

THE MOTHER OF ALL PATH DEPENDENCIES
TOWARD A CROSS-CULTURAL THEORY
OF CORPORATE GOVERNANCE SYSTEMS

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ABSTRACT

The goal of this article is threefold. First, it points out the growing awareness among practitioners and theorists of the relevancy of national culture to corporate governance and securities regulation. It shows that efforts to treat cross-cultural aspects so far have been few and sporadic and thus posits the urgent need for a systematic cross-cultural theory of corporate governance systems. Second, this article introduces the framework of cultural value dimensions (CVD) of cross-cultural psychology and demonstrates its potential usefulness for analyzing problems of the sort discussed here. It highlights the promise held by the CVD framework for producing testable hypotheses with regard to cultural features of corporate governance systems, in a fashion similar to standard analyses of corporate finance. Third, this article sketches out an outline for a cross-cultural theory of corporate governance systems based on the CVD framework by implementing it to fundamental issues like shareholding structures and the regulation of self-dealing, insider trading, and disclosure. It concludes that national cultures can be seen, metaphorically, as the mother of path dependence dynamics in the sense that they play a role in both the origin and in future development of corporate governance systems. The mode of analysis proposed in this article could be extended to other legal fields and also looks very promising for the study of law and social norms.

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I. INTRODUCTION

Why do companies in some countries have a dispersed ownership structure while in other countries ownership is concentrated in large blocks, quite often held by wealthy families? Why are corporate officers in some countries prohibited from extracting private benefits from the corporation, through self dealing or insider trading, for example, yet in other countries such conduct is either allowed or leniently treated? In trying to answer these questions, modern corporate governance analyses often invoke path dependence dynamics — the tendency of corporate governance systems to preserve conditions that existed in the past due to economic or political reasons or simply due to historical accident. Many comparative accounts turn to national culture as a possible explanation for idiosyncrasies that cannot otherwise be accounted for, possibly using it as a caveat to indicate the limits of the analysis. Other accounts, however, simply ignore them.

This article advocates the use of cultural differences in the design and analysis of corporate governance systems¹ in a way that goes beyond mere hand-waving. If cultural differences are to be given weight they must not be used as a vague residual variable or, worse yet, a discussion stopper. In order to operationalize cultural differences, an existing body of psychological theory and evidence should be utilized. Drawing on this body of knowledge, this article puts forward a novel theory about the role culture

¹Throughout this article, "corporate governance systems" is used to denote the legal and factual environment in which publicly held business corporations operate. Corporate governance systems thus constitute corporate governance rules (company law), corporate governance structures (mainly patterns of shareholding), and securities regulation rules. For a discussion of the role of corporate law and securities regulation in corporate governance, see Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 CARDOZO L. REV. 227, 245 (1998).

may play in the development of corporate governance systems and financial regulation. Moreover, it demonstrates how that theory can be used to derive testable hypotheses; thus, elevating the discourse in this field to a new level, comparable to standard corporate finance analyses.

A nation's culture can be perceived as the mother of all path dependencies. Figuratively, it means that a nation's culture might be more persistent than other factors believed to induce path dependence. Substantively, a nation's unique set of cultural values might indeed affect — in a chain of causality — the development of that nation's laws in general and its corporate governance system in particular.

A number of reasons render the role of culture in corporate governance and securities regulation an issue of growing importance. As a result, large institutional investors, like CalPERS in the United States, now find it necessary to adopt corporate governance principles that are sensitive to cultural differences. Powerful international bodies, including the Organization for Economic Co-operation and Development (OECD), International Monetary Fund (IMF) and the World Bank, have put corporate governance at the top of their agendas and include it in their aid programs for developing countries. These bodies acknowledge that cultural differences prevent the implementation of a single corporate governance model and warrant country-specific adaptations, but they do not provide any systematic guidance as to how such adaptations could be made. Ironically, policy makers in the closely related field of securities regulation might be altogether oblivious to these aspects.

In addition, most scholars mention culture as an important factor. But, with few exceptions, they treat it as a black box — an opaque component in the path dependence dynamics of corporate governance systems. Other scholars offer mechanisms for avoiding clashes between national legal systems that assert jurisdiction over international securities transactions. These scholars hardly considered or simply ignored cultural differences, while other scholars fully acknowledge their importance but focus only on specific countries.

To demonstrate the need for such guidance, suppose that Germans, in general, are (statistically) significantly more sensitive than Americans to issues like equality, social justice, and mutual help; Americans, in contrast, put more emphasis on ambition, success, wealth, and social power. If Greece, for example, decided to reform its corporate governance system, Greek experts might consider adopting the German model of corporate governance, with its paradigmatic corporate governance structure of large blockholdings, mandatory employee representation on the supervisory board,

relatively opaque disclosure, et cetera. Alternatively, Greece might consider imitating the American model, with dispersed public ownership of shares, ample discretion to the board of directors (with no employee representation), and an aggressive disclosure regime.

Adopting features of the German corporate governance system would be much smoother than adopting the American system if Greeks shared more cultural values with Germans. If some American features still look attractive, more effort and resources would need to be invested in order to implement them in Greece. In the extreme, a corporate law reform that ignores cultural differences can fail miserably, as the recent Russian experience proves.

A relatively young but thriving field of psychology called cross-cultural psychology can provide the means for evaluating international cultural differences and for assessing their effects on corporate governance systems. The most commonly used concept in modern cross-cultural psychology is values. Values are constructs, commonplace in every society. They reflect each society's preferences and priorities as to fundamental issues such as interactions between its individual members and the interrelations between society and the rest of the world.

Values refer to desirable goals (e.g., equality) and to the modes of conduct that promote these goals (e.g., fairness, helpfulness). They serve as standards to guide the selection or evaluation of behavior, people, and events. Values transcend specific actions and situations. Obedience, for example, is relevant at work or in school, in sports or in business, with family, friends or strangers. Finally, values are ordered by importance relative to one another. The ordered set of values form a system of value priorities. National cultures can be sampled and given scores.

These qualities of values and value dimensions indicate the great promise of cross-cultural psychology in the design and analysis of corporate governance systems. As used in this discipline, values appear to be the best means for operationalizing culture for such purposes. First, instead of focusing on particular national idiosyncrasies, arguments about cultural differences can be couched in pre-defined concepts that were shown to transcend national boundaries. Second, because value types can take numerical values they may be used to derive statistically testable hypotheses about national corporate governance systems. Such information could be used to explain existing systems and to help design corporate governance reforms.

This article also outlines a general theory on the links between principal value types postulated by cross-cultural psychology theories and

central issues tackled by every corporate governance system. The issues covered range from structural aspects like typical shareholding structures (dispersed versus concentrated), to practical aspects like executive compensation, to legal ones like the regulation of self-dealing and disclosure. With respect to each issue, this article posits how a particular society's set of cultural values — its coordinates along value dimensions — may affect its choice of specific approaches to corporate governance and securities regulation.

The task undertaken in this article is ambitious. My hope is that it will stimulate critique, refinement, and most important, empirical testing. The treatment of culture in corporate governance analysis is in urgent need of reformulation, mainly by strengthening rigor and empirical testability. The mode of analysis presented here will prove equally valuable if further theoretical analysis or empirical evidence does not support the hypothesized links. Such findings would indicate, *inter alia*, that corporate governance reforms could proceed on track while rendering claims for special cultural considerations questionable.

Following this introduction, Part II reviews the growing awareness among practitioners and scholars of the importance of culture to corporate governance systems and presents the need for a means to operationalize cross-cultural differences in their analyses. Part III provides a thumbnail introduction to cross-cultural psychology by briefly reviewing prominent prevailing models, statistical techniques used for empirical testing, and major findings. It concludes with an example of implementing these tools in international accounting research. Part IV culminates the article with an outline of a cross-cultural theory of corporate governance systems. It also discusses internationalization and convergence trends in corporate governance and financial regulation vis-à-vis similar trends in national cultures. Part V concludes with an agenda for further research.

II. THE NEED FOR A CROSS-CULTURAL THEORY OF CORPORATE GOVERNANCE SYSTEMS

A. *Introduction*

Toward the end of the 1990s, comparative corporate governance has ceased to be a subject of academic interest only and has become a major item on the agenda of powerful economic actors at both national and international levels. This Part first reviews the growing awareness among those actors of the need for a better understanding of foreign corporate

governance systems, and in particular, the importance of cultural differences. This situation is then contrasted with the little progress made so far by the academia toward such an understanding.

B. *Corporate Governance, Securities Regulation, and Culture in Practice*

1. The New Cultural Awareness

In the United States, large and small investors alike include foreign stocks as a growing part of their portfolios in order to take advantage of the various benefits this may offer.² Institutional investors, in particular, seek to invest in foreign securities since they can usually afford the extra cost involved in maintaining the required administration. Foremost among these investors are pension funds and mutual funds that specialize in foreign markets. For the larger investors, corporate governance has become a regular agenda item in their relationship with their portfolio companies.³ After a few years of experience, many investors are discovering the importance of cultural differences in effective portfolio management.

A well-documented example is CalPERS, the largest American pension fund, with over \$150 billion in assets. In the wake of a strategic decision to increase its foreign portfolio investment CalPERS found it necessary to develop policies on foreign corporate governance. It discovered that cultural differences prevented it from directly implementing the methods it successfully used to improve corporate governance in American corporations.⁴ CalPERS thus had to specifically adopt more

²Through international diversification of their portfolio, investors can enjoy two major benefits. First, by not limiting their investment to a single country they can diversify away part of the systematic risk (e.g., an economy-wide recession or a large-scale natural catastrophe). Second, foreign securities may offer higher returns for higher, or even comparable levels of risk due to international segmentation (the so-called "emerging markets"). For a review, see Alan Alford, *Assessing Capital Market Segmentation: A Review of the Literature*, in INTERNATIONAL FINANCIAL MARKET INTEGRATION 3 (Stanley R. Stansell ed., 1993); Rene M. Stulz, *International Portfolio Choice and Asset Pricing: An Integrative Survey*, in 9 HANDBOOKS IN OPERATIONS RESEARCH AND MANAGERIAL SCIENCE, FINANCE, ch. 6 (R.A. Jarrow, V. Maksimovic, & W.T. Ziemba eds., 1995).

³Note, however, that some writers question the value of such activities. For a review of related empirical evidence, see Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 459 (Peter Newman ed., 1998).

⁴See, e.g., Thomas J. Andre, Jr., *Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany*, 73 TUL. L. REV. 69, 104-05 (1998).

culture-sensitive corporate governance principles for the major markets it invests in⁵ CalPERS's current position is stated as follows: "CalPERS . . . recognizes that the modern corporation is influenced by the *legal, economic and cultural traditions that are unique to each market*. These traditions must affect the corporate governance structures and principles that are appropriate for the different markets."⁶

Smaller investors may also need to analyze corporate governance aspects of their foreign portfolio companies, for example, how to participate in a shareholder vote. To enable investors to do that, special consulting firms specialize in foreign corporate governance analysis.⁷ One should have little doubt that like CalPERS, such consulting firms will also have to incorporate cultural differences into their analysis.

Similar developments take place in the major international economic organizations. In April 1998, "the OECD established an Ad-Hoc Task Force on Corporate Governance to develop a set of nonbinding principles that embody the views of Member countries on this issue."⁸ In April 1999,

⁵See CalPERS, Corporate Governance Facts, July 1999 (visited Oct. 15, 2000) <<http://www.calpers.ca.gov/about/factglan/corpgov/corpgov.htm>>.

In December 1994, The CalPERS Board adopted a strategic asset allocation policy that called for a three-year increase in the System's foreign equity holdings from 12 to 20 percent. The percentage of foreign securities in the portfolio logically requires the System to dedicate more time to issues affecting the value of its international investments. CalPERS conducted a study of the role of international corporate governance and increased performance monitoring of its international stockholdings.

Id. CalPERS's interest in foreign corporate governance is an extension of its interest in corporate governance in general. See, e.g., Claire Crutchley et al., *The Shareholder Wealth Effects of CalPERS' Activism*, 7(1) FIN. SERV. REV. 1 (1998). For a review and additional sources, see Black, *supra* note 3.

⁶CalPERS, GLOBAL CORPORATE GOVERNANCE PRINCIPLES (1999) (visited Aug. 28, 2000) <<http://www.calpers-governance.org/principles/international/global/page03.asp>> (emphasis added).

⁷See, e.g., Institutional Shareholder Services (visited Aug. 28, 2000) <<http://iss.cda.com>>, and Davis Global Advisors, Inc. (visited Oct. 15, 2000) <<http://www.davisglobal.com>> the web-sites of two prominent U.S. consulting firms.

⁸AD HOC TASK FORCE ON CORPORATE GOVERNANCE, OECD PRINCIPLES OF CORPORATE GOVERNANCE, DOCUMENT SG/CG (99) 5, 2 (1999) [hereinafter OECD PRINCIPLES]. These developments came in the wake of earlier activities. In 1996, the OECD set up a Business Sector Advisory Group on Corporate Governance "to review and analyse international corporate governance issues and to suggest priorities for the work of the OECD in this area." See OECD, *Advisory Group on Corporate Governance Reports to OECD*, OECD News Release, Paris (Apr. 2, 1998) (visited Aug. 28, 2000) <<http://www.oecd.org/media/release/n98-35a.htm>>. The Advisory Group reported in April 1998, and suggested "that the OECD recommended minimum standards of corporate governance to promote fairness, transparency, accountability, and responsibility. Rejecting a "one-size-fits-

the Task Force presented its Principles.⁹ The Principles are intended to assist Member and non-Member governments in their efforts to evaluate and improve the legal, institutional, and regulatory framework for corporate governance in their countries.¹⁰ According to the Task Force's report, there is no single model for good corporate governance.¹¹ Hence, policy makers can examine and develop these frameworks, with those principles serving as reference points, such that they reflect "their own economic, social, legal and cultural circumstances."¹² Shortly thereafter, the OECD and the World Bank signed a Memorandum of Understanding. The signatory parties agreed to adopt the OECD principles as the point of reference in their corporate governance reform initiatives in transition economies and developing countries.¹³

Like the OECD, the IMF and the World Bank also acknowledge the importance of cultural differences to corporate governance.¹⁴ Senior IMF staff members argue, for instance, that "[f]undamental cultural and

all" approach to corporate governance, [it] advocate[d] the need for pluralism and adaptability in corporate governance." *Id.*

⁹See OECD PRINCIPLES, *supra* note 8.

¹⁰*Id.*

¹¹*Id.* at 3.

¹²*Id.* Separately, an expert group working under the auspices of the OECD developed a set of general principles of company law for transition economies. Principle I of the General Principles states, for instance, that cultural differences between transition economies and more developed market economies should lead to variances in their company law. See Gainan Avilov et al., *General Principles of Company Law for Transition Economies*, 24 J. CORP. L. 190 (1999).

In May 1999, institutional investors representing some US\$6 trillion in capital adopted a manifesto on global corporate governance. The decision came in an annual meeting of the International Corporate Governance Network (ICGN), which called on companies to adopt the OECD Principles, with some "amplifications." INTERNATIONAL CORPORATE GOVERNANCE NETWORK, STATEMENT ON GLOBAL CORPORATE GOVERNANCE PRINCIPLES (July 9, 1999) (visited Aug. 28, 2000) <<http://www.icgn.org/documents/globalcorpov.htm>>. See also \$6 Trillion Voice, GLOBAL PROXY WATCH, July 9/16, 1999, at 1.

¹³ORGANIZATION FOR ECONOMIC DEVELOPMENT AND CO-OPERATION, A FRAMEWORK FOR CO-OPERATION BETWEEN THE OECD AND THE WORLD BANK (1999) (visited Sept. 1, 2000) <<http://www.oecd.org/daf/corporate-affairs/governance/oecd-wb-mou.htm>>.

¹⁴See Bijan B. Aghevli, *The Asian Crisis: Causes and Remedies*, 36(2) FIN. & DEVELOPMENT (1999) (visited Aug. 28, 2000) <<http://www.imf.org/external/pubs/ft/fandd/1999/06/aghevli.htm>> (illustrating that poor corporate governance was clearly identified as one of the underlying causes of the Asian crisis); John Nellis, *Time to Rethink Privatization in Transition Economies?*, 36(2) FIN. & DEVELOPMENT (1999) <<http://www.imf.org/external/pubs/ft/fandd/1999/06/nellis.htm>> (citing a 1998 OECD report that states that the Czech voucher approach to privatization produced ownership structures that "impeded efficient corporate governance and restructuring").

institutional changes are required if a new corporate governance structure is to be established with arm's-length, transparent relations between corporations, government, and banks."¹⁵ Senior policy makers further take pains to emphasize the need to be attentive to local specificities and traditional responses. Mr. Michel Camdessus, former managing director of the IMF, approvingly cited the Thai Minister of Finance, who stated: "[S]ocial policy must be consistent with our values and culture. Some social policy instruments may promise to produce great relief in the short term, but we have to make sure that they do not undermine our national values of hard work, self-reliance, community and family cohesion, and spiritual strength."¹⁶

The World Bank has expressed a similar position:

The World Bank Group recognizes the importance of a strong corporate sector as a pillar to promote a dynamic and competitive economy. An effective corporate governance system contributes to this objective by attracting domestic and foreign long-term capital The objective of the Bank is to complement the work that is carried out by its partners by helping its member countries implement standards and best practices *within their national, legal, corporate, and cultural circumstances*.¹⁷

The picture that emerges reveals a clear sensitivity to unique national features, foremost of which is culture. This is significant progress compared with the situation about a decade earlier when national corporate governance systems were seen as on an evolutionary tree,¹⁸ with the

¹⁵Magdi Iskander et al., *Corporate Restructuring and Governance in East Asia*, 36(1) F I N . & D E V E L O P M E N T (1 9 9 9) <<http://www.imf.org/external/pubs/ft/fandd/1999/03/iskander.htm>> (emphasis added).

¹⁶Michel Camdessus, *Global Financial Reform: The Evolving Agenda*, remarks at the Council on Foreign Relations, New York (June 4, 1999) <<http://www.imf.org/external/np/speeches/1999/060499.htm>>. *But see infra* text accompanying note 29.

¹⁷The World Bank's Corporate Governance web-page (visited Aug. 28, 2000) <<http://www.worldbank.org/html/fpd/privatesector/cg/index.htm>> (emphasis added). Similar sensitivity to cultural differences is reflected in EUROPEAN ASSOCIATION OF SECURITIES DEALERS, CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS 8 (2000) (visited Jan. 24, 2001) <<http://www.easd.com/recomendations.htm>>.

¹⁸*See* Licht, *supra* note 1, at 239-40 (describing the "evolutionary" approach to corporate governance and its abandonment).

American system at the top.¹⁹ Economic actors that put their, or other people's money where their mouth is, like CalPERS, have since modified their corporate governance agenda for specific countries.

Similar developments take place in international securities regulation. In a celebrated policy statement, the Securities and Exchange Commission (SEC) announced that it would prefer cooperative measures over unilateral ones.²⁰ It further stated that "in seeking solutions to common problems, securities regulators should be sensitive to cultural differences and national sovereignty concerns."²¹ Notwithstanding this noble stance, a realistic description of actual cooperation among national securities regulators, made by a senior French regulator, went like this: "My experience as a regulator taught me that hindrances to international cooperation seldom are of a technical nature; they have more to do with cultural differences, in the wider meaning of the term. Thus, any improvement in mutual understanding among regulators contributes to the lifting of technical obstacle [sic]."²²

2. Implications for Business and Policy Making

What is missing in the above statements is the exact manner in which national culture is or should be factored into these modifications. One cannot avoid the impression that there is no clear idea how to do this. This lacuna in our knowledge is not benign. The International Corporate Governance Network (ICGN), for instance, is dominated by American and British institutional investors who may perceive fundamental concepts like

¹⁹See Mark J. Roe, *Comparative Corporate Governance*, in 1 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 339-46 (Peter Newman ed., 1998).

²⁰See Regulation of International Securities Markets — Policy Statement of the U.S. Securities and Exchange Commission, Securities Act Release No. 33,6807, [1988-89 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 84,341, at 89,576 (Nov. 14, 1988) [hereinafter SEC, 1988 Policy Statement]. See Paul G. Mahoney, *Securities Regulation by Enforcement: An International Perspective*, 7 YALE J. ON REG. 305, 310-20 (1990) (discussing statement). The SEC's position reflected a diametrical shift from its previous regulatory policy which championed unilateralism and noncompromising extraterritorial application of American law. The SEC, however, found this policy increasingly difficult and politically costly to implement in the face of foreign regulators' objections. See Michael D. Mann et al., *Developments in International Securities Law Enforcement and Regulation*, 29 INT'L LAW. 729, 730 (1995).

²¹SEC, 1988 Policy Statement, *supra* note 20.

²²A.A. Sommer, Jr., *IOSCO: Its Mission and Achievement*, 17 NW. J. INT'L L. & BUS. 15, 29 (1996) (citing Speech from Messr. Jean Saint-Geours (then chairman of IOSCO's Technical Committee and president of the Commission des Operations de Bourse) to IOSCO (Paris, 1994)).

"equitable treatment of shareholders"²³ differently than management and local shareholders in continental European companies. The case of CalPERS indicates that much more information is needed about cultural effects on corporate governance if the trillions of investor dollars at stake are to be invested intelligently.

Policy makers too would be well advised to seek better understanding of the subject. In the European Union (EU), cultural differences were blamed for the recurring failures to adopt the Draft Fifth Directive on Company Law.²⁴ Intended to harmonize company law across the EU, the Draft Directive has undergone many revisions and changes in response to bitter conflicts between member states.²⁵ In May 1997, an expert panel concluded that the significant differences in national cultures preclude the possibility of harmonization as originally envisaged. Consequently, it said, without further details, there can be no single ideal system.²⁶ With the rise of the subsidiarity principle in the EU and in light of its forthcoming enlargements, one may assume that company law in the EU will remain un-unified and country-specific.²⁷

The Fifth Directive case provides a vivid lesson for policy makers about the potential obstacles cultural differences present in the convergence

²³See OECD PRINCIPLES, *supra* note 8, at 15.

²⁴See Amended Proposal for a Fifth Council Directive Based on Art. 54 of the EEC Treaty in an European Company and Financial Law [European Community Law: Text Collection] (Klaus J. Hopt & Eddy Wymeersch eds., 1994).

²⁵The most bitter battles were fought with respect to employees' rights, for example, representation of employees on a company's board of directors, and a duty to provide detailed information on the company's financial and business situation to its employees and allow them an opportunity to comment. See Commission Proposal for a Council Directive on Procedures for Informing and Consulting the Employees of Undertakings with Complex Structure, in Particular Transnational Undertakings, 1980 O.J. (C 297) 3. For a detailed discussion of the EU's failure to reach convergence through harmonization in corporate governance, see Licht, *supra* note 1, at 239-40, 281-82. See generally Terence L. Blackburn, *The Unification of Corporate Laws: The United States, the European Community and the Race to Laxity*, 3 GEO. MASON INT'L L. REV. 1 (1994) (describing EU projects); Terence L. Blackburn, *The Societas Europea: The Evolving European Corporation Statute*, 61 FORDHAM L. REV. 695 (1993) (same).

²⁶See *Corporate Governance Update*, 5 CORP. GOVERNANCE: INT'L REV. 256 (1997).

²⁷The admission of more member states (particularly Eastern European ones) means higher diversity, and subsidiarity means more deference to national and local preferences. See Erik Berglöf, *Corporate Governance*, in THE EUROPEAN EQUITY MARKETS 147, 166 (Benn Steil ed., 1996).

of corporate governance systems.²⁸ It demonstrates the need for a cross-cultural theory to inform corporate governance reforms. It also means that policy makers who attempt to consider cultural aspects in reform programs should not do so based on stereotypical views. Worse yet, one might question whether such calls for culture-sensitive reform policies are not, in fact, efforts made by incumbent elites to thwart reforms.²⁹ Even if this was the case in some countries, there is an urgent need to better understand the role of culture in corporate governance, perhaps even *a fortiori*.

The situation is just as urgent in the field of securities regulation. Since its 1988 Policy Statement, the SEC has not made it clear exactly how it would respect cultural differences. In fact, its position with regard to international disclosure standards has been extremely combative and uncompromising until very recently.³⁰ Nor has the International Organization of Securities Commissions (IOSCO), yet, taken any steps toward mitigating the cultural problem.

Indeed, several projects are currently under way towards harmonization of securities regulation laws. The most prominent project was conducted by the International Accounting Standards Committee (IASC) and IOSCO, with the intention to produce international accounting

²⁸The Fifth Directive case is not a single anecdote in this regard. During the 1960s and 1970s the Law and Development movement sought to align the laws of countries in Asia, Africa, and Latin America with those of the United States, on the assumption that the latter are superior and that their adoption would accelerate development. The major vehicle for that purpose was legal transplantation. The movement was proclaimed a failure and the standard account attributes it to cultural differences. See Philip M. Nichols, *The Viability of Transplanted Law: Kazakhstani Reception of a Transplanted Foreign Investment Code*, 18 U. PA. J. INT'L ECON. L. 1235, 1242-43 (1997). Nichols, however, also found evidence of successful transplantation. *Id.* at 1235.

²⁹See, e.g., Seth Mydans, *In Debris of Economic Crash: Thailand's Faith in Authority*, N.Y. TIMES, Aug. 10, 1999 (reporting that in Thailand, wealth and power remain in the hands of a small elite group but that the country's traditional centers of power are being challenged).

³⁰For a long time, the SEC insisted that foreign issuers that raise capital in the United States or exceed a certain threshold of public holding make disclosure according to American law and U.S. General Accepted Accounting Principles (GAAP), refusing to recognize International Accounting Standards (IAS). For reviews and critique, see Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2397-99 (1998); Amir N. Licht, *Games Commissions Play: 2x2 Games of International Securities Regulation*, 24 YALE J. OF INT'L L. 61, 92-95 (1999). In February 1999, however, the SEC finally acknowledged the adequacy of IAS — not before they were made significantly more demanding — and proposed to replace foreign issuer disclosure Form 20-F with IAS disclosures, with some additional requirements. See International Disclosure Standards — Policy Statement of the U.S. Securities and Exchange Commission, Release Nos. 33-7637; 34-41014; International Series Release No. 1182 (visited Feb. 1999) <<http://www.sec.gov/rules/proposed/33-7637.txt>>.

standards to be used universally for cross-border listings.³¹ There is, however, a discrepancy between the IOSCO/IASC project and an OECD/World Bank project. The OECD Advisory Group explicitly rejected a "one-size-fits-all" approach to implementing its corporate governance principles,³² while IASC explicitly endorsed it.³³

C. *Corporate Governance, Securities Regulation, and Culture in Theory*

This subsection critically reviews the academic treatment of culture in corporate governance systems and establishes the need for a basic theory on the subject. Unfortunately, scholars' general notion is similar to that held by practitioners and policy makers, having little to say about the role of culture in the development of corporate governance and securities regulation. Although many analyses mention culture as an important factor, with few exceptions, they treat it as a "black box" — an opaque component in path dependence dynamics of corporate governance systems.

1. Comparative Analyses

In static or traditional comparative analysis, culture appears as one of the factors that influence the way managers, *qua* agents, behave. Consider three examples.

According to some accounts, cultural and ethical norms are among the reasons that American managers may abstain from self-dealing.³⁴

³¹Other projects with similar goals include the European Union's (EU, formerly the European Community) project of the Single European Market—the "1992 Plan." EU directives promulgated as part of this plan cover many of the major issues in securities regulation, including disclosure, antifraud, and broker-dealer and stock exchange regulation. In 1991, the Securities and Exchange Commission (SEC) and securities regulators from three Canadian provinces established the Multi-Jurisdictional Disclosure System (MJDS). Under MJDS, disclosure statements of corporations from each jurisdiction are recognized by the others. *See* Securities and Exchange Commission, Multi-jurisdictional Disclosure and Modification to the Current Registration and Reporting System for Canadian Issuers, Release No. 33-6902, 49 SEC Doc (CCH) 260 (June 21, 1991) (adopting MJDS).

³²*See* OECD, *supra* note 8.

³³*See* International Accounting Standards Committee, *One Size Fits All?*, IASC INSIGHT, June 1997, at 1.

³⁴Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 831 (1992) (arguing that nonregulatory constraints on managers' opportunism include "cultural norms of behavior"). *See also* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 573 (1990) (attributing

Others explicitly relate international differences in the incidence of self-dealing to different ethical standards that prevail in each country.³⁵ Such claims are positive as well as normative, namely, they reflect a notion that American cultural (or ethical) values regarding self-dealing are better than parallel continental European ones.

In a different example, American managers fare worse when contrasted to their Japanese counterparts. The standard story of Japanese corporate governance tells of managers imbued with Confucian cultural values of harmony and consensus, which mitigate self-interest and opportunism. Unlike their American counterparts, the Japanese people allegedly do not resort to combative litigation. These cultural values also facilitate the working of the *keiretsu* — the hallmark of Japanese corporate structure.³⁶

Finally, culture is often invoked as a reason for differences between various national regimes of insider trading regulation. In many countries, such as Japan³⁷ and Germany,³⁸ insider trading has been tolerated for a long

the rarity of directors' self-dealing in American public corporations to "the developed sense of proper and improper behavior" internalized by their managers); cf. Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1473 (1989) ("Most top managers will probably refrain from unfair self-dealing simply because they have internalized the rules of social morality.").

³⁵See Luca Enriques, *The Law on Corporate Directors' Self-Dealing: A Comparative Analysis*, 2 J. INT'L & COMP. CORP. L. 297 (2000). For a more comprehensive version, see <http://papers.ssrn.com/paper.taf?ABSTRACT_ID=135674>.

³⁶For further details and a fine critique, see Curtis J. Milhaupt, *A Relational Theory of Japanese Corporate Governance: Contract, Culture, and the Rule of Law*, 37 HARV. INT'L L.J. 3, 6-7 (1996). See also Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871, 899 (1993) (noting that Japanese culture affects corporate structure). To be sure, culture is not the sole, or even most important factor in the emergence of the *keiretsu*. For sample reviews in the outpouring literature on Japanese corporate governance, see Takeo Hoshi, *Japanese Corporate Governance as a System*, in COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH 847 (Klaus J. Hopt et al. eds., 1998); Ronald J. Gilson & Mark J. Roe, *Lifetime Employment: Labor, Peace, and the Evolution of Japanese Corporate Governance*, 99 COLUM. L. REV. 508 (1999).

³⁷See Mahoney, *supra* note 20, at 319 ("[Some] contend that the mores of the Japanese market reflect Japanese culture and are unlikely to change even under the influence of increased foreign participation."). See generally Dan Fenno Henderson, *Securities Markets in the United States and Japan: Distinctive Aspects Molded by Cultural, Social, Economic, and Political Differences*, 14 HASTINGS INT'L & COMP. L. REV. 263 (1991) (noting the absence of insider trading regulation in Japan).

³⁸See, e.g., Ursula C. Pfeil, *Finanzplatz Deutschland: Germany Enacts Insider Trading Legislation*, 11 AM. U. J. INT'L L. & POL'Y 137 (1996) (arguing that insider trading was rooted in Germany's corporate culture); Daniel J. Standen, *Insider Trading Reforms Across Germany:*

time as "part of the game" of securities trading and has not even carried a stigma of being immoral. Against this backdrop, the United States has stood alone in holding a very hostile stance toward insider trading that has often been couched in cultural and ethical views.³⁹

2. Dynamic and Path Dependence Analyses

Culture features highly in connection with the dynamic concept of path dependency which, in turn, is embedded in the field of comparative corporate governance. An important development within the mainstream of economic analysis of corporate law is the growing prominence of political economy analyses. The trend began with William Cary in 1974⁴⁰ and culminated with the works of scholars like Mark Roe⁴¹ and Roberta Romano.⁴² This development gave rise to comparative corporate governance.

Bracing for the Cold Winds of Change, 36 HARV. INT'L L.J. 177, 178 (1995) (noting that German market players face something of a culture shock in light of anti-insider trading legislation).

³⁹See, e.g., James A. Kehoe, Note, *Exporting Insider Trading Laws: The Enforcement of U.S. Insider Trading Laws Internationally*, 9 EMORY INT'L L. REV. 345, 374 (1995) ("[International] differences among insider trading laws exist because of fundamentally differing cultural views concerning what should be regulated by securities laws."). A colorful exposition of this view was provided by James Cox: "American jurisprudence abhors insider trading with a fervor reserved for those who scoff at motherhood, apple pie, and baseball." James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School"*, 1986 DUKE L.J. 628, 628. Another well-known claim about insider trading is that "it's just not right." See Kim L. Scheppele, *It's Just Not Right: The Ethics of Insider Trading*, 56 L. & CONTEMP. PROBS. 123 (1993).

⁴⁰See generally William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974).

⁴¹See generally MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); Mark J. Roe, *Backlash*, 98 COLUM. L. REV. 217 (1998); Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996); Mark J. Roe, *German Codetermination and German Securities Markets*, 1998 COLUM. BUS. L. REV. 167; Mark J. Roe, *German "Populism" and the Large Public Corporation*, 14 INT'L REV. L. & ECON. 187 (1994). For a political account of the German system, see Katharina Pistor, *Co-determination in Germany: A Socio-Political Model with Governance Externalities* (Working Paper, 1997).

⁴²See generally ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 52-85 (1993); Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987). Another related and noteworthy approach includes public choice accounts. See, e.g., Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987).

"In the last few years, comparative corporate governance — German and Japanese corporate governance in particular — has been a hot topic in U.S. law reviews and conferences."⁴³ This interest arose hand-in-hand with the growing prominence of institutional investors. This brought them closer to the large blockholders of other countries, such as the German *Hausbank* and the Japanese main bank. While shareholder activism rose in visibility, scholars debated whether it could become as significant as it was (or portrayed to be) in other countries.⁴⁴ Empirical evidence in this regard is mixed.⁴⁵

Then came path dependence. The point is relatively simple. Those who produce corporate law — legislatures, courts, and entrepreneurs — face similar problems, such as the agency problem⁴⁶ and the impossibility of complete contingent contracts.⁴⁷ Corporate law producers, however, may solve these problems in different ways. Various factors may account for such diversity. Included among them are the economic and financial environments in each country, such as the depth and liquidity of the stock

⁴³Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L.Q. 367, 367 (1996) (footnote omitted). The omitted footnote includes an extensive list of law review articles in this spirit, which is nevertheless far from exhaustive. For additional references, see Roe, *supra* note 19, at 345-46.

⁴⁴See Black, *Agents Watching Agents*, *supra* note 34; Bernard S. Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence*, 39 UCLA L. REV. 895 (1992); Bernard S. Black & John C. Coffee, Jr., *Hail, Britannia?: Institutional Investor Behavior under Limited Regulation*, 92 MICH. L. REV. 1997 (1994); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991); Jill E. Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO ST. L.J. 1009 (1994); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).

⁴⁵See Black, *supra* note 3 (a review).

⁴⁶See Roe, *supra* note 19, at 339-46.

⁴⁷See Luigi Zingales, *Corporate Governance*, in 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 497-503 (Peter Newman ed., 1998).

market,⁴⁸ industrial organization,⁴⁹ and politics.⁵⁰ In addition, there is a view anchored in economic models,⁵¹ that events may happen simply due to chance or historical accident. Once in place, such systems may sustain and even thrive.⁵²

Against this backdrop, culture is constantly mentioned by prominent writers as one of the factors that may engender path dependence or exacerbate the persistence of existing corporate governance structures. A representative argument runs as follows: "But we are not complete materialists. Culture and ideology, not only value maximization and self-interest, might influence a country's choice of corporate law."⁵³

⁴⁸See, e.g., Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets*, 47 J. FIN. ECON. 243 (1998); Coffee, *supra* note 44, at 1328; Roe, *German Codetermination*, *supra* note 41, at 177.

⁴⁹See, e.g., Gilson & Roe, *Understanding the Japanese*, *supra* note 36, at 876. See generally Ronald Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?*, 74 WASH. U. L.Q. 327 (1996).

⁵⁰See, e.g., ROE, *supra* note 41; Mark J. Roe, *Political Preconditions to Separating Ownership from Control: The Incompatibility of the American Public Firm with Social Democracy* (Working Paper, 1999). But see Brian R. Cheffins, Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom, paper presented at Tilburg University Law and Economics Conference on "Convergence and Diversity in Corporate Governance Regimes and Capital Markets," Eindhoven, The Netherlands, November 4-5, 1999 (criticizing Roe's argument on social democracy).

⁵¹For reviews, see Stephen E. Margolis & S.J. Leibowitz, *Network Externalities (Effects)*, in 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW (Peter Newman ed., 1998); Stephen E. Margolis & S.J. Leibowitz, *Path Dependence*, in 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW (Peter Newman ed., 1998).

⁵²For a comprehensive theory, see Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999). See also Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347 (1996) (contending that standard ethical terms are produced by cultural factors). These ideas first appeared in the domestic United States context. See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); see also Ian Ayres, *Supply-Side Inefficiencies in Corporate Charter Competition: Lessons from Patents, Yachting, and Bluebooks*, 43 U. KAN. L. REV. 541 (1995) (noting that innovation may occur even in an unchanged corporate system).

⁵³Bebchuk & Roe, *supra* note 52, at 168. See also Gilson, *supra* note 49, at 329-30.

In a path dependent environment, . . . [i]nitial conditions, determined by fortuitous events or factors traditionally viewed as non-economic, such as culture or politics, can move the system down a particular path. Later deviation from that path may be extremely difficult despite the existence of alternatives that, absent transition costs, would be more efficient.

Roe, *Chaos*, *supra* note 41, at 646-47 ("Path dependence could explain the forms [of business and legal institutions] we see. Multiple, equally efficient results might abound and path dependence — paths shaped by a nation's political and cultural institutions, or chaotic chance

Some writers openly acknowledge that to date, culture is actually a "black box" in the comparative corporate governance literature and that its effects are ambiguous.⁵⁴ Many others simply stop at this point without specifying how exactly culture brings about this effect beyond just impeding change.

Note that according to current analyses, culture is considered to be a very powerful impediment to change. Under a weak version of the story, culture is just another factor guiding the system along the beaten path. Developments are spontaneous. Children learn at school that one should forcefully stand for one's rights (or seek harmony and reconciliation). Upon maturation, they file securities class actions (or they do not). Under a stronger version, culture could actually stand as a roadblock on the way to reform, even when such reform is intentional and backed by considerable political power. However, as the system evolves, "it would be remarkable if a key economic institution were antithetical to a country's culture; either the institution would change or the culture would change."⁵⁵

A large-scale effort to tackle cross-cultural aspects of corporate governance and securities regulation was made by James Fanto.⁵⁶ Fanto argues that as a product of U.S. culture, the U.S. disclosure system was designed to identify corporate governance information that is significant from a U.S. perspective and therefore may be insensitive to cultural differences in corporate governance.⁵⁷ In order to translate cultural differences in corporate governance of foreign companies for U.S. investors, Fanto proposes an open-ended disclosure requirement on both

events — could determine which among equally efficient end results we have.").

⁵⁴Ronald J. Mann & Curtis J. Milhaupt, *Foreword*, 74 WASH. U. L.Q. 317, 323 (1996) (referencing "the black box of culture").

⁵⁵Gilson & Roe, *Lifetime Employment*, *supra* note 36, at 517. Drawing on sociological and historical accounts, Gilson and Roe question the influence (and the very existence) of a culture of lifetime employment. As will be clarified below, this is a loose use of the term "culture."

⁵⁶James A. Fanto, *The Absence of Cross-Cultural Communication: SEC Mandatory Disclosure and Foreign Corporate Governance*, 17 NW. J. INT'L. & BUS. 119 (1996). See also Henderson, *supra* note 37, at 272-79 (discussing differences between the U.S. and Japan). In response to the internationalization of stock markets around the globe, writers are also offering mechanisms for avoiding clashes between different legal systems that may have a claim for jurisdiction over international securities transactions. In these writings, cultural differences are hardly considered or simply ignored. For references and further discussion, see Licht, *supra* note 1, at 234 nn.22-23.

⁵⁷Fanto, *supra* note 56, at 124-25.

culturally significant corporate governance information and the relevant conceptual framework.⁵⁸

Fanto's proposal is praiseworthy for recognizing the cross-cultural problem in corporate governance and securities regulation. Furthermore, Fanto identified the need to draw on other disciplines for a working definition of "culture."⁵⁹ His critical analysis of the SEC's policies and rulemaking and his examples for implementing the proposal, however, are couched in mainstream political economic concepts.⁶⁰ Fanto's work and those of other scholars⁶¹ are important contributions but they still leave us without workable means for operationalizing cultural differences in corporate governance analysis.

D. Conclusion

In sum, the extant academic literature acknowledges the importance of cultural differences in the development of corporate governance and securities regulation regimes. To date, however, the literature tends to use "culture" rather loosely — as shorthand for all the country-specific, nonfinancial residual factors or as a rough synonym for national idiosyncrasies. This, while conceding that the explanatory power of this residual factor might be quite large. The academic literature fails to provide a general theory for conceptualizing cultural differences in this context that are not, in fact, economic, political, or institutional. In addition, it fails to move beyond country-specific case studies and generalizes corporate governance as a universal system.⁶² This would be quite striking if we

⁵⁸*Id.* at 126.

⁵⁹*Id.* at 121 (citing anthropologist Clifford Geertz's definition of "culture").

⁶⁰*See, e.g., id.* at 182-83 (discussing the special relationships between managements of French world-class companies and the French State); *id.* at 184-85 (discussing the French "noyau dur" arrangement of cross-shareholding).

⁶¹*See, e.g.,* Milhaupt, *supra* note 36. Milhaupt provides a more detailed picture of arguments made about the role of Japanese culture in Japanese corporate governance. *Id.* at 4-6. But like Fanto, and perhaps even more purposefully, Milhaupt's insightful analysis employs political and institutional economy arguments and pretty much rejects the somewhat romanticized cultural account of corporate governance.

⁶²Case study-like analyses are commonplace in the legal strand of the Law and Economics literature. The most studied countries are the U.S., Germany, and Japan, but the list is growing. For a thorough list of references, see Fanto, *supra* note 56, at 120 n.4. Starting in the mid-1990s, economists began to show interest in the relationship between the legal system and corporate finance. A turning point may be located in Andrei Shleifer and Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737 (1997), which demonstrated such an awareness. In the ensuing years, that interest began to be translated into a growing body of

realized that such an exercise is equivalent to conducting a case study without having an underlying theory. This is not to say that in-depth studies of legal regimes and corporate governance structures in particular countries are not important. But they should be treated as case studies, and like case studies in other fields of social science, they need to be contextualized with a general theory.⁶³

III. A THUMBNAIL INTRODUCTION TO CROSS-CULTURAL PSYCHOLOGY

A. Introduction

Having established the need for a systematic cross-cultural theory of corporate governance systems, this Part presents in broad brush-strokes the main features of cross-cultural psychology while emphasizing those that render it appropriate for the required task. The following sections provide a brief introduction to the trade, its tools, and its products. Parts B and C describe the parameters used to distinguish between cultural groups — "cultural dimensions" or "value types" — and the empirical techniques used for extracting them. Part D reviews the findings of major studies that undertook international cultural comparisons among nations. Part E reviews efforts to apply the results yielded by early studies in international accounting research — a subject with direct applicability to corporate governance and securities regulation.

B. From "Culture" to "Values"

1. Defining Culture

"Culture" is recognized as "one of the two or three most complicated words in the English language."⁶⁴ Various social science disciplines such as psychology, anthropology, and sociology discuss culture and define it for their purposes. For example, according to the preeminent anthropologist Clifford Geertz, culture "denotes an historically transmitted pattern of

empirical literature. These studies differ from those in the legal branch of the literature precisely in that they deal with international cross-section analysis. *See* works cited *infra* note 160.

⁶³*See* GARY KING ET AL, *DESIGNING SOCIAL INQUIRY* ch. 1 (1994).

⁶⁴Nichols, *supra* note 28, at 1236 (citing RAYMOND WILLIAMS, *KEYWORDS: A VOCABULARY OF CULTURE AND SOCIETY* 76 (1976)).

meaning embodied in symbols, a system of inherited conceptions expressed in symbolic forms by means of which men communicate, perpetuate, and develop their knowledge about and attitudes toward life."⁶⁵

Geertz's often cited definition may conform to many people's notion about the concept of culture. When corporate governance scholars or policy makers discuss "culture," they probably are reminded of Geertz's definition. This definition does not, however, lend itself readily to operationalization. That is, one cannot use it to derive variables for empirical testing except by way of narrow, detailed case studies like the few we have on Japan or France.⁶⁶

Likewise, a canonical definition of "culture" in psychology adds some crucial elements and surely looks more technical but essentially suffers from the same drawback, namely, that it is not operationalizable:

The system of information that codes the manner in which the people in an organized group, society or nation interact with their social and physical environment. In this sense the term is really used so that the frame of reference is the sets of rules, regulations, mores and methods of interaction within the group. A key connotation is that culture pertains only to non-genetically given transmission; each member must learn the systems and the structures.⁶⁷

This article does not make any claim as to definitions of culture used in different disciplines, including psychology, or any alleged superiority of one over another. The argument advanced here is that in discussing international cultural differences among corporate governance systems, a very promising way is to treat "culture" within the framework used by

⁶⁵CLIFFORD GEERTZ, *THE INTERPRETATION OF CULTURES: SELECTED ESSAYS* 89 (1973). This oft-cited definition is but an example. For an anthropological approach to culture in the specific context of corporate finance, see John M. Conley & William M. O'Barr, *The Culture of Capital: An Anthropological Investigation of Institutional Investment*, 70 N.C. L. REV. 823 (1992) (studying pension fund managers).

⁶⁶According to Geertz, anthropology should not seek to classify a particular case under a general rule but rather to study cases through "thick descriptions" from which one could derive broader conclusions. See Clifford Geertz, *Thick Description: Toward an Interpretive Theory of Culture*, in GEERTZ, *supra* note 65, at 28.

⁶⁷ARTHUR S. REBER, *DICTIONARY OF PSYCHOLOGY* 170 (1986). See also Michael Harris Bond & Peter B. Smith, *Cross-Cultural Social and Organizational Psychology*, 47 ANNU. REV. PSYCHOL. 205, 209 (1996) (adopting a definition of culture as a set of "shared constraints that limit the behavior repertoire available to members of a certain . . . group").

cross-cultural psychologists and in particular through the concept of "values."

2. Values

A catchy definition proposed by a pioneering scholar, Geert Hofstede, considers culture to be "the collective level of mental programming"⁶⁸ or the "software of the mind."⁶⁹ On its face, however, these definitions and others like it⁷⁰ are not any better than Geertz's or Reber's for the present purpose. The advantage of the cross-cultural psychology framework does not lie in the definitions of culture its scholars adopt but rather in its concept of "values." The framework's promise and progress lie in its move from general statements about culture and cultural phenomena to reliable dimensions of cultural variation — usually defined in terms of values. "The identification of [such] dimensions . . . should help create a framework that is both capable of integrating diverse attitudinal and behavioral empirical phenomena and of providing a basis for hypothesis generation."⁷¹

According to a leading scholar, Shalom Schwartz, the ways that societal institutions function, their goals, and modes of operation express cultural value priorities.⁷² "When values are used to characterize cultures, what is sought are the socially shared, abstract ideas about what is good,

⁶⁸GEERT H. HOFSTEDE, *CULTURE'S CONSEQUENCES: INTERNATIONAL DIFFERENCES IN WORK-RELATED VALUES* 15 (1980).

⁶⁹GEERT H. HOFSTEDE, *CULTURES AND ORGANIZATIONS: SOFTWARE OF THE MIND: INTERCULTURAL COOPERATION AND ITS IMPORTANCE FOR SURVIVAL* (1991). Hofstede's use of computer science metaphors may be explained by the fact that his entire mammoth project was conducted with IBM employees.

⁷⁰See, e.g., RONALD INGLEHART, *MODERNIZATION AND POSTMODERNIZATION: CULTURAL, ECONOMIC AND POLITICAL CHANGE IN 43 SOCIETIES* 15 (1997) (stating that "[a] culture is a system of attitudes, values, and knowledge that is widely shared within a society and is transmitted from generation to generation").

⁷¹Peter B. Smith et al., *National Culture and the Values of Organizational Employees: A Dimensional Analysis Across 43 Nations*, 27 *J. CROSS-CULTURAL PSYCHOL.* 231, 232 (1996).

⁷²Shalom H. Schwartz, *A Theory of Cultural Values and Some Implications for Work*, 48 *APPL'D PSYCHOL. INT'L REV.* 23 (1999). For example, Schwartz argues that:

[i]n societies where individual ambition and success are highly valued, the organization of the economic and legal system is likely to be competitive (e.g., capitalist markets and adversarial legal proceedings). In contrast, a cultural emphasis on group well-being is likely to be expressed in more cooperative economic and legal systems (e.g., socialism and mediation).

Id.

right, and desirable in society or other bounded cultural group."⁷³ Cultural values are the bases for the specific norms that communicate to people what is appropriate in various situations.

Creating a single definition for "values" is very difficult. Following is a summary of the many definitions of values that suggests the main features on which most cross-cultural psychologists agree:

1. Values are beliefs. But they are not objective, cold ideas. Rather, when values are activated, they become infused with feeling.
2. Values refer to desirable goals (e.g., equality) and to the modes of conduct that promote these goals (e.g., fairness, helpfulness).
3. Values transcend specific actions and situations. Obedience, for example, is relevant at work or in school, in sports or in business, with family, friends or strangers.
4. Values serve as standards to guide the selection or evaluation of behavior, people, and events.
5. Values are ordered by importance relative to one another. The ordered set of values forms a system of value priorities. Cultures and individuals can be characterized by their systems of value priorities.⁷⁴

3. Level of Analysis – Cultural vs. Individual

It is important to emphasize that the level of analysis in cross-cultural studies is that of the culture as a whole. We want to identify the different ways that societies set priorities for their members in regards to their relationships with one another, with social institutions, et cetera. The

⁷³Shalom H. Schwartz & Maria Ros, *Values in the West: A Theoretical and Empirical Challenge to the Individualism-Collectivism Cultural Dimension*, 1 *WORLD PSYCHOL.* 91, 93 (1995) (citing R.M. WILLIAMS, JR., *AMERICAN SOCIETY: A SOCIOLOGICAL INTERPRETATION* (1970)).

⁷⁴Peter B. Smith & Shalom H. Schwartz, *Values*, in 3 *HANDBOOK OF CROSS-CULTURAL PSYCHOLOGY* 77, 80 (2d ed., J.W. Berry et al. eds., 1997).

correct unit of reference — the level of analysis — is society as a whole. A particular society's set of value priorities reflects its culture, permitting comparisons to be made between cultural groups.⁷⁵

In contrast, one could also (as many scholars have) refer to the individual as the unit of reference. Individuals may also possess sets of value priorities that represent the motivational goals, which serve as guiding principles in their lives.⁷⁶ These sets are different than culture-level value priorities. For instance, giving high priority to both authority and humility would be incompatible at the individual level: one cannot conduct one's life simultaneously seeking authority and trying to be humble at the same time.⁷⁷ At the cultural level, however, these values are compatible. "The societal system will run more smoothly if people accept authority as a desirable basis for organizing human relations *and* humility as the appropriate response toward those with greater authority."⁷⁸

The need to conduct comparisons at cultural level begs the question of how to define cultural groups. The vast majority of cross-cultural studies have compared nations.⁷⁹ In most cases, there are strong forces towards integration in nations that have existed for some time.⁸⁰ "There is usually a single dominant language, educational system, army, political system, and shared mass media, markets, services, and national symbols (e.g., flags, sports teams)."⁸¹ All this warrants treating national samples as good proxies for cultural group samples. This will not be the case, of course, where national boundaries encompass several heterogeneous groups with separate distinctive cultures, for example, in nations with sharp cleavages among ethnic groups.⁸²

C. *Extracting Values and Value Types*

This Part describes the basic steps and procedures used in a generic cross-cultural study aimed to identify values and extract national scores for them. Because this field is little known within the legal community, particularly in the law and economics branch of it, such a description is

⁷⁵See *id.* at 80.

⁷⁶See *id.* at 82.

⁷⁷See *id.* at 82-83.

⁷⁸Smith & Schwartz, *supra* note 74, at 83.

⁷⁹*Id.* at 95-96.

⁸⁰HOFSTEDE, *supra* note 69, at 12.

⁸¹See Smith & Schwartz, *supra* note 74, at 95.

⁸²*Id.* at 95-96.

necessary in order to substantiate its relevance for corporate governance analysis in the eyes of lawyers and policy makers. One should bear in mind, however, that only a handful of multinational studies have been conducted so it is still difficult to talk about "generic" studies. Therefore, the following paragraphs outline the features that a good study should include with examples from two prominent research projects by Hofstede and Schwartz.⁸³

1. An Underlying Theory

A cross-cultural study of values starts with an underlying theory about the basic issues addressed by national cultures in general, on the assumption that different societies face similar fundamental problems. Such a theory would move through three steps. First, it would set forth the goals or challenges faced by cultures. The definitions of "culture" in both anthropology and psychology circles reflect the notion that people and societies indeed face similar issues.

At this level, Hofstede postulated four basic societal problems:

1. Social inequality, including the relationship with authority;
2. The relationship between individual and group;
3. Concepts of masculinity and femininity: the social implications of gender;
4. Dealing with uncertainty.⁸⁴

Schwartz postulated three basic societal problems:

1. The relation between the individual and the group;
2. Guaranteeing responsible behavior that will preserve the social fabric;

⁸³A discussion of possible objections to the theories and methodologies of Hofstede and Schwartz is well beyond the scope of this article. The narrow goal of this Part is to familiarize the reader with the processes that generate the numbers that, I argue, should inform legal analysis and reform.

⁸⁴HOFSTEDE, *supra* note 69, at 13-14.

3. The relation of humankind to the natural and social world.⁸⁵

Second, the theory would conjecture as to the types of societal orientations that may be adopted for meeting these goals. For example, in respect with each problem postulated by Hofstede, he defined a "cultural dimension" that reflects ways for members of a society to cope with that problem. Note that each value dimension, in fact, represents a range of possible stances between two polar ties illustrated by Hofstede's four basic problems:

1. *Power Distance*: Accepting an unequal distribution of power in institutions as legitimate or illegitimate;
2. *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;
3. *Masculinity/Femininity*: Valuing achievement, heroism, assertiveness, and material success versus relationships, modesty, caring for the weak, and interpersonal harmony.⁸⁶
4. *Uncertainty Avoidance*: Feeling uncomfortable or comfortable with uncertainty and ambiguity and therefore valuing or devaluing beliefs and institutions that provide certainty and conformity.⁸⁷

⁸⁵Schwartz, *supra* note 72, at 26-28.

⁸⁶Writing in 1980 (and again in 1991), Hofstede was well aware of the problematic in attributing such qualities to particular genders. He nonetheless kept this dimension, arguing that it reflects a positive reality that is independent of its normative undesirability. HOFSTEDE, *supra* note 68, at 191-93.

⁸⁷HOFSTEDE, *supra* note 69, at 12.

Schwartz adopts a similar framework of bipolar dimensions, or "value types":⁸⁸

1. *Embeddedness/Autonomy*: Embeddedness⁸⁹ represents a cultural emphasis on maintenance of the status quo, propriety, and restraint of actions or inclinations that might disrupt the solidary group or the traditional order. The opposite pole describes cultures in which the person is viewed as an autonomous, bounded entity who finds meaning in his or her own uniqueness.
2. *Hierarchy/Egalitarianism*: This dimension refers to guaranteeing responsible behavior that will preserve the social fabric. Hierarchy represents a cultural emphasis on obeying role obligations within a legitimately unequal distribution of power, roles, and resources. Egalitarianism represents an emphasis on transcendence of selfish interests in favor of voluntary commitment to promoting the welfare of others.
3. *Mastery/Harmony*: This dimension refers to the relation of humankind to the natural and social world. Mastery stands for a cultural emphasis on getting ahead through active self-assertion whereas Harmony represents an emphasis on fitting harmoniously into the environment.⁹⁰

⁸⁸See Schwartz, *supra* note 72, at 26-28. Schwartz theorizes further about the relations between these value types. See *infra* note 108.

⁸⁹In earlier works, this pole was named Conservatism but was recently replaced with Embeddedness. See Lilach Sagiv & Shalom H. Schwartz, *National Cultures: Implications for Organizational Structure and Behavior*, in THE HANDBOOK OF ORGANIZATIONAL CULTURE AND CLIMATE (N.N. Ashkanasy et al. eds., forthcoming); Shalom H. Schwartz & Gila Melech, *National Differences in Micro and Macro Worry: Social, Economic and Cultural Explanations*, in SUBJECTIVE WELL-BEING ACROSS CULTURES AND NATIONS (E. Diener & E. Suh eds., forthcoming).

⁹⁰Schwartz notes that in modern societies Harmony may be better conceptualized as referring to nonassertiveness in social relations as submission to the environment is uncommon in contemporary national cultures. Schwartz, *supra* note 72, at 28 n.4.

The third theoretical level would specify the particular values that express the locations of cultures on each dimension. Societal members acquire these values by exposure to a shared social and institutional environment. Decision makers use them to guide and justify their everyday decisions. This is the level of operationalization. Schwartz explicitly specifies values that reflect societal orientations on cultural dimensions. Hofstede uses a variety of value and other statements to measure cultural orientations. For instance, an emphasis on Hierarchy in a culture is expressed in such values as social power, authority, humility, and wealth, whereas an emphasis on Egalitarianism in a culture is expressed in such values as equality, social justice, freedom, responsibility, and honesty.⁹¹

2. Research Instruments, Samples, and Scores

Cross-cultural studies use questionnaires (also called instruments) to elicit participants' evaluations of the importance of the various values hypothesized by theory. Questionnaires need to be checked in order to verify that different language versions do not echo unintended culture-specific meanings. This is done by back-translations from each language into the others, by comparisons among different translators, and in more sophisticated studies, by empirical analyses of the similarity of concepts among associations (i.e., values) in the various samples from different language groups.

Another feature of cultural dimension studies is that they must be based on samples from a large number of cultures. In order to verify that value types are truly universal, researchers strive to cover cultures from all corners of the world.⁹² Substantial samples are needed in each culture to yield reliable estimates of national cultural orientations. For example,

⁹¹*Id.* at 28.

⁹²This issue and the issue of questionnaire language are fairly technical aspects of empirical testing but in cross-cultural experimentation they acquire special importance. A fascinating example is a study conducted by the Chinese Culture Connection group led by Michael Bond. The animating intention of that research was to develop a measure of values that would reflect indigenous themes of Chinese culture. To this end, Chinese scholars prepared lists of "fundamental and basic values for Chinese people" which were then consolidated, clarified, and translated from the Chinese original into other languages. The instrument was given to respondents from 22 countries. Analysis of the results yielded a value dimension that did not correlate with any of Hofstede's dimensions (while some of the others did) and was called Confucian Work Dynamism. See Chinese Culture Connection, *Chinese Values and the Search for Culture-Free Dimensions of Culture*, 18 J. CROSS-CULTURAL PSYCHOL. 143 (1987). Hofstede later adopted it as a fifth dimension of his model. See HOFSTEDE, *supra* note 69, at 164.

Hofstede's project surveyed over 117,000 respondents in fifty countries and three regions,⁹³ and Schwartz's published results reflect a sample of over 35,000 respondents in forty-nine nations. Schwartz's project is still under way and has now covered some sixty-seven nations.⁹⁴

Once responses are gathered, the researcher computes the average score on each question per national sample group. This procedure yields the average orientation among national culture members towards the value targeted by each question. Individual differences are "ironed out" because the focus is on culture-level analysis.⁹⁵

3. MDS Analysis⁹⁶

With a database of average national scores in hand, the next step is to analyze the scores in order to first identify value types (dimensions) that discriminate among cultures, and second, to determine the values that characterize particular cultures. The statistical techniques used for this purpose belong to a family called Multidimensional Scaling (MDS). These tools search for underlying dimensions that influence the scores on the variables. For each technique, special statistics exist that express the

⁹³Hofstede's project was rather unique among all other value surveys. The project originated as an audit of company morale among the employees of the IBM corporation between 1967 and 1973. Most of the questions therefore predominantly tapped work-related values. Notwithstanding these and other limitations, his study is considered path-breaking. See Smith & Schwartz, *supra* note 74, at 96-97. Ironically, while prominent cross-cultural psychology scholars generally approve of Hofstede's methodology, scholars in other fields tend to criticize it, possibly without sufficient basis. See, e.g., Helen Gernon & R.S. Olusegun Wallace, *International Accounting Research: A Review of its Ecology, Contending Theories, and Methodologies*, 14 J. ACCT. LIT. 54, 86-90 (1995) (criticizing the use of Hofstede's method in the accounting field); John D. Jackson, *Playing the Culture Card in Resisting Cross-Jurisdictional Transplants: A Comment on "Legal Processes and National Culture,"* 5 CARDOZO J. INT'L & COMP. L. 51 (1997) (criticizing the use of Hofstede's method in the field of law).

⁹⁴See also Smith *et al.*, *supra* note 71, at 239-40 (using 8841 responses from nearly 11,000 respondents in 43 nations).

⁹⁵Doubtless, there are numerous other issues involved in conducting surveys of such scale, scope, and subject matter. Such issues include selecting respondents in order to have a matched and representative sample, using ranking versus rating of values as the format of responses, correcting responses for national differences in use of response scale, et cetera. Another important subject is the method of representation or results after the raw data are processed; however, these issues are beyond the scope this article.

⁹⁶Thanks to Chanan Goldschmidt for enlightening me about the intricacies of the statistical methods described in this Part. Errors remain mine alone.

"quality" of the model, analogous, for instance, to *R-Squared* for regression analysis.

Early studies⁹⁷ used a method called exploratory factor analysis.⁹⁸ This method searches for underlying factors that account for the intercorrelations among variables. For each factor, the researcher looks for a set of questions that "load" most strongly on that factor. This set of questions is assumed to be influenced by a shared dimension. Examination of what these questions share conceptually and what distinguishes them from others is necessary to discover this shared dimension and permit identification and labeling of the factor (hence the label "exploratory").⁹⁹ After the factors (here: value dimensions) are defined, the researcher computes nation/culture scores on each dimension by combining the questions that loaded on the relevant factor.

More recent studies employ other multidimensional techniques, sometimes in addition to factor analysis.¹⁰⁰ One of those techniques is called Similarity Structure Analysis (or Smallest Space Analysis (SSA)). In the stage of value type identification, SSA takes as input the intercorrelations between national mean scores for each value across all national samples. It yields a spatial plot in which each value is represented by a point; the more positive the intercorrelation between any pair of values the closer they are in the space, and the less positive their intercorrelation, the more distant.¹⁰¹ To compute the mean importance of a value type in a nation, a researcher would average the importance that members of the sample from that nation attribute to the set of values that represent that type.¹⁰²

⁹⁷*E.g.*, HOFSTEDE, *supra* note 68; Chinese Culture Connection, *supra* note 92.

⁹⁸This method is also sometimes called "ecological factor analysis." Ecological meaning that the analysis used country mean scores rather than individual ones, or in other words, that it was a culture-level analysis. See Geert H. Hofstede & Micheal Harris Bond, *Hofstede's Culture Dimensions: An Independent Validation Using Rokeach's Value Survey*, 15 J. CROSS-CULTURAL PSYCHOL. 417, 420 (1984).

⁹⁹See Smith et al., *supra* note 71, at 246 (noting with regard to another MDS technique, "[t]he naming of dimensions is as much an art as a science").

¹⁰⁰See, *e.g.*, Smith et al., *supra* note 71; Chinese Culture Connection, *supra* note 92.

¹⁰¹Schwartz, *supra* note 72, at 30. For example, "being influential" and "social power," both reflecting a preference for Hierarchy, would appear near one another. "Being helpful" and "social justice," both reflecting Egalitarianism, would also appear near one another but at a large distance from the former pair of values.

¹⁰²*Id.* at 32.

D. *Findings: From Hofstede to Schwartz and Beyond*

The findings of extant cross-cultural studies can be divided into two main categories. The first category, extensively discussed by cross-cultural psychologists is the issue of a universal set of value dimensions that could be used to distinguish among particular cultures. The second category, which is important primarily in applied contexts like the present one, deals with classifying countries into cultural groups. The following parts briefly review these categories in this order.

1. Fundamental Value Dimensions

Factor analysis of Hofstede's data resulted in the extraction of three rather than his four hypothesized value dimensions. The factors that emerged corresponded to the Masculinity/Femininity and the Uncertainty Avoidance dimensions, in addition, to a combination of Power Distance and Individualism/Collectivism dimensions. Hofstede, however, preferred to separate the latter two on theoretical grounds.

Hofstede's study has been criticized on various grounds in regards to his sample and instrument choice,¹⁰³ but his basic findings as to fundamental value dimensions remain largely intact. A 1987 study led by Michael Bond constructed a questionnaire purposefully derived from traditional Chinese concepts.¹⁰⁴ Factor analysis yielded dimensions that partially corresponded with Hofstede's. Partial parallels were found in the Individualism/Collectivism¹⁰⁵ and Masculinity/Femininity dimensions. There was no direct approximate to Uncertainty Avoidance. In addition, there emerged a new dimension, named Confucian Work Dynamism, which emphasized Confucian work ethics such as thrift and persistence.

MDS analysis of Schwartz's data provided impressive support to his theory about the structure of value types under a number of sample specifications.¹⁰⁶ Bond and Smith concluded their review of Schwartz's model by stating that "[i]n terms of both convergent and external validity,

¹⁰³See Smith et al., *supra* note 71, at 233-34; Smith & Schwartz, *supra* note 74, at 97-98. See *supra* note 93.

¹⁰⁴See *supra* note 92.

¹⁰⁵The Individualism/Collectivism dimension in particular raised tremendous interest and debate with regard to its ability to distinguish between national cultures. For a thorough review, see Cigdem Kagitcibasi, *Individualism and Collectivism*, in 3 HANDBOOK OF CROSS-CULTURAL PSYCHOLOGY 1 (2d ed., John W. Berry et al. eds., 1997).

¹⁰⁶Schwartz, *supra* note 72, at 30-32; Smith et al., *supra* note 71, at 236.

the Schwartz domains appear most promising.¹⁰⁷ Because Schwartz's value types are interrelated,¹⁰⁸ they do not directly parallel those suggested by Hofstede and his progeny. Efforts were thus made in order to reconcile the different sets of value dimensions found by these studies and others. The result was summarized as follows:

[A] close positive association between two basic dimensions [is] identified in different ways by different authors:

1. The preferred cultural view of individual-group relations (autonomous versus embedded)
2. The preferred cultural mode of motivating responsible social behavior and allocating resources (negotiation among equals versus acceptance of unequal, hierarchical roles).

These dimensions are virtually identical to the first two culture-level dimensions identified by Schwartz.¹⁰⁹

2. Mapping the Nations of the World

Although Hofstede's and Schwartz's projects differ in numerous respects, they have reached remarkably similar results in term of grouping the nations of the world into clusters that share similar cultural traits. Hofstede was able to divide his sample countries into seven groups: Nordic, Anglo, Germanic, Near Eastern, less developed Asian, less developed Latin, and more developed Latin. Schwartz identified six such clusters: West

¹⁰⁷Bond & Smith, *supra* note 67, at 210.

¹⁰⁸Schwartz argues that the basic cultural dimensions probably form a complex, circular structure of interrelated concepts. In this configuration, value types that are conceptually close to one another, e.g., Harmony and Egalitarianism, will be neighbors on a circle's circumference and be diametrically opposed to their bipolar counterparts, Mastery and Hierarchy, respectively. See Schwartz, *supra* note 72, at 29.

¹⁰⁹Smith & Schwartz, *supra* note 74, at 103. In addition to the two dimensions mentioned in the text which have empirical support, one could also conceptualize an analogy between Hofstede's Uncertainty Avoidance and Schwartz's Mastery/Harmony. Both dimensions can be interpreted as dealing with the relation between man and the real world (environment), with all of its unknown future contingencies. Letter from Shalom H. Schwartz, *The Hebrew University of Jerusalem*, to Amir N. Licht (Feb. 23, 1998).

European, Anglo, East European, Islamic, East Asian, and Latin American. The absence of an East European group in Hofstede's results is readily explained by its absence in his sample. The two groupings are fairly similar. Moreover, according to both studies, countries belonging to the same cluster have conceptually similar cultural value dimensions. For the sake of brevity, only a few highlights are provided.¹¹⁰

For example, in Hofstede's study the Nordic group shares with the Anglo group a cultural preference for Individualism (i.e., preferring personal independence) and low Power Distance (i.e., preferring equal division of power), but the Anglo group scores high in Masculinity while the Nordic group scores low.¹¹¹ Under Hofstede's interpretation, this reflects an Anglo preference for assertiveness and material success whereas the Nordic emphasized caring for the weak and interpersonal harmony. Schwartz's framework yields a similar picture: the English-speaking group emphasizes Hierarchy at the expense of Egalitarianism more than the West European group does. The same is true with regard to Mastery versus Harmony, respectively.

In both Hofstede and Schwartz's studies, East Asian countries (with the important exception of Japan which is a conspicuous outlier in both studies) share with English-speaking countries acceptance of unequal, hierarchical personal settings relatively more than continental European countries do. On the other hand, in terms of their view on individual and group relations, Western countries emphasize personal autonomy relatively more than the East Asian do.¹¹²

E. Implementations

Implementation of country scores on cultural value dimensions for further research began instantaneously with Hofstede's study. In his books he correlated these number series with economic data like gross national product, growth rate,¹¹³ and numerous other variables. Scholars in other

¹¹⁰For a partial review, see Smith & Schwartz, *supra* note 74, at 104-05.

¹¹¹HOFSTED, *supra* note 68, at 332-36.

¹¹²Schwartz, *supra* note 72, at Figure 2. These and other differences led Schwartz, with Maria Ros, to argue that "the West" comprises two separate cultural groups that are just as distinctive from one another as the West is from East Asia. See Schwartz & Ros, *supra* note 73.

¹¹³For a review and critique, see Ryh-song Yeh & John J. Lawrence, *Individualism and Confucian Dynamism: A Note on Hofstede's Cultural Root to Economic Growth*, 26 J. INT'L BUS. STUD. 655 (1995).

disciplines were also quick to recognize the value of cross-cultural studies, for instance, in business administration studies.¹¹⁴ Of the many efforts to implement a cross-cultural perspective, one that may be of special interest here because of its high relevance to corporate governance and securities regulation is the field of international accounting.¹¹⁵

Students of international accounting have tried to explain international diversity in accounting systems (including rules, practices, and institutions) by analyzing the effect of culture on accounting.¹¹⁶ Until now, theoretical and empirical studies in international accounting have relied exclusively on the conceptual framework and findings laid down by Hofstede.¹¹⁷ Several studies were especially inspired by the framework introduced in 1988 by Sidney Gray.¹¹⁸

Gray posited a systematic theory of cultural influence on the development of international accounting systems.¹¹⁹ He postulated four bipolar "accounting value dimensions" that exist at the level of the accounting subculture: professionalism versus statutory control, uniformity

¹¹⁴See, e.g., Viv J. Shackleton & Abbas H. Ali, *Work-Related Values of Managers: A Test of the Hofstede Model*, 21 J. CROSS-CULTURAL PSYCHOL. 109 (1990); Stephen Bochner & Beryl Hesketh, *Power Distance, Individualism/Collectivism, and Job-Related Attitudes in a Culturally Diverse Work Group*, 25 J. CROSS-CULTURAL PSYCHOL. 233 (1994). For a recent review and critique, see Greame Harrison & Jill L. McKinnon, *Cross-Cultural Research in Management Control System Design: A Review of the Current State*, 24 ACCT. ORG. & SOC. 483 (1999). For a review from a cross-cultural psychology perspective, see Peter B. Smith, *Organizational Behaviour and National Cultures*, 3 BRIT. J. MGMT. 39 (1992).

¹¹⁵See, e.g., Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335, 1339-42 (1996) (arguing that accounting standards play a significant role in corporate governance and in the success of financial markets); see also Joel Seligman, *Accounting and the New Corporate Law*, 50 WASH. & LEE L. REV. 943 (1993).

¹¹⁶For a review, see Gernon & Wallace, *supra* note 93, at 84-91. See also GERHARD G. MUELLER ET AL., ACCOUNTING: AN INTERNATIONAL PERSPECTIVE 10-11 (4th ed. 1997) (acknowledging the effect of culture on accounting concepts, standards, and practices); Hary H.E. Fechner & Alan Kilgore, *The Influence of Cultural Factors on Accounting Practice*, 29 INT'L J. ACCT. 265 (1994).

¹¹⁷See Gernon & Wallace, *supra* note 93, at 85. Cf. Harrison & McKinnon, *supra* note 114, at 491 (criticizing same phenomenon in management studies).

¹¹⁸Sidney J. Gray, *Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally*, 24 ABACUS 1 (1988). See also Hector M. Perera, *Towards a Framework to Analyze the Impact of Culture on Accounting*, 24 INT'L J. ACCT. 42 (1989) (suggesting a theory surprisingly similar to Gray's).

¹¹⁹See Gray, *supra* note 118, at 8-11. Gray later updated his model to reflect the adoption by Hofstede of Confucian Dynamism (long-term versus short-term orientation) to his model, *supra* note 92. See LEE H. RADEBAUGH & SIDNEY J. GRAY, INTERNATIONAL ACCOUNTING AND MULTINATIONAL ENTERPRISES 75-80(4th ed. 1996).

versus flexibility, conservatism versus optimism, and secrecy versus transparency.¹²⁰ With regard to each accounting value, Gray hypothesized how its development in a particular accounting system might be affected by each of Hofstede's societal value dimensions.¹²¹ For example, a preference for secrecy was hypothesized to be consistent with strong Uncertainty Avoidance, high Power Distance, Collectivism, and Confucian long-term orientation.¹²²

Salter and Niswander tested Gray's theory using his accounting values as dependent variables and Hofstede's cultural values as independent variables.¹²³ Using data from twenty-nine countries, they found that while Gray's model has statistically significant explanatory power, it is best at explaining actual financial reporting practices and is relatively weak in explaining extant professional and regulatory structures from a cultural base. Further tests suggested that both the development of financial markets and levels of taxation enhance the explanations offered by Gray.¹²⁴ Gray's theory and the empirical results are remarkable and perhaps warrant further analysis in light of the fact that in almost all of his accounting values, Gray mentions that as the primary value dimension affecting them is Uncertainty Avoidance.¹²⁵ However, in an effort to generalize the value dimensions emerging from different theories the latter dimension did not come up clearly.¹²⁶

IV. CORPORATE GOVERNANCE SYSTEMS AND VALUE DIMENSIONS

¹²⁰See Gray, *supra* note 118, at 8-11.

¹²¹See *id.*

¹²²RADEBAUGH & GRAY, *supra* note 119, at 79.

¹²³Stephen B. Saltern & Frederick Niswander, *Cultural Influence on the Development of Accounting Systems Internationally: A Test of Gray's (1988) Theory*, 26 J. INT'L BUS. STUD. 379 (1995).

¹²⁴See also Sidney J. Gray & Hazel M. Vint, *The Impact of Culture on Accounting Disclosures: Some International Evidence*, 2 ASIA-PAC. J. ACCTG. 33 (1995) (showing evidence supporting the secrecy/transparency dimension especially with regard to Uncertainty Avoidance and Individualism); cf. Marilyn Taylor Zarzeski, *Spontaneous Harmonization Effects of Culture and Market Forces on Accounting Disclosure Practices*, 10 ACCTG. HORIZONS 18 (1996) (arguing the secretiveness of a culture does underlie disclosure practices of its business enterprises but enterprises operating globally disclose more than dictated by their local culture). See also Nabil Baydoun & Roger Willett, *Cultural Relevance of Western Accounting Systems to Developing Countries*, 31 ABACUS 67 (1995) (applying and extending the Hofstede-Gray framework).

¹²⁵See Schwartz, *supra* note 72, and accompanying text.

¹²⁶See *id.*

A. Introduction

The idea of applying cross-cultural psychology for analyzing legal problems is novel. Its novelty may be assessed in light of the fact that in all the legal literature available "on-line" there is less than a handful of serious references to that discipline.¹²⁷ The law and economics literature seems devoid of references to it altogether. Part B thus begins by contextualizing the proposed theory within this framework. This Part then proceeds to outline a cross-cultural theory of corporate governance systems. Part C points out fundamental economic problems of the corporate form, which corporate governance sets out to tackle, and argues how preexisting cultural values are likely to bear on it. Part D exemplifies how cultural values may affect the choice of particular corporate governance solutions and how respective testable hypotheses can be derived. Part E discusses dynamic aspects, including the effect of culture on convergence of corporate governance systems and the likelihood of cultural change in response to external shocks. Part F concludes with a note on the empirical testability of the proposed theory.

B. From Behavioral to Cross-Cultural Law and Economics

Recent developments in the law and economics discipline render the approach advanced here as a natural step forward in light of the growing

¹²⁷Lexis and WestLaw searches for cites of the two preeminent scholars in cross-cultural psychology, Geert Hofstede and Shalom Schwartz, yielded but a handful of references to Hofstede, whose main work dates back to 1980, and none to Schwartz, whose prolific writing during the 1990s has revamped the field. The one single case where cross-cultural psychology was seriously invoked in discussing the potential effect of cultural differences on legal reform relates to civil procedure. See Oscar G. Chase, *Legal Processes and National Culture*, 5 CARDOZO J. INT'L & COMP. L. 1, 10-14, 17-18 (1997) (describing Hofstede's work and applying it in a comparison between the American and German systems of civil procedure); see also Oscar G. Chase, *Some Observations on the Cultural Dimension in Civil Procedure Reform*, 45 AM. J. COMP. L. 861, 864-65 (1997) (same). In separate rejoinders, Professors Jackson and Langbein criticize Chase's reliance on Hofstede's theory and findings. See Jackson, *supra* note 93, at 57-58; see also John H. Langbein, *Cultural Chauvinism in Comparative Law*, 5 CARDOZO J. INT'L & COMP. L. 41, 45-46 (1997) (criticizing Chase's analysis of German civil procedure compared to American civil procedure). While these critiques may have some valid points as to the subject matter, it seems clear that Jackson and Langbein were not familiar with the details of Hofstede's work which makes their critique on this point rather misguided. In a related context, a handful of articles briefly cite Hofstede's work while discussing international arbitration and litigation. See, e.g., Mary C. Daly, *The Cultural, Ethical, and Legal Challenges in Lawyering for a Global Organization: The Role of the General Counsel*, 46 EMORY L.J. 1057, 1109 n.228 (1997) (citing Hofstede with no further details).

integration of other psychological theories into mainstream law and economics. Economists were quick to recognize the relevance of psychology to their field.¹²⁸ Of special importance since the 1970s has been the sub-discipline of behavioral decision theory within cognitive psychology. Pioneered by Tversky and Kahneman, work in this field suggests that there are heuristics, biases, and other departures from rational decision-making processes that are systematic and predictable and can thus be modeled and tested with a fair degree of rigor.¹²⁹ Notwithstanding on-going debates, there is a growing willingness to accept the psychologists' empirical claims seriously and "behavioral economics" has become an accepted sub-discipline within economics.¹³⁰

According to Donald Langevoort, "[M]any legal academics have become aware of this behavioral research only in the last few years, and there's a sense of newness to these materials (not to mention the sense that it stands in stark contrast to 'economic analysis')." ¹³¹ The situation is changing rather rapidly since Professors Jolls, Sunstein, and Thaler called for adopting a behavioral approach to law and economics.¹³² Scholars like Judge Posner and Professors Issacharoff and Ulen voiced various critiques,¹³³ but the trend is now irreversible. Like the development in economics, economic analysis of law will enrich itself with insights from cognitive psychology. The proof, as always, will be in pudding, namely, in plausible yet falsifiable theories that could produce testable hypotheses.¹³⁴

¹²⁸See Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998).

¹²⁹See *id.* at 1501.

¹³⁰See *id.* at 1502.

¹³¹*Id.* Langevoort, however, provides a broad review of works that show that behavioral judgment and decision research already have a significant past in legal scholarship. *Id.* at 1526.

¹³²See Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998).

¹³³See, respectively, Samuel Issacharoff, *Can There Be a Behavioral Law and Economics?*, 51 VAND. L. REV. 1729 (1998) (defining the conditions for a successful behavioral law and economics); Richard A. Posner, *Rational Choice, Behavioral Economics, and the Law*, 50 STAN. L. REV. 1551 (1998) (criticizing the article of Jolls, Sunstein, and Thaler); Thomas S. Ulen, *The Growing Pains of Behavioral Law and Economics*, 51 VAND. L. REV. 1747 (1998). See also Mark Kelman, *Behavioral Economics as Part of a Rhetorical Duet: A Response to Jolls, Sunstein, and Thaler*, 50 STAN. L. REV. 1577 (1998) (criticizing JST [Jolls, Sunstein, and Thaler] theories of behavioral economics); Jennifer Arlen, *Comment: The Future of Behavioral Economic Analysis of Law*, 51 VAND. L. REV. 1765, 1770 (1998) (demonstrating the problems with employing behavioral analysis in deriving normative policy conclusions).

¹³⁴This is also the main thrust of the rejoinder by Jolls, Sunstein, and Thaler to Posner, *supra* note 133, and to Kelman, *supra* note 133. See Christine Jolls et al., *Theories and Tropes: A Reply to Posner and Kelman*, 50 STAN. L. REV. 1593 (1998). See generally Cass R. Sunstein,

The behavioral mini-revolution has only left a minor imprint on economic analyses of corporate governance and securities regulation.¹³⁵ This is disappointing because a corporation consists of a dense nexus of relationships between people — in the now classic economic view, a nexus of contracts.¹³⁶ These people stand in different positions of power, wealth, and information. Their behavior is likely to be affected at least by some of the major bounds identified by cognitive psychology: bounded rationality, bounded willpower, and bounded self-interest. This article will not delve any further into these issues as it argues that other psychological factors also play a role in corporate settings — the cultural value dimensions identified by cross-cultural psychology.

How would national cultural values affect people's behavior in corporate settings? It seems that the best way to conceptualize these channels of influence is by perceiving values as an integral part of people's tastes.

Economists assume that people's revealed preferences — their actual choices in real world situations — reflect their personal tastes.¹³⁷ In other words, people's behavior is assumed to be guided by a personal utility function that cause them to choose lines of action that would maximize their expected personal utility.¹³⁸ Such expected-utility-maximizing behavior is commonly called "rational." Respectively, systematic departures from rational behavior due to cognitive bounds are subsumed as "bounded

Behavioral Law and Economics: A Progress Report, 1 AM. L. & ECON. REV. 115 (1999) (discussing how behavioral economics may inform predictions about the affects of law and what the law ought to be doing).

¹³⁵A notable exception is the writings of Professor Langevoort on disclosure aspects of securities regulation. See, e.g., Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Misdemean Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101 (1997); Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law From Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CAL. L. REV. 627 (1996); Donald C. Langevoort, *Toward More Effective Risk Disclosure For Technology-Enhanced Investing*, 75 WASH. U.L.Q. 753 (1997); see also Robert B. Thompson, *Securities Regulation in an Electronic Age: The Impact of Cognitive Psychology*, 75 WASH. U.L.Q. 779 (1997) (discussing how cognitive psychology will shape the economies).

¹³⁶Michael C. Jensen & William H. Meckling, *Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). See Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211 (1995).

¹³⁷Indeed, it is enough for revealed preferences to change as if the actor's preferences are determined by her actual taste. See Marcel K. Richter, *Revealed Preference Theory*, in 4 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 166, 167 (John Eatwell et al. eds., 1998).

¹³⁸*Id.* at 166.

rationality."¹³⁹ As noted, law and economics scholars debate about whether the working assumption for legal analysis and law making should regard boundedly rational behavior as "irrational" (and hence largely ignore it) or as a special version of rational behavior.¹⁴⁰ Additional questions arise as to whether national societies, embodied as states, can be assumed to behave rationally.¹⁴¹

For present purposes, it is possible to sidestep this debate altogether. Instead, we should regard values as parameters of the personal utility function, and therefore, as characteristics of rational behavior. The central idea is that an actor's utility function is shaped and informed, at least partially, by the process of socialization. During that process societal members have ample opportunity to internalize the prevailing choices and preferences that had already been made by previous generations, namely, the surrounding culture. As one develops the ability to decide for oneself, his or her decision making is affected by these cultural bounds just as it is limited by cognitive bounds on human memory and computational capability.

Concurrently, as certain cultural values take roots among individual members of society, they shape social institutions and the general social environment. This environment gives meaning to action, defines what is socially acceptable, and exercises social control through sanctioning.

To the extent that individuals have acquired culture, they can know how their actions are likely to be perceived, normatively, by most others in their environment such as professional peers, family, the media, et cetera. They can know whether an action is generally considered right or wrong. As should be clear from the review of value dimension theories, choices in numerous interpersonal interactions involve such judgments. Value dimensions that are likely to be relevant to particular situations in corporate settings will probably be Schwartz's dimensions of Hierarchy/Egalitarianism and Embeddedness/Autonomy or Hofstede's Individualism/Collectivism and Power Distance. In light of empirical findings about accounting systems, Uncertainty Avoidance may also emerge as a significant dimension. Corporate structures and regulatory measures may attain different levels of social approval, depending on the degree to which it conforms to prevailing cultural values in a particular society.

¹³⁹See Herbert A. Simon, *Bounded Rationality*, in 1 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 266 (John Eatwell et al. eds., 1998).

¹⁴⁰See, e.g., Jolls et al., *supra* note 132, at 1595.

¹⁴¹See Jeffrey L. Dunnoff & Joel P. Trachtman, *Economic Analysis of International Law*, 24 YALE J. INT'L L. 1, 20-21 (1999) (discussing this problem); Licht, *supra* note 30, at 78-81.

Incorporating the CVD framework into legal analysis would be a direct extension of incorporating behavioral psychology where national characteristics are posited to affect governance structures. Behavioral psychology proved to be useful in enriching standard models of economic decision making. Hence, there is every reason to believe that CVD would prove equally valuable for fine-graining basic economic models with regard to questions that are laden with far-reaching political and economic ramifications. To be sure, mainstream law and economics will face a considerable challenge to incorporate the CVD framework as it still does with respect to behavioral psychology. Also, it would often be more sensible to cut the Gordian knot and do away with psychological refinements for the sake of clarity and conciseness. But as Part II demonstrates, there is a long-felt need within law and economics to account for cultural differences and cross-cultural psychology should provide a good framework for doing so.

C. Culture and the Fundamental Problems of Corporate Governance

In most countries of the world business entities are legal institutions known for many years, if not centuries. One can reasonably assume that the laws in all of these countries also distinguish between partnerships, closely-held (private) corporations, and widely-held (public) corporations, albeit under different titles and slightly different definitions. One major exception to this assumption is the group of formerly communist countries where private business entities — particularly business corporations — did not play a role in economic life during the last half-century (in Eastern Europe) or more (in Russia). These countries are now designing their corporate governance systems from scratch.¹⁴²

Each and every society that recognizes corporations as legal entities immediately faces the fundamental problem of how to ensure that investors

¹⁴²See, e.g., Avilov et al., *supra* note 12 (proposing general principles of company law for transition economies); Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911 (1996) (presenting the principles of a new corporate law for Russia). The project of privatizing the Russian economy and establishing self-enforcing corporate governance, however, failed miserably. A culture of extreme self-dealing and corruption was among the major reasons. See Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 STAN. L. REV. 1739 (2000). Countries that gained their independence only during the twentieth century also needed to design corporate governance systems and many of them are now reforming theirs. In such former colonies legal institutions of Western private law were introduced (at least formally) at an earlier stage.

get their investment back. The primary question for investors is how to "make sure that managers do not steal the capital they supply or invest in bad projects?"¹⁴³ A similar question also arises in the relations between controlling or public shareholders. Analogous problems further arise between shareholders and suppliers of debt capital and labor. All of these interactions exhibit the fundamental problem of the corporate form and the agency problem. Corporate governance systems are supposed to provide the means to cope with it.¹⁴⁴

The agency problem stems directly from the natural limits on human capabilities. Under the standard view of the corporation as a nexus of contracts, people will never be able fully to specify all future contingencies in their contract. Furthermore, certain future contingencies will be unobservable, meaning that at least one party will not be able to ascertain whether the contingencies occurred or not. Some contingencies may further be nonverifiable, meaning that even if a party observed them personally they would not be able to prove this to a third party, for example, a court. As a result, parties to a corporate contract will not be able to fully allocate the risks and benefits it entails between them *ex ante*. Incompleteness of the contract will leave room for *ex post* bargaining. Corporate governance systems constitute the environment — both legal and institutional — in which *ex post* bargaining takes place.¹⁴⁵

In corporations where economic interests are widely dispersed among numerous stakeholders, the agency problem is further exacerbated by the collective action problem. More often than not, exercising the rights of such stakeholders would exhibit features of a collective good. Fearing that all other stakeholders will free-ride their efforts to exercise their collective right, each stakeholder will eschew investing in such exercise in the first place.¹⁴⁶

¹⁴³Shleifer & Vishny, *supra* note 62, at 737.

¹⁴⁴*Id.* at 740.

¹⁴⁵See Zingales, *supra* note 47, at 497. In fact, *ex ante* contracting is also affected as it is conducted "in the shadow of the law." Cf. Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 997 (1979).

¹⁴⁶When collective goods are involved, common wisdom holds that large numbers of actors will lead to a higher likelihood that the group will be latent, unable to provide that good. The reasons are threefold: (1) the fraction of the group benefit received by any one individual declines as the group size increases; (2) larger groups are less likely to exhibit small-group strategic interaction that could help in collective good provision; and (3) organization costs increase with an increase in group size. "[T]he larger the group, the farther it falls short of providing an optimal amount of a collective good." MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* 35 (1965) (emphasis omitted). See generally RUSSEL HARDIN,

Any society that wanted to encourage conducting business through incorporated entities would face these fundamental problems and would have to establish social institutions to support them. But the fundamental problems of corporate governance are not unique to this area. In fact, problems quite similar to these arise in numerous other situations in life. It would be meaningless, for example, to attempt to count all the situations in which people could improve their aggregate welfare if they were able to ensure that group members take other members' interest into account. Incomplete information and information asymmetry pervade human relations of all kinds. Risk has been part of the human condition since people appeared on this earth.

To be sure, the scope of economic activity and assets concentrated in corporations renders solving these fundamental problems highly important. But doing so in a particular society will never start from a clean slate. In designing solutions to such problems as they arise and develop in corporate settings, societal leaders and lay members are more likely to draw on generally accepted views of what is appropriate and on approaches adopted for analogous situations — in short, on their common cultural values.

Cultural values thus emerge as the "mother of all path dependencies" in corporate governance systems. The mother metaphor may be useful for pointing out two major implications often associated with path dependence. First, from a hindsight viewpoint, cultural values constitute a heritage of common tastes for certain interpersonal relations and institutions. As a result, they may influence the choice of particular corporate structures and legal rules out of a larger menu. Second, from a forward-looking viewpoint, cultural values are deeply embedded in people's minds and in social institutions. As a result, a corporate governance system that is compatible with social preferences in other areas (most importantly, legal areas) is more likely to work smoothly in a particular society. Additionally, such compatibility may increase the persistence of certain features and impede reforms.¹⁴⁷

D. Applying Value Dimensions in Corporate Governance Analysis

COLLECTIVE ACTION 155-72 (1982).

¹⁴⁷For further discussion of the dynamic aspects of cultural values and corporate governance, including cultural changes and legal reform, *see infra* Part IV.E.

This Part outlines a theory about the linkage between cultural value dimensions and the basic approaches observed in corporate governance systems around the world. Each of the following subsections posits how the prevailing cultural values in a society may affect the way publicly held companies approach corporate governance. Throughout this Part, examples are mentioned from the few better-researched countries. These examples should not be taken as solid evidence. The discussion of empirical testability is postponed to a later part. Likewise, due to the broader goal of this article, as well as exigencies of scope, the elements that are discussed here are more suggestive than exhaustive. More comprehensive discussion is postponed to a later stage.

The value dimensions referred to are those suggested by Hofstede and Schwartz. Students of corporate governance, particularly those from the law and economics branch, may consider these concepts too "soft." The vocabulary introduced here is indeed new and the names given to some of the dimensions are admittedly quite vague and elusive. The methodology, however, that stands behind the vocabulary is rigorous and thus warrants the effort to implement them. A by-product of the following discussion is an exercise in the use of new concepts.

Note also that the CVD set posited by Schwartz does not fully parallel the one posited by Hofstede. While Schwartz's value dimensions are generally preferred, there is an occasional reference to Hofstede's Uncertainty Avoidance dimension, which does not have a direct equivalent in Schwartz's model. Notions like future contingencies, risk and risk aversion, and uncertainty are central to finance theory, and consequently, to corporate governance and securities regulation analysis. Hofstede's Uncertainty Avoidance dimension purports to capture these notions directly while Schwartz's model does not. Schwartz's theory comes closest to Hofstede's Uncertainty Avoidance with his dimension of Mastery/Harmony where Harmony arguably reflects a similar attitude of submission to or fitting in with the world around us.¹⁴⁸ For the present purposes, however, Mastery/Harmony seem less self-explanatory than Uncertainty Avoidance.¹⁴⁹

Finally, readers might note that some arguments made below are hedged in that they talk about potential cultural effects. This is because a

¹⁴⁸See Smith & Schwaratz, *supra* note 74, at 96-98.

¹⁴⁹Further research may be warranted on this subject. This point also exemplifies the importance of good naming for value dimensions such that they convey applicable meanings. See Smith et al., *supra* note 71, at 259-60.

repeating theme in this article is that a valid cross-cultural theory should be tested statistically rather than impressionistically. In the end, a negative showing that certain corporate governance aspects are not systematically related to cultural features would be just as informative for policy makers as an affirmative one.

1. Preliminary Choices

A preliminary choice that societies make is the extent to which they want to encourage conducting business through large public corporations. Culture is often noted among the reasons for high or low incidence of widely held corporations in particular countries. Versions of this argument range from popular culture of sorts that detested concentration of economic power in nineteenth century United States,¹⁵⁰ to the absence of "equity culture" among Germans, which arguably impedes the thriving of public companies and capital markets.¹⁵¹ Relatedly, James Fanto has called for implementing investor education programs in the United States in light of "[c]onstraints in American culture [that] significantly limit paternalism because the culture favors, promotes and thus determines a preference for individual responsibility and decision-making."¹⁵²

One common denominator in such arguments is the notion that the populace in different societies views equity securities differently. An argument about "equity culture" actually means that some cultures favor, or at least tolerate, the typical features of equity securities more than others do. These features are a higher return coupled with a higher risk, compared with debt instruments that have equivalent expected return. A plausible hypothesis about people who lack "equity culture" is that on average they have a higher degree of risk aversion.

Transforming the latter hypothesis into a cultural dimension framework is straightforward. The "cultural" hypothesis would be that in countries that score high on Uncertainty Avoidance, where living in an

¹⁵⁰See ROE, *supra* note 41.

¹⁵¹See, e.g., Andre, *supra* note 4, at 75 (describing the lack of "equity culture" among German households); see also Pfeil, *supra* note 38, at 147 (same).

¹⁵²James A. Fanto, *We're All Capitalists Now: The Importance, Nature, Provision and Regulation of Investor Education*, 49 CASE W. RES. L. REV. 105, 119 (1998) (discussing American "culture of saving and investing"). See also James A. Fanto, *Investor Education, Securities Disclosure, and the Creation and Enforcement of Corporate Governance and Firm Norms*, 48 CATH. U. L. REV. 15 (1998) (discussing Americans' need to save and invest individually to meet retirement and educational goals).

environment of unknown future contingencies is considered particularly undesirable, one should expect to find lower shares of equity securities in household portfolios. Also, one should expect to find a lower share of business firms with dispersed ownership, as opposed to large private blockholdings and state-owned corporations. The United States and the United Kingdom versus Germany and France, respectively, immediately come to mind as anecdotal examples.¹⁵³

Relatedly, it should be interesting to investigate whether the incidence and level of cognitive bounds also vary systematically with nationality. Until very recently, however, the topic of culture and decision making has not received much attention from either decision-making researchers or cross-cultural psychologists.¹⁵⁴ In a number of recent papers, Hsee and Weber document cross-cultural differences in risk-preference between American and Chinese respondents whereby Americans appear more risk averse than their Chinese counterparts. This result obtains especially with regard to financial investment decisions.¹⁵⁵ Comparing the risk preference of American, Chinese, and German respondents yielded similar results. The researchers interpret this as supporting their "cushion hypothesis," namely, that people from collectivist cultures may be more willing to take financial and other entrepreneurial risks, believing that they can rely on a social "safety net."¹⁵⁶ This result, at least regarding American and German investors, is hard to reconcile, however, with the wisdom that unlike Americans, Germans lack "equity culture," and with Hofstede's rankings of Uncertainty Avoidance among nations.

2. Shareholding Structures

¹⁵³In Hofstede's Uncertainty Avoidance ranking of fifty countries and three regions these countries rank as follows: France – 9th; Germany (then Federal Republic) - 29th; the United States - 43rd; Great Britain – 47/48th (together with the Republic of Ireland). HOFSTED, *supra* note 69, at 113. Under Schwartz's framework, an equity culture is compatible with cultural support for Mastery (assertiveness, daring) as a way to cope with reality rather than trying to maintain things as they are with low risk to everyone (Harmony).

¹⁵⁴See Elke U. Weber & Christopher K. Hsee, *Culture and Individual Judgment and Decision Making*, J. APPL'D PSYCHOLOGY (forthcoming) (providing a review of extant literature).

¹⁵⁵See, e.g., Christopher K. Hsee & Elke U. Weber, *Cross-National Differences in Risk Preference and Lay Predictions*, J. BEHAVIORAL DECISION MAKING (forthcoming).

¹⁵⁶See Elke U. Weber et al., *What Folklore Tells Us about Risk and Risk Taking: A Cross-Cultural Comparison of American, German, and Chinese Proverbs*, 75 ORGN'L BEHAVIOR & HUMAN DECISION PROCESSES 170 (1998).

Corporate governance systems are now understood to rely on two major, complimentary pillars: legal rules and shareholding structures. For the purpose of curbing the agency problem, concentrated shareholding (CS) may compensate for deficiencies in protection provided to noncontrolling stakeholders by the legal system. Where such protection is effective, however, dispersed ownership (DO) structures can thrive.¹⁵⁷

Interest in the relation between shareholding structures and legal regimes has surged in recent years. New theoretical advances substantiate the connection between large control blocks and private benefits of control (namely, agency costs) and indicate that CS structures could entail substantial efficiency losses.¹⁵⁸ Worse yet, CS structures may also be quite persistent and resistant to change or reform.¹⁵⁹ Large scale empirical studies generally confirm the theoretical predictions. They shed light on the high incidence of CS structures around the world and portray a global picture in which the archetypal American DO structure is the exception rather than the rule. Furthermore, the evidence supports the proposition that CS structures are correlated with weak legal protection on noncontrolling stakeholder such as public shareholders and creditors.¹⁶⁰

¹⁵⁷See, e.g., Roe, *supra* note 19, at 344.

¹⁵⁸For recent models and further references, see Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control*, Harvard Law School, Olin Discussion Paper No. 260 (1999) at <<http://www.law.harvard.edu/faculty/bebchuk/pdfs/nber7203.pdf>> [hereinafter Bebchuk, *A Rent-Protection Theory*]; Lucian A. Bebchuk & Christine Jolls, *Managerial Value Diversion and Shareholder Wealth*, 15 J. L. ECON. & ORG. 487 (1999); Lucian A. Bebchuk et al., *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights*, Harvard Law School, Olin Discussion Paper No. 249 (1999); Lucian A. Bebchuk & Luigi Zingales, *Corporate Ownership Structures: Private Versus Social Optimality* (NBER Working Paper No. 5584, 1996).

¹⁵⁹See Bebchuk & Roe, *supra* note 52; Bebchuk, *A Rent-Protection Theory*, *supra* note 158.

¹⁶⁰Studies of corporate governance structures and rules in single or a handful of countries are too numerous to count. The groundbreaking studies in terms of their international scope of coverage are Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); see also Rafael La Porta et al., *Agency Problems and Dividend Policies Around the World* (NBER Working Paper No. 6594, 1998). For studies in the same spirit with a European focus, see Marco Becht, *European Corporate Governance: Trading Off Liquidity Against Control*, 43 EUR. ECON. REV. 1071 (1999); Marco Becht & Ailsa Roell, *Blockholding in Europe: An International Comparison*, 43 EUR. ECON. REV. 1049 (1999). For studies in the same spirit with an East Asian focus, see Stijn Claessens et al., *Expropriation of Minority Shareholders: Evidence from East Asia* (The World Bank Working Paper, 1999); Stijn Claessens et al., *Who Controls East Asian Corporations?* (The World Bank Working Paper, 1999).

This exciting line of research generally ignores the role of culture in explaining international diversity in corporate governance structures, or treats it with stereotypical images.¹⁶¹ One exception is a short article by La Porta et al. (LLSV), who have pioneered empirical research in this field.¹⁶² LLSV set out to test the role of trust in the success of large organizations, including large public firms, in different societies.¹⁶³ They find, *inter alia*, that trust has a significant positive effect on the success of large publicly traded firms.¹⁶⁴ LLSV also found that the level of trust is inversely related to the existence of a dominant, hierarchical, organized religion in a country, suggesting that "hierarchical religion and distrust may both reflect some underlying 'factor' in a society that is detrimental to the performance of large organizations."¹⁶⁵

It would seem straightforward to posit that LLSV's intuitive "underlying factor" is no other than (or at least closely related to) Schwartz's Hierarchy/Egalitarianism or Hofstede's Power Distance. They all convey the notion that people in different countries are socialized differently to accept hierarchical relationships, separation of classes, and other facets of nonequality. They also reflect the assumption that these features are not limited to corporate settings but rather permeate all contexts of life. The crucial difference between these attitudes is that while LLSV use proxies for what they later acknowledge as a cultural feature,¹⁶⁶ cross-cultural

¹⁶¹See Bebchuk & Roe, *supra* note 52, at 170.

American culture, for example, resists hierarchy and centralized authority more than, say, French culture. German citizens are proud of their national codetermination. Italian family firm owners may get special utility from a longstanding family-controlled business, while an American family might prefer to cash the company earlier and run the family scion for the U.S. Senate.

Id. (footnote omitted).

¹⁶²Rafael La Porta et al., *Trust in Large Organizations*, 87 AM. ECON. REV. PAPERS & PROCEEDINGS 333 (1997).

¹⁶³LLSV invoke, *inter alia*, Fukuyama's argument that high trust among citizens accounts for the superior performance of all institutions in a society. *Id.* at 333 (citing FRANCIS FUKUYAMA, *TRUST* (1995)).

¹⁶⁴*Id.* at 335. On trust and corporate governance, see also Brian R. Cheffins, *Trust, Loyalty and Cooperation*, in *THE REALM OF COMPANY LAW* 53 (Barry A.K. Rider ed., 1998) (arguing against efforts to foster trust through regulation).

¹⁶⁵La Porta et al., *supra* note 162, at 337. LLSV further pursue this line of inquiry in the direction of investigating the quality of government. See Rafael La Porta et al., *The Quality of Government*, 15 J. L. ECON. & ORG. 222 (1999).

¹⁶⁶In La Porta et al., *supra* note 165, at 223-24, 262-64. In particular, LLSV use national law, or the traditional classification into families of laws, as a proxy for national culture. *Id.* While convenient, this is not an appropriate methodology, *inter alia*, because it ignores the fact that European laws were either enacted in or adopted by countries with

psychologists take the bull by the horns and derive this dimension from first principles.

In the particular context of shareholding structures, a first-cut hypothesis might be that countries that score high on Hierarchy will have a higher incidence of hierarchical structures like stock pyramids. The cultural dimension framework suggests that, in such countries, the entire populace, rich and poor, of higher and lower classes alike, are likely to perceive such shareholding structures as just another facet of a proper social order. If this were true it would help solve the question of why small investors in some countries put their savings in suspicious stock pyramid schemes or subject them to the whims of controlling families.

Note, however, that the Hierarchy value type cannot provide the entire explanation. For instance, in Schwartz's data, Western European countries¹⁶⁷ come up higher on Egalitarianism than most other countries, while empirical surveys report a high incidence of large blockholdings there.¹⁶⁸ This does not mean that the Hierarchy/Egalitarianism dimension does not apply. To begin with, it is undoubtedly richer than a crude substitute proxy to "hierarchy-favoring attitudes." Second, one could argue that Western European countries try to compensate for nonegalitarian effects of large blockholdings by giving special rights to workers and other constituencies, which other countries tend to disregard. Finally, cultural values may simply have a low impact on this issue compared with economic incentives and political constraints.¹⁶⁹

3. Self-Dealing Regulation

Self-dealing is the quintessential form of the agency problem in that it inherently involves a conflict of interests.¹⁷⁰ It, therefore, is the very root of the problems faced by any corporate governance regime in the world. National laws, nonetheless, vary considerably in their basic attitude toward

distinctively different cultures. To take a famous example, Japan's statutory law on insider trading has largely been a verbatim copy of U.S. law. Yet the gaps between the two countries in terms of incidence of insider trading, public opinion about it, and anti-insider trading enforcement are huge. See Licht, *supra* note 30, at 114-15.

¹⁶⁷West European countries included in Schwartz's data have prominently Catholic religious cultures, such as Italy, France, and Spain.

¹⁶⁸See, e.g., Becht & Roell, *supra* note 160.

¹⁶⁹*Cf.* La Porta et al., *supra* note 165, at 266 (rejecting cultural theories of institutions in favor of political history ones).

¹⁷⁰ROBERT C. CLARK, CORPORATE LAW 142-43 (1986).

self-dealing and in the preferred modes for coping with it.¹⁷¹ Although lawyers agree that cultural norms are among the tools that nations deploy to cope with self-dealing,¹⁷² they do not specify how this is done.

The modern view on self-dealing, even in countries that aggressively curb it, like the United States, is that in and of itself, it is not inherently bad and therefore does not warrant a flat, per se prohibition.¹⁷³ In many instances, a transaction involving an element of self-dealing could go forward if full disclosure were made with regard to all material information and consent was given by the parties who might be adversely affected by it. In other words, the defect that legal systems set out to remedy is the lack of informed consent by affected parties, primarily public shareholders. Had it been possible to receive every shareholder's free consent, as if she were the sole owner of the interest at stake, there would be no grounds for objecting the transaction.¹⁷⁴

Blueprints for corporate governance reform thus include a major part about introducing or strengthening anti-self-dealing rules. Such rules would be justified on efficiency grounds. A legal system, however, that gives greater weight to personal preferences of every shareholder by giving and better protecting her legal rights makes a statement on the way it seeks an efficient outcome. Such a system expresses an underlying position that everybody counts with regard to their economic judgment and that protection is to be rendered through legal rights. Anti-self-dealing rules work to give effect to economic judgments of parties who would have otherwise been outnumbered or simply ignored by those that are to benefit from the transaction.

We can thus hypothesize about the value dimensions of countries whose legal systems have traditionally restricted self-dealing. Under Schwartz's framework, such countries would be more likely to demonstrate a combination of relatively high Autonomy and Mastery, as the former reflects respect for personal preferences and ambitions and the latter

¹⁷¹See, e.g., Enriques, *supra* note 35 (comparing self-dealing regimes in continental Europe with Anglo-American ones). See also La Porta et al., *Law and Finance*, *supra* note 160 (constructing an index of Anti-Director rights).

¹⁷²See Black, *Agents Watching Agents*, *supra* note 34, at 831; Eisenberg, *supra* note 34, at 1473.

¹⁷³See CLARK, *supra* note 170, at 160-71 (reviewing the development of self-dealing law in the United States).

¹⁷⁴See, e.g., Lucian A. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985) (developing a criterion of "sole-owner's" consent for judging public shareholder approval of takeover bids); Lucian Arye Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 J. LEGAL STUD. 197 (1988) (same).

emphasizes personal initiative. In Hofstede's system of value dimensions, we should expect such countries to score high on Individualism, for analogous reasons, and low on Power Distance, as it reflects greater consideration of rank-and-file parties. If we interpret Uncertainty Avoidance to reflect a notion analogous to Schwartz's Harmony (and opposite to Mastery), then such countries should score low on the former two, i.e., Uncertainty Avoidance and Harmony.

Impressionistic inspection of Schwartz's and Hofstede's groupings of countries seem to support this hypothesis. In both cases, the Anglo group of countries is located closer than any other group to the hypothesized location. The Anglo group also scored highest in LLSV's survey of legal protection on minority shareholders.¹⁷⁵ The regular caveat about the need for rigorous testing of cultural hypotheses still applies.

4. Insider Trading Regulation

International diversity in insider trading regimes is often attributed to cultural diversity.¹⁷⁶ Donald Langevoort traced the roots of American hostility towards insider trading to American "egalitarianism and obsession with the appearance of fair play."¹⁷⁷ He argues further that

[u]nder this view, insiders should be content with their paychecks and not overreach for profits. That this smacks a bit of populism, of envy and resentment directed at the privileges of class and wealth, is hard to deny. But appeal to populism is a recurrent theme in American economic history.¹⁷⁸

¹⁷⁵See La Porta et al., *Law and Finance*, *supra* note 160.

¹⁷⁶See *supra* text accompanying note 37.

¹⁷⁷Donald C. Langevoort, *Fraud and Insider Trading in American Securities Regulation: Its Scope and Philosophy in a Global Marketplace*, 16 HASTINGS INT'L & COMP. L. REV. 175, 182 (1993). Langevoort's use of "egalitarianism" here might be confusing. In the cross-cultural psychology terminology, Egalitarianism denotes a society-wide preference for ensuring a decent share in life for everybody more than just a fair chance. Thus understood, West Europeans are more egalitarian than Americans and indeed, in Schwartz's groupings they come up much higher on Egalitarianism than the Anglo group, including the United States.

¹⁷⁸*Id.* Cf. ROE, *supra* note 41, at 28-32 (exploring the effects of political factors, including populism, on American corporate finance).

Insider trading is often classified as a specific case of self-dealing or a conduct equivalent to it.¹⁷⁹ A richer analysis of insider trading would portray it either as an offense against the corporation (and thus close to self-dealing) or as an offense against the market. The former interpretation differs from the latter in that it sees the company as the protected interest. The latter, "market protecting" interpretation may be superior for purposes of asserting regulatory jurisdiction when foreign companies or investors are involved.¹⁸⁰ Under either interpretation, however, an anti-insider trading rule like the U.S.'s "disclose or abstain" rule would seek to equalize the information basis of outside investors with that of insiders. This intended effect of insider trading regulation makes clear why it is likened to self-dealing, as I elaborated in the preceding subsection.

The cross-cultural hypothesis for insider trading regulation would thus be similar to the hypothesis regarding self-dealing. Namely, that nations that score high on Autonomy and Mastery are more likely to have laws that restrict or prohibit insider trading, and vice versa, nations high on Harmony could tolerate insider trading more lightly. This would only be true, however, as a first cut. Insider trading regulation is among the prominent subjects, which underwent a strong convergence process as part of the internationalization of securities markets.¹⁸¹ As a result, one is likely to find laws, which prohibit insider trading in many countries in quite similar language.

This convergence of laws can be attributed to convergence of cultural attitudes only marginally. For the most part, competitive pressures are the more likely reason, and political pressures, primarily from the United States, playing a major role as well.¹⁸² The convergence trend is furthered by institutional factors, for example, the European Union's Directive on Insider Trading and the existence of a focal point text adopted by IOSCO, again, following US prodding.¹⁸³

¹⁷⁹See, e.g., Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1441 (1992); Bebchuk & Jolls, *supra* note 158, at 487.

¹⁸⁰For a development of this argument, see Licht, *supra* note 30, at 116-17.

¹⁸¹See Michael D. Mann et al., *International Agreements and Understandings for the Production of Information and Other Mutual Assistance*, 29 INT'L LAW. 780, 795-96 (1995).

¹⁸²See Licht, *supra* note 30, at 122-25. I thus find it appropriate to call the way the United States has acted with regard to insider trading regulation by other countries an Ideological Hegemony game. *Id.*

¹⁸³*Id.*

To summarize, one could reasonably assume that nations still differ considerably in the degree their cultural values are compatible with a strict ban on insider trading. Such divergence, however, would be difficult to reveal simply by comparing legal texts. It is more likely to persist at the level of enforcement or lack thereof.¹⁸⁴

5. Executive Compensation

Top executive compensation is among the issues that ignite the public's imagination, or its wrath, in many countries. To be sure, top managers earn a lot across the globe. But the level of total compensation packages and the different components they comprise look similar in some countries but different among others.¹⁸⁵ Much greater international variability exists with regard to the relative difference between top executives' remuneration and regular employee remuneration.¹⁸⁶ Finally, countries may differ in the institutional manner in which executive compensation is set, for example, whether independent remuneration committees are used in practice and the extent to which they are required by law.

From a legal perspective, executive compensation is a distinctive paradigm of conflict of interests, like self-dealing.¹⁸⁷ The setting of executive compensation lies at the heart of the agency problem and is thus a major feature of corporate governance systems. This has led to an explosion in academic research on executive compensation.¹⁸⁸

¹⁸⁴Cf. Katharina Pistor et al., *Law and Finance in Transition Economies*, EBRD Working Paper No., 48 (2000) ("For the law on the books to affect financial market development, law enforcement must be at least credible."). See also Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, J. FIN. (forthcoming 2001) (documenting anti-insider trading enforcement).

¹⁸⁵See TOWERS PERRIN, *WORLDWIDE TOTAL REWARDS 1998*, at 21 (1999) (comparing remuneration packages of chief executive officers in 23 countries).

¹⁸⁶See Towers Perrin's statistics, available on-line at <<http://www.towers.com/towers/wtr98/extra2.pdf>> (comparing CEO total remuneration as a multiple of manufacturing employee total remuneration).

¹⁸⁷See CLARK, *supra* note 170, at 143-44.

¹⁸⁸For a recent and thorough literature review, see Kevin J. Murphy, *Executive Compensation*, in 3 *HANDBOOK OF LABOR ECONOMICS* (Orley Ashenfelter & David Card eds., 1999) (hereinafter "Handbook"). See also [http://www.papers.ssrn.com/s013/papers.\(fm?cfid=878348&abstract_id=163914\)](http://www.papers.ssrn.com/s013/papers.(fm?cfid=878348&abstract_id=163914).

International comparisons between pay practices are made difficult by a variety of reasons, including details such as tax and exchange rates.¹⁸⁹ For example, when these factors were isolated in a comparison between the United Kingdom and the United States, Conyon and Murphy found it necessary to resort to cultural differences between the two countries as an explanation for pay practices divergence.¹⁹⁰ They argued that "[t]he U.S., as a society, has historically been more tolerant of income inequality, especially if the inequality is driven by differences in effort, talent, or entrepreneurial risk taking."¹⁹¹

Conyon and Murphy's assertion sounds plausible but one should note that their take on American culture seems quite the opposite from Donald Langevoort's one regarding the close issue of insider trading.¹⁹² With some effort the two views can be reconciled, but they vividly attest to the need for a more structured deployment of cultural explanations. The cultural value dimensions that dominate the issue of executive compensation are probably Mastery, Hierarchy, and Egalitarianism. Mastery here stands again for an emphasis on encouraging and rewarding entrepreneurship, while Hierarchy signifies the legitimacy of differential pay practices as a function of one's position in the corporation. Egalitarianism would stand for opposite societal values, delegitimizing large pay differentials unless the public at large agreed that they promote the common good.

6. Disclosure Regulation

Corporate governance and disclosure regimes are closely related, as disclosure is a powerful means for curbing the agency problem. Accounting

¹⁸⁹*Id.* at 8-9.

¹⁹⁰Martin J. Conyon & Kevin J. Murphy, *The Prince and Pauper? CEO Pay in the US and UK*, Paper presented at Tilburg University Law and Economics Conference on "Convergence and Diversity in Corporate Governance Regimes and Capital Markets," Eindhoven, The Netherlands, Nov. 4-5, 1999.

¹⁹¹*Id.*

¹⁹²Langevoort, *supra* note 177, at 179-82. For the now classical argument on the desirability of insider trading as a component of executive compensation, see HENRY MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966). *See also* Kevin J. Hebner & Takao Kato, *Insider Trading and Executive Compensation: Evidence from the US and Japan*, 6 *INT'L REV. ECON. & FIN.* 223 (1997).

standards often play a pivotal role in determining the scope of disclosure in this regard.¹⁹³

As recently as 1995, Salter and Niswander were able to find significant statistical evidence for a correlation between financial reporting practices and Hofstede's value dimensions.¹⁹⁴ Reproducing these findings is growing less likely every day as more countries adopt IASC's set of International Accounting Standards (IAS). For most countries this means a major upgrade of accounting standards, although many of them have a "me first" clause. Even in the United States, however, which has staunchly required reporting from every issuer that seriously wanted to tap its stock market — the SEC recently expressed willingness to adopt IAS as sufficient standards for foreign issuers.¹⁹⁵

The relatively swift convergence of national accounting standards entails ironing out the imprint of pre-existing country-specific cultural values. This does not mean that the cultural diversity that existed only half a decade ago has suddenly disappeared. More likely, cultural diversity has lost only part (perhaps even most) of its impact on disclosure practices.¹⁹⁶ As in the case of insider trading, one should expect cultural diversity to persist at the level of compliance with and enforcement of the unified standards.¹⁹⁷

Public companies are further required to disclose information beyond financial statements. Prominent disclosure items in this category include contentious issues like forward-looking ("soft") information, immediate disclosure of material events, detailed personal breakdown of top-management remuneration, and the identity and intentions of shareholders who cross certain holding thresholds. These issues are also relatively more critical to corporate governance.

¹⁹³See, e.g., Merritt B. Fox, *Required Disclosure and Corporate Governance*, 62 *COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH* 701 (Klaus J. Hopt et al. eds., 1998); Lowenstein, *supra* note 115; Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 *U. CHI. L. REV.* 1047 (1995).

¹⁹⁴See *supra* text accompanying note 123-24.

¹⁹⁵See *supra* note 30.

¹⁹⁶*Cf.* Zarzeski, *supra* note 124 (arguing that a global disclosure culture may be emerging among large international issuers).

¹⁹⁷See, e.g., Carol A. Frost & Kurt P. Ramin, *International Auditing Differences*, 181 *J. ACCT.* 62 (1996) (discussing the dissimilarities in audit standards between the US, Germany, and the UK); David W. Wright, *Evidence on the Relation Between Corporate Governance Characteristics and the Quality of Financial Reporting* (University of Michigan Working Paper, 1996) (noting the negative correlations between the financial reporting quality measures and the presence of insiders and "grey" directors on the audit committee).

Competitive pressures, especially among stock markets, may lead to convergence of disclosure rules affecting these issues. But by and large, they are still governed by separate national regimes rather than a wide international one.¹⁹⁸ Therefore, cultural values may still affect disclosure rules. This should be particularly true with regard to disclosure by small-to-medium size issuers that do not plan to tap foreign markets.

How, then, should cultural values affect disclosure rules? To begin, Hofstede's Uncertainty Avoidance dimension seems like a good starting point, especially in light of the empirical support his model had received with regard to accounting standards. Countries that score high on this dimension may prefer to suppress transparency so as to avoid conflict and competition and to preserve security.¹⁹⁹ They would thus be likely to impose lower disclosure requirements.

The answer may further depend on the intended purpose of the particular disclosure item. Items that mainly address the agency problem, for example, top management's remuneration disclosure, would likely be affected in the same way that self-dealing rules. Similar hypotheses could thus be made.

Disclosure requirements may be warranted on other grounds, such as the economics of information as a public good.²⁰⁰ Disclosure rules in this category, for example, with regard to soft information or material negotiations, can readily differ and reflect different general attitudes towards transparency. In terms of cultural value dimensions, high Uncertainty Avoidance is consistent with low disclosure requirements.

7. Other Issues

The preceding subsections exemplify how culture can be systematically related to major issues of corporate governance. The mode of analysis employed here can be extended to other facets of corporate

¹⁹⁸A prominent exception is the European Union, which, as a supranational organization, has promulgated directives on such issues as insider trading and disclosure of major shareholdings. However, Becht and Boehmer report that in Germany there was a "clash of cultures" over the implementation of the Transparency Directive, which requires disclosure of major shareholdings. See MARCO BECHT & EKKEHART BOEHMER, *TRANSPARENCY OF OWNERSHIP AND CONTROL IN GERMANY* (Working Paper, 1999) (visited Sept. 5, 2000) <<http://www.ecgn.ulb.ac.be/ecgn/euprelimreport.htm>> (arguing that that implementation of the major shareholdings disclosure legislation in Germany is not effective).

¹⁹⁹Cf. RADEBAUGH & GRAY, *supra* note 119, at 79.

²⁰⁰See, e.g., John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984).

governance, corporate law, and securities regulation. For example, the argument with regard to self-dealing can be extended *mutatis mutandis* to cases of oppression of minority, freeze-out mergers, amendment of company bylaws, et cetera. One could also argue that culture influences national positions on broader questions such as social responsibility of corporations or their role in society at large. A detailed discussion exceeds the scope of this article.

To generalize, the basic idea is to identify major features of the corporation that are likely also to appear in other contexts of life. Features that involve division of power, wealth, and information should be expected to reflect the ways that society deals with them outside of the corporation.

Certain prominent issues are not addressed here, for example, two-tier boards or the market for corporate control. One could hypothesize, for instance, that hostile takeovers are more likely in countries that score high on Masculinity and Individualism, or respectively, on Mastery and Autonomy. This roughly applies to Anglo countries where hostile takeovers indeed take place. While the hypothesis needs not be ruled out, there are too few observations (only the US and UK) to substantiate a statistical test. Similarly, mandatory two-tiered boards can be found only in Germany and the Netherlands, which is too small a sample as well.

E. *Dynamic Aspects: Causality and Change*

Corporate governance systems evolve over time as do national cultures. Thus far the discussion has been conducted in a static fashion by looking for possible correlations between culture and corporate governance. This Part now addresses two dynamic aspects of the connection between the two. First, it briefly touches on the issue of causality: can we sensibly say that culture preceded the law and structure of companies and financial markets? Second, this Part discusses how change and reform in corporate governance systems may be influenced by national cultures.

There should be very dense relations between a nation's culture and its law, older nations have traced their roots to antiquity. In the present context, however, we are interested only in laws that regulate business corporations and financial markets. Both are clearly more recent phenomena than the principle features of national cultures. When companies and financial markets emerged, they developed in societies with different economic and political compositions and had to be compatible with different legal systems. This is the "path dependence" argument in a nutshell. Under this framework, culture can be perceived as the "mother"

of path dependence in the evolution of corporate governance systems in a causal sense. In other words, national cultures had set the starting conditions when companies and financial markets first emerged.

More interesting, however, is the interaction between culture and corporate governance today. At the risk of stretching the mother metaphor a little bit, it can be argued that culture may indeed be perceived as an old mother. It knows a lot, but some of this knowledge might be obsolete today; it is sometimes nagging; it will resist change unless absolutely required. Most importantly, it must not be ignored.

The internationalization of business and of capital markets will strain culturally induced features of corporate governance systems. First, certain cultural values may have the upper hand in a global context. For example, a world in which competitive market arrangements are generally preferred over central planning is also a world where Autonomy is given more value than Embeddedness. Nations that score high on Embeddedness will have to adjust.

Second, internationalization of business and finance entails similar trends in regulatory regimes. Certain issues may be regulated at a supra national level, with different degrees of uniformity. Directives promulgated by the European Union, for instance, impose upon member states uniform regimes as minimum standards. Similarly, the IAS, especially after being endorsed by IOSCO, will serve as a strong focal point for disclosure in multinational offerings.

To a certain extent, these processes will undoubtedly lead to the emergence of an international culture of corporate governance. People and companies whose national cultures differ significantly from the international culture will have to adjust, *inter alia*, by shedding some culturally induced features and laws, adopting others. Countries that will want to integrate in the globalization trend will have to do the same.²⁰¹

National cultures, however, will not go away anytime soon. Multinational corporations have learned this lesson the hard way when they needed to adjust to local cultural features in conducting business and in their own administration.²⁰² Large institutional investors are developing a similar

²⁰¹See Pistor et al., *supra* note 184 (documenting rapid legal changes related to shareholder protection in transition economies).

²⁰²See generally EDWARD T. HALL & MILDRED REED HALL, UNDERSTANDING CULTURAL DIFFERENCES (1989) (describing how German, French, and American cultures affect corporate relationships); FONS TROMPENAARS, RIDING THE WAVES OF CULTURE (1993) (describing cultural differences to corporate practices).

awareness. In the foreseeable future, therefore, national cultures will not be fully supplanted by a single global culture even for global players.

For the numerous companies that conduct business mainly at the domestic level (including with neighboring countries) their national set of cultural value dimensions may better fit with other local conditions, for example, laws and practices concerning contracts and employment.²⁰³ In addition, and as already noted, private compliance with and public enforcement of regulatory regimes that are shaped by international factors will be carried out by local agents.²⁰⁴ This will be particularly true whenever an international regulatory regime is based on the principle of mutual recognition.²⁰⁵

Finally, culture, in the sense used in this article, may change. There is evidence that nations change and adapt their cultural values in response to external shocks. For example, Schwartz and Bardi have shown that people in European countries that came under communist rule exhibited values that, first, were more compatible with life conditions under such a regime, and second, were distinctively different than the values prevailing in neighboring noncommunist West European countries.²⁰⁶ These findings have direct implications on business practices and corporate governance.²⁰⁷ There is reason to believe, therefore, that in countries that have undergone severe economic crises, such as South Korea and perhaps also Japan, reform in corporate structures — the *chaebol* and *keiretsu*, respectively — will be accompanied by cultural adjustment as well.

F. A Note on Empirical Testability

²⁰³Cultural value dimensions can be seen as part of a "system" in the sense used in systems analysis. See Lynn M. LoPucki, *The Systems Approach to Law*, 82 CORNELL L. REV. 479 (1997) (reviewing the theory and its application to law-related systems). A theoretical definition cited by LoPucki defines a system as "a set of interrelated and interactive elements that work together to accomplish specific purposes." *Id.* at 485 n.26. The systems approach perspective emphasizes the tendency of culture to preserve stability and inertia in corporate governance systems.

²⁰⁴See *supra* note 166.

²⁰⁵See Gerard Hertig, *Corporate Governance: Comparing Convergence of Substantive Rules and Convergence of Enforcement*, in CONVERGENCE IN CORPORATE LAW: THE EMERGING QUESTIONS (Jeffrey Gordon & Mark J. Roe eds., forthcoming 2000) (reviewing international differences in the quality of enforcement).

²⁰⁶See Shalom H. Schwartz & Anat Bardi, *Influences of Adaptation to Communist Rule on Value Priorities in Eastern Europe*, 18 POL. PSYCHOL. 385 (1997).

²⁰⁷See *id.* (arguing that the values that were suitable for survival under communist rule are not conducive to personal entrepreneurship and competition). This could have been an invaluable insight for the Russian privatization project. See *supra* note 142.

One of the central themes in this article is the call for empirical testing of culture-based arguments about corporate governance. In particular, this article advocates using the values extracted for value dimensions, as demonstrated by Hofstede or Schwartz, as independent variables denoting the cultural profiles of specific countries. This Part addresses an important methodological issue that must be acknowledged if such testing is to be pursued, namely, the joint hypothesis problem.

The joint hypothesis problem is best known among students of finance with respect to the Efficient Capital Markets Hypothesis (ECMH) and the Capital Asset Pricing Model (CAPM). In its semi-strong version, the ECMH claims that market prices reflect all publicly available information.²⁰⁸ In order to empirically test whether the ECMH holds, one has to have a pricing model as a reference against which to make the comparison. CAPM can provide such a reference. However, testing the ECMH while using values generated by CAPM will jointly test both theories without indicating which theory engenders the results.²⁰⁹

Testing cross-cultural hypotheses about corporate governance while using country scores from Hofstede or Schwartz's studies would be susceptible to the same problem. Numerical values for national value dimensions are not measured in reality but rather computed contingent on an underlying CVD model of the structure of culture and on the particular samples analyzed. To illustrate, suppose we do not find a statistically significant correlation between disclosure rules around the world and value dimensions in sample countries. It would be impossible to tell whether national disclosure rules are not culture-dependent, or rather the value dimensions used are not sensitive to this aspect or maybe not well defined.

Notwithstanding the joint hypothesis problem and numerous other problems, the ECMH and CAPM proved highly successful and became standard analytical frameworks for discussing capital markets and corporate

²⁰⁸See generally Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 24 J. FIN. 383 (1970) (classifying market efficiency); Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984).

²⁰⁹See Eugene F. Fama, *Efficient Capital Markets: II*, 46 J. FIN. 1575, 1589 (1991) ("Depending on the emphasis desired, one can say that efficiency must be tested conditional on an asset-pricing model or that asset-pricing models are tested conditional on efficiency. The point is that such tests are always joint evidence on efficiency and an asset-pricing model."); see also Richard Roll, *A Critique of the Asset Pricing Theory's Tests Part I: On Past and Potential Testability of the Theory*, 4 J. FIN. ECON. 129 (1977) (observing that it is nearly impossible to test the validity of asset-pricing theories). Note, that the joint hypothesis problem becomes serious only when the evidence does not support the models, since it then that one cannot attribute the failure to either of the theories that are jointly tested.

finance.²¹⁰ One can only wish that the framework presented here would prove equally useful.

V. CONCLUSION

The goal of this article is threefold. First, it points out the growing awareness among practitioners and theorists of the relevance of national culture to corporate governance and securities regulation. It shows that efforts to analyze cross-cultural aspects so far have been few and sporadic and thus posits that a systematic cross-cultural theory of corporate governance systems is urgently needed. Second, this article introduces the central concepts and methodologies of cross-cultural psychology and demonstrates their potential usefulness for analyzing problems of the sort discussed here. It highlights in particular the promise held by the CVD framework for producing testable hypotheses with regard to cultural features of corporate governance systems in a similar fashion to standard analyses of corporate finance. Third, this article sketches out an outline for a cross-cultural theory of corporate governance systems based on the CVD framework by implementing it to fundamental issues like shareholding structures and the regulation of self-dealing, insider trading, and disclosure. It concludes that national cultures can be seen, metaphorically, as the mother of path dependence dynamics in the sense that they play a role in both the origin and in future development of corporate governance systems.

The theory advanced in this article also implies an agenda for further research. Arguments for special cultural considerations in corporate governance research and reform sometimes run the risk of relying on myths and stereotypes, if not outright caricatures of nations. The CVD framework should prove helpful for avoiding such risk, but the few pieces of evidence mentioned in this article are anecdotal at best. First and foremost on the agenda is thus to statistically verify or refute the particular hypotheses laid down in Part IV. In order to do that, however, a more structured comparative analysis of national legal regimes will have to be carried out. Research of the structural aspects of corporate governance is already underway, as witnessed by the studies led by LLSV, Becht, and Claessens,²¹¹ but more detail will be needed.

²¹⁰See, e.g., John H. Cochrane, *New Facts in Finance* (Center for Research in Security Prices (CRSP) Working Paper No. 490 & NBER Working Paper No. 7169, 1999); Eugene F. Fama, *Market Efficiency, Long-Term Returns, and Behavioral Finance* (Center for Research in Security Prices, University of Chicago, Working Paper No. 448, 1997).

²¹¹See *supra* note 160.

It should be emphasized that reliable statistical evidence for absence of cross-cultural effects in certain corporate governance issues would be equally valuable for policy makers as evidence to its existence. Claims for special cultural considerations could be deployed by political or economic constituencies in order to protect their interests and thwart reform. The framework introduced here should be helpful in assessing such claims.

The present framework could be extended to areas of corporate law and securities regulation that were not covered in this article, but there is also room for bolder efforts. An interesting direction for further research is to apply the present mode of analysis to other areas of law. This is especially true with regard to old areas such as contract law and civil procedure. They may also prove useful in more recently developed fields like antitrust. Many of these legal fields are now undergoing changes due to internationalization of economic activity. Economic analysis of such fields could be enriched with structured aspects of culture.

Finally, a very promising avenue for further research lies in the thriving field of law and social norms.²¹² This line of research recently reached corporate law too.²¹³ Legal scholars generally perceive social norms as rules "governing an individual's behavior that third parties other than state agents diffusely enforce by means of social sanctions."²¹⁴ Norms guide people's behavior after having been internalized as a result of a socialization process. At this point, readers should be able readily to recognize how the concept of values, as employed by cross-cultural psychology and implemented in the analysis of legal institutions, can enrich the study of law and social norms. In their very essence, values *are* social norms, as social norms affect individual behavior and social institutions.

²¹²Some examples from the booming literature on law and social norms, especially from an economic analysis perspective, include ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991); Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U.P.A.L. REV. 1643 (1996); Richard McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH. L. REV. 338 (1997); Eric A. Posner, *The Regulation of Groups: The Influence of Legal and Nonlegal Sanctions on Collective Action*, 63 U. CHI. L. REV. 133 (1996); Richard A. Posner, *Social Norms and the Law: An Economic Approach*, 96 COLUM. L. REV. 903 (1996). For a critical review, see Amitai Etzioni, *Social Norms: Internalization, Persuasion, and History*, 34 L. & SOC'Y REV. 157 (2000).

²¹³See generally Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253 (1999).

²¹⁴Robert C. Ellickson, *The Evolution of Social Norms: A Perspective from the Legal Academia*, in *SOCIAL NORMS* (Michael Hechter & Karl-Dieter Opp eds., forthcoming 2001).

To be sure, the social norms addressed in most of the current law and economics literature tend to be particular and context specific and may also change rather quickly.²¹⁵ In contrast, values are more general and stable. One may thus imagine a pyramid of social norms in which cultural values constitute the foundations. Corporate governance systems build on these foundations to develop both formal and non-formal rules as well as structures. I postpone a fuller discussion of this issue to a later stage, but it should be clear that the CVD framework can lend itself to developing a rigorous comparative approach to social norms and their interrelations with the law in different cultures. It may also prove helpful in a study of dynamic aspects of social norms.

²¹⁵See, e.g., corporate governance norms addressed by Eisenberg, *supra* note 213.