach to corporate governance is the classification of legal regimes into legal families. Common law regimes rank first in the legal protection afforded to external investors, whereas the French civil law group ranks last and the German and Scandinavian groups rank in between. Yet, countries may belong to particular legal families for many reasons, ranging from voluntary adoption of a legal system to forced imposition by colonial powers. Countries that belong to the same family (save Scandinavian countries) are spread across the globe. There is no a priori reason, therefore, to expect an identity between countries' cultural region and their legal family affiliations. This section argues that without considering countries' cultural region affiliation, the legal family classification alone may yield inaccurate depictions of global patterns in corporate governance regimes.

We first cross-tabulated the countries in each legal family with each cultural region for the Schwartz and Hofstede cultural regions.⁵⁷ The cross-tabulation revealed that the two taxonomies overlap only partially. Countries in the Schwartz and Hofstede English-speaking/Anglo cultural region stand out as legally homogenous, with a common law system. Countries in their Latin American/Less Developed Latin region are also homogeneous with a French civil law origin. The remaining cultural regions each contain countries from a variety of legal families. Moreover, countries with the same legal pedigree often belong to different cultural regions. The Far Eastern/Asian region is particularly noteworthy. It includes relatively equal proportions of countries with common law or civil law origins.

We use the Goodman–Kruskal lambda statistic L_B to assess the relative reduction in error in predicting legal family when the cultural region is known.⁵⁸ L_B values are .44 (Schwartz regions) and .62 (Hofstede regions), both statistically significant at 1%. Knowing the cultural region of a country helps to predict its legal family affiliation, though prediction is far from perfect ($L_B = 1$).

The key question is whether the location of a country in a cultural region predicts its corporate governance regime. Significant differences among cultural regions would suggest that differences in corporate governance regimes may be associated not only with historical legal pedigrees but also with concurrent, general societal orientations. Table 6 reports mean levels of ATD and CRD for each cultural region identified by Schwartz and Hofstede.⁵⁹ *t*-tests of the differences between the mean levels of ATD and CRD for each pair of regions reveal whether regions that differ in their cultural profiles differ systematically in legal rules.

4.3.1. Anti-director rights

The Schwartz cultural region that stands out as different from the others with a high anti-director rights score is the English-speaking region. For Hofstede's classification, the Anglo

⁵⁷ Not shown. See Appendix A. The category "Other" includes legal systems that could not be classified into LLSV's categories and several East European countries with a general Civil Law origin.

⁵⁸ See Sidney N. Siegel & John Castellan, Jr., *Nonparametric Statistics for the Behavioral Sciences* 298–299 (2nd ed., 1988).

⁵⁹ We omitted regions for which we have too few observations.

Table 6

Mean ATD and CRD scores for each cultural region and t-tests for differences between regions

Variable	Cultural region	Mean	English speaking	Latin America	Western Europe		
A. Regions identified by Schwartz							
ATD	English-speaking	4.29					
	Latin America	2.80	1.99				
	Western Europe	2.46	4.31***	.53			
	Far East	3.75	1.13	1.23			2.89***
	Far East-common law	4.50	.49	1.81			3.95***
	Far East-civil law	3.00	2.64**	.21			1.00
CRD	English-speaking	2.14					
	Latin America	1.00	1.42				
	Western Europe	1.77	.70	1.49			
	Far East	2.88	.97	2.36**			2.14**
	Far East-common law	3.75	2.09	5.75***			4.04***
	Far East-civil law	2.00	.15	1.10			.37
Variable	Cultural region	Mean	Anglo	Germanic	Nordic	MDL	LDL
B. Regions identified by Hofstede							
ATD	Anglo	4.57					
	Germanic	2.00	6.39***				
	Nordic	2.80	4.50***	1.44			
	More-developed Latin	2.50	3.17***	.57	.37		
	Less-developed Latin	2.50	3.90***	.69	.45	.00	
	Asian	3.55	2.09**	2.33**	1.24	1.50	1.79
	Asian-common law	4.60	.09	5.73***	4.03***	2.71**	3.36***
	Asian-civil law	2.67	5.05***	1.27	.27	.22	.27
CRD	Anglo	2.14					
	Germanic	2.75	.69				
	Nordic	2.00	.20	1.14			
	More-developed Latin	1.33	1.20	2.18	1.43		
	Less-developed Latin	1.29	1.08	1.64	.98	.07	
	Asian	3.00	1.32	.34	1.64	2.89**	2.61**
	Asian-common law	3.80	2.42**	1.76	4.81***	6.01***	3.60***
	Asian-civil law	2.33	.24	.49	.49	1.54	1.31

t-statistic values are reported in absolute values.

** Significant at 5%.

*** Significant at 1%.

region also emerges as distinct in its higher level of ATD scores. Cultural regions in which the dominant legal origins are continental civil law codes (i.e. West European and Latin American countries) do not differ from one another in their levels of anti-director rights. Thus, with regard to English-speaking countries, legal uniqueness and cultural uniqueness overlap and likely reinforce one another. Corporate governance rules in English-speaking common law countries seem to be grounded in a deep cultural infrastructure.

Differences in ATD scores for the Far Eastern and Asian regions made us suspect that the results may be misleading, because countries in this region have different legal origins. We split this region into sub-sets of nations according to legal origin: common law and

civil law. Comparing the ATD means of Far Eastern nations with common law ($n = 5$ in the Schwartz data) versus civil law origins ($n = 5$) suggests that legal origin dominates cultural affiliation with regard to anti-director rights. The ATD means of the common law sub-set of nations are significantly higher (at 1%) both for the nations in the Schwartz and in the Hofstede studies.

Do the results indicate that Asian countries with a common law heritage protect minority shareholders better? We doubt it. The historical fact that many of these laws were first enacted by colonial powers means that there was not necessarily a good fit between the legal structure and the cultural foundation on which it had to stand. Elsewhere, we find that perceived legality in the East Asian cultural region is significantly lower than in English-speaking and West European countries.⁶⁰ This finding is *prima facie* evidence that the law on the books may play only a minor role in determining shareholder protection in practice in East Asian countries. A decisive answer will require in-depth empirical research. In the meantime, we advocate caution in judging East Asian shareholder protection solely according to legal origin.

4.3.2. *Creditor rights*

Analysis of creditor rights across cultural regions also yields interesting insights. Apart from the Far Eastern/Asian cultural region, there are virtually no differences among cultural regions in mean levels of creditor protection, whether we classify nations according to the Schwartz or to the Hofstede data. This finding may look puzzling because LLSV do report that common law regimes score highest and French origin regimes score lowest on CRD. A cultural analysis may resolve the puzzle and indeed changes the picture substantially. To see why, consider the Far Eastern cultural region.

The mean CRD level in Far Eastern countries with a common law origin is the highest among all cultural groups.⁶¹ Counter-intuitively, it is even higher than in English-speaking countries (at 7%). In contrast, the mean CRD level in Far Eastern countries with a civil law origin does not differ from that in English-speaking countries. These findings question LLSV's broad claim that common law regimes protect investors best. Legal rules in the English-speaking (common law) region offer no more creditors rights than the civil law systems in Western Europe, Latin America, and even in Asia. Members of the British Commonwealth and the United States score low or medium on CRD. Most of the common law countries that score high on CRD are the United Kingdom itself or countries formerly under British rule in the Far Eastern or African cultural regions.⁶² It is the latter countries that elevate the CRD score of the common law family, giving it first rank among legal families.

⁶⁰ Amir N. Licht, Chanan Goldschmidt, & Shalom H. Schwartz, *Culture Rules: The Foundations of the Rule of Law and Other Norms of Governance* (Working Paper 2003).

⁶¹ *t*-statistic values for the difference in CRD between the two Far Eastern subgroups are 2.05 (significant at 9%) and 2.53 (significant at 5%) for the Schwartz and Hofstede classifications, respectively.

⁶² The countries in LLSV's common law family that received the highest CRD score (4) are: Hong Kong, India, Israel, Kenya, Malaysia, Nigeria, Pakistan, Singapore, United Kingdom, and Zimbabwe. The following common law countries score only 1: Australia, Canada, Ireland, and the United States. La Porta et al., *supra* note 1, in Table 1.

Different dynamic processes may have led to the patterns we observe. The laws in areas formerly under British rule may reflect British rulers' practice of enacting ordinances that consolidated English statutory and judge-made law. Countries formerly under British rule may thus amplify a unique feature of English law. On the other hand, the observed difference could be illusory, reflecting LLSV's focus only on statutory law. Case law in English-speaking countries other than the United Kingdom might have complemented statutory law with identical protections, such that these countries offer stronger investor protection. Alternatively, creditor protection laws may have eroded over time in some English-speaking countries.

5. Discussion

Legal reform is the primary vehicle in the hands of policy makers for peacefully inducing social change. The limited scope of legal rules considered here notwithstanding, the approach employed that yielded the present results suggests some general insights that may inform policy- and law-making.

In terms of the theoretical framework presented in part II, the value dimension approach provides a new means for rigorously addressing informal social institutions located in Level 1 of Williamson's model. We demonstrate how these deep-seated institutions need not be "taken as a given" as customarily done. Instead, the value dimension approach provides a theory-driven, universally validated operationalization of fundamental societal orientations. This approach thus enables us to derive and empirically test hypotheses about relations between institutions at Level 1 (culture) and Level 2 (legal rules).

The literature on causal relations among institutions and economic performance is in flux. Contemporary proponents of the view that "law matters" do not claim that a simple causal link runs from legal rules to economic outcomes. Likewise, the present evidence that *culture* matters does not imply that *law* does not matter. The observed relations between culture and legal rules support the proposition that, in the long term, formal institutions should be consistent with the informal cultural environment. Regarding the direction of causality, we find evidence that history (colonial rule) may have impacted both levels.

More specifically, this article considers differences among nations regarding preferred modes of regulating conflicting economic interests in corporations. The cultural orientation of Harmony features as a significant factor in this regard. Yet, corporate governance involves numerous other issues on which nations differ. Such issues include ownership structures, distribution of benefits among corporate constituencies, etc. In contexts like these, other cultural dimensions may be relevant. The present framework can be applied to assess the role of culture in such issues.

The foregoing discussion further shows that a comparative analysis of corporate governance laws cannot rely on any single method of classification. Relying only on the "legal approach"—as LLSV dubbed it—led them to conclude that "[i]n general, differences among legal origins are best described by the proposition that some countries protect all investors better than others, and not by the proposition that some countries protect shareholders

while other countries protect creditors.”⁶³ The case of Far Eastern countries demonstrates that combining classifications based on cultural dimensions and on legal families can yield insights obscured by using one approach alone. The combined approach thus militates against assessing legal regimes in isolation from their cultural environment.

Legal engineering intended to facilitate socio-economic development in countries has roots in the 1960s “law and development” movement, which by 1975, had been declared a failure.⁶⁴ During the 1990s, the demise of communist regimes in Europe turned the region into a real-life testing ground for legal and structural reforms aimed to establish market economies. The idea that “law matters”—reinvigorated in large part by LLSV’s work—motivated legal reforms that were expected to provide investors with an hospitable environment. Measured by LLSV’s ATD index, the average level of shareholder rights rose from substantially below the world average to well above it in just 6 years from 1992 to 1998, surpassing the three civil law families in the LLSV sample.⁶⁵ Meanwhile, American academics advised Russia on how to legislate an optimal corporate law that would rely extensively on litigation over bright-line rules.⁶⁶ As noted above, these reforms generally yielded poor results.

As far as we can find, beyond passing comments, the law and economics literature has paid scant attention to the cultural environment in East-Central Europe as a potential impediment to reform. There is evidence that culture is such an impediment, however. Shortly after the collapse of the communist regimes in 1989–1993, Schwartz gathered samples in nine European countries that had endured communist rule.⁶⁷ Compared with Western Europe, former communist countries more strongly endorsed cultural Embeddedness and Hierarchy. Such value emphases correlate robustly with low perceived legality.⁶⁸ Stated otherwise, these countries lacked the cultural foundation that is consistent with widespread, voluntary law-abidingness. Their relatively high average score on Harmony further suggests that the populace may be inclined to avoid the court system. Engendering beneficial social change through legal reform thus faces massive hurdles in such societies.

A claim is often made that culture adjusts to socio-economic conditions such as democratization and free markets.⁶⁹ While such a causal link is plausible, Williamson surmises that “institutions at this level change very slowly—on the order of centuries and millennia.” Putnam noted the centuries long impacts of culture in Italy on the emergent social institutions.⁷⁰ The little evidence regarding historical trends in national culture confirms that cultural change is very slow. Schwartz, Bardi, and Bianchi revisited several countries in East-Central Europe 5–9 years after the collapse of communism. During that interval, major transforma-

⁶³ See La Porta et al., *supra* note 4, at 8.

⁶⁴ Kevin E. Davis & Michael J. Trebilcock, *Legal Reforms and Development*, 22 *Third World Q.* 21 (2001).

⁶⁵ Pistor, Raiser, & Gelfer, *supra* note 7.

⁶⁶ Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 *Harv. L. Rev.* 911 (1996).

⁶⁷ Shalom H. Schwartz & Anat Bardi, *Influences of Adaptation to Communist Rule on Value Priorities in Eastern Europe*, 18 *Pol. Psychol.* 385 (1997).

⁶⁸ Licht, Goldschmidt, & Schwartz, *supra* note 60.

⁶⁹ Timur Kuran, *Cultural Obstacle to Economic Development: Not Necessarily Real, Often Transitory*, in *Culture and Public Action* (Vijayendra Rao & Michael Walton, Eds., 2004).

⁷⁰ Robert Putnam, with Roberto Leonardi & Raffella Nanetti, *Making Democracy Work: Civic Traditions in Modern Italy* (1993).

tions toward democracy and a market economy, including legal reform, took place. Overall, these changes had no discernable effect on prevailing cultural orientations.⁷¹ The World Values Survey gathered parallel data in a number of countries around the world several times during the past 15 years. Although values did change somewhat, cultural *differences* between nations remained quite stable.⁷²

Thus, absent severe exogenous shocks such as colonial occupation, cultural value adaptation takes place slowly, mostly in response to change in real life circumstances rather than to formal reform or indoctrination. Prevailing cultural values generate a path dependence dynamic that may slow down or block adaptation to change. Both from a narrow corporate governance context and from a broader perspective, reforms are more likely to succeed if their designers adjusted them to the cultural environment. Toward this end, the present framework can be used to assess the suitability of transplanting legal mechanisms from one nation to another.

How to design culture-compatible legal reforms remains a major challenge. The link between a societal aversion to litigation and high scores on Harmony and Uncertainty Avoidance implies that in such high scoring countries, implementing a new legal regime may require alternatives to the court system. For example Gleaser, Johnson, and Shleifer contrast Poland's success with the Czech Republic's failure in establishing functioning securities markets.⁷³ They argue that active regulation by state authorities may be superior where investor protection cannot rely on litigation.

Giving regulatory power to state agencies presents problems, however. Cultural emphases on Embeddedness and Hierarchy—prevalent in many developing and transition economies—may be conducive to corruption, in parallel to general disregard of the law.⁷⁴ The challenge for reform designers would be to find mechanisms for encouraging pro-social conduct among state regulators and other power holders—a daunting task without doubt. Research in this direction may benefit from in-depth analysis of Confucian-inspired Asian societies (e.g. South Korea, China). These societies may have developed norms of social responsibility that do not rely on court litigation nor on other accountability mechanisms known in the West.

That said, countries that have not relied on court litigation traditionally need not forego this mechanism for corporate governance. For instance, there are preliminary signs of somewhat greater willingness to file shareholder suits in both Korea and Japan, possibly due to legal reforms that followed economic downturns.⁷⁵ Nonetheless, the fact that such proceedings are so celebrated attests to their being exceptional, at least at this point.

⁷¹ Shalom Schwartz, Anat Bardi, & Gabriel Bianchi, *Value Adaptation to the Imposition and Collapse of Communist Regimes in East-Central Europe*, in *Political Psychology: Cultural and Cross-Cultural Foundations* 217 (Stanley A. Renshon & John Duckitt, Eds., 2000).

⁷² Ronald Inglehart & Wayne Baker, *Modernization, Cultural Change, and the Persistence of Traditional Values*, 65 *Am. Sociological Rev.* (2000).

⁷³ Glaeser, Johnson, & Shleifer, *supra* note 6.

⁷⁴ Licht, Goldschmidt, & Schwartz, *supra* note 60.

⁷⁵ See Jill Frances Solomon, Aris Solomna, & Chang-Young Park, *A Conceptual Framework for Corporate Governance Reform in South Korea*, 10 *Corp. Governance: Int'l Rev.* 29 (2002); Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 *Del. J. Corp. L.* 189 (2000).

6. Conclusion

This article presents evidence on relations between statutory law and culture, especially in the context of corporate governance. An analysis of cross-sectional samples of nations from around the world, drawing on national scores on cultural value dimensions from the two leading theories in cross-cultural psychology, demonstrates that corporate governance laws relate systematically to the prevailing culture. Consistent relations between cultural emphases and the degree of formalism in civil procedure laws also emerge. More generally, the approach employed to uncover these relations suggests a new way to analyze bases of social institutions.

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Appendix A

See [Table A.1](#).

Table A.1
Country classifications

Country	Schwartz's regions	Hofstede's regions	Legal family	LLSV ^a
Argentina	Latin America	More-developed Latin	French	+
Australia	English speaking	Anglo	Common law	+
Austria	Western Europe	Germanic	German	+
Belgium		More-developed Latin	French	+
Bolivia	Latin America		French	
Brazil	Latin America	More-developed Latin	French	+
Canada	English speaking	Anglo	Common Law	+
Chile	Latin America	Less-developed Latin	French	+
China	Far East		Other	
Colombia		Less-developed Latin	French	+
Cyprus	Eastern Europe		Common law	
Czech Republic	Eastern Europe		German	
Denmark	Western Europe	Nordic	Scandinavian	+
Ecuador		Less-developed Latin	French	+
Egypt			French	+

Table A.1 (Continued)

Country	Schwartz's regions	Hofstede's regions	Legal family	LLSV ^a
Estonia	Eastern Europe		Other (civil law)	
Ethiopia	African		Other	
Finland	Western Europe	Nordic	Scandinavian	+
France	Western Europe	More-developed Latin	French	+
Georgia	Eastern Europe		Other (civil law)	
Germany	Western Europe	Germanic	German	+
Ghana	African		Common law	
Greece	Western Europe	Near Eastern	French	+
Hong Kong	Far East	Asian	Common law	+
Hungary	Eastern Europe		Other	
India	Far East	Asian	Common law	+
Indonesia	Far East	Asian	French	+
Iran		Near Eastern	Other	
Ireland	English speaking	Anglo	Common law	+
Israel	English speaking	Germanic	Common law	+
Italy	Western Europe	More-developed Latin	French	+
Japan	Far East	Asian	German	+
Jordan			French	+
Kenya			Common law	+
Macedonia	Eastern Europe		Other (civil law)	
Malaysia	Far East	Asian	Common law	+
Mexico	Latin America	Less-developed Latin	French	+
Namibia	African		French	
Nepal	Far East		Common law	
Netherlands	Western Europe	Nordic	French	+
New Zealand	English speaking	Anglo	Common law	+
Nigeria			Common law	+
Norway	Western Europe	Nordic	Scandinavian	+
Pakistan		Asian	Common law	+
Peru		Less-developed Latin	French	+
Philippines	Far East	Asian	French	+
Poland	Eastern Europe		Other	
Portugal	Western Europe	Less-developed Latin	French	+
Russia	Eastern Europe		Other	
Singapore	Far East	Asian	Common law	+
Slovakia	Eastern Europe		German	
Slovenia	Eastern Europe		Other (civil law)	
South Africa		Anglo	Common law	+
South Korea		Asian	German	+
Spain	Western Europe	More-developed Latin	French	+
Sri Lanka			Common law	+
Sweden	Western Europe	Nordic	Scandinavian	+
Switzerland	Western Europe	Germanic	German	+
Taiwan	Far East	Asian	German	+
Thailand		Asian	German	+
Turkey	Eastern Europe	Near Eastern	French	+
Uganda	African		Common law	
United Kingdom	English speaking	Anglo	Common law	+
United States	English speaking	Anglo	Common law	+
Uruguay		Less-developed Latin	French	+
Venezuela	Latin America	Less-developed Latin	French	+

Table A.1 (Continued)

Country	Schwartz's regions	Hofstede's regions	Legal family	LLSV ^a
Yugoslavia		Near Eastern	German	
Zimbabwe	African		Common law	+

Rafael La Porta et al. *Law and Finance*, 106 J. Pol. Econ. 1113 (1998).

^a “+” denotes that the country is included in LLSV's study.

Appendix B

See Table B.1.

Table B.1

Mean scores on cultural value dimensions in each cultural region

Region and number of countries	Cultural value dimensions						
	Harmony	Embeddedness	Hierarchy	Mastery	Affective Autonomy	Intellectual Autonomy	Egalitarianism
A. Regions identified by Schwartz							
Africa (5)	3.75	4.17	2.71	4.20	3.04	4.20	4.52
Eastern Europe (12)	4.49	4.00	2.31	3.85	3.01	4.29	4.63
English-speaking (7)	3.91	3.66	2.26	4.01	3.64	4.38	4.94
Far East (10)	4.05	4.02	2.85	4.07	3.09	4.09	4.49
Latin America (6)	4.25	3.85	2.24	4.00	3.00	4.40	4.91
Western Europe (14)	4.57	3.34	1.90	3.93	3.74	4.86	5.13
Region and number of countries	Cultural value dimensions						
	Power Distance	Uncertainty Avoidance	Individualism	Masculinity			
B. Regions identified by Hofstede							
Anglo (7)	35.57	44.71	80.57	61.43			
Germanic (4)	23.25	68.50	61.00	65.50			
Nordic (5)	30.20	42.50	71.40	13.80			
More-developed Latin (6)	59.67	83.83	59.50	52.33			
Less-developed Latin (8)	69.75	85.25	20.63	51.00			
Asian (11)	71.45	53.18	25.45	53.09			