Egalitarianism and international investment ☆

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ABSTRACT

This study identifies how country differences on a key cultural dimension—egalitarianism—influence international investment flows. A society's cultural orientation toward egalitarianism is manifested by intolerance for abuses of market and political power and a desire for protecting less powerful actors. We show egalitarianism to be based on exogenous factors including social fractionalization, dominant religion circa 1900, and war experience from the 19th century. We find a robust influence of egalitarianism distance on cross-national flows of bond and equity issuances, syndicated loans, and mergers and acquisitions. An informal cultural institution largely determined a century or more ago, egalitarianism exercises its effect on international investment via an associated set of consistent contemporary policy choices. But even after controlling for these associated policy choices, egalitarianism continues to exercise a direct effect on cross-border investment flows, likely through its direct influence on managers' daily business conduct.

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1. Introduction

Tell a financial economist that cultural distance affects investment and she may cringe. Although evidence obtained during the last decade no longer allows such a claim to be dismissed out of hand (e.g., Grinblatt and Keloharju, 2001; Sarkissian and Schill, 2004; Chan, Covrig, and Ng, 2005), the mechanisms that may engender these widely observed correlations remain poorly understood. Some proxies for cultural distance such as common language may provide a partial explanation as measures of friction on information flow. But when, in a related context, a measure of cultural distance based on bilateral score data from the Eurovision Song Contest is said to

robustly affect bilateral trade volumes (Felbermayr and Toubal, 2010), one may be justified in feeling discomfort. Such findings challenge one to advance a fuller, theory-driven account of the causal link between cultural distance and investment, and to present robust evidence for such relations.

To meet this challenge, we advance an analytical framework that draws on several disciplines. Culture in this framework stands for the foundational institutions of society—the system of values and beliefs that underlies more specific formal institutions and informal ones (North, 1990; Williamson, 2000). A central factor in every culture is its stance toward egalitarianism, defined as "the belief that all people are of equal worth and should be treated equally in society" (Schwartz, 2001, p. 65). This deep-seated institution addresses every society's need to guarantee responsible behavior that preserves the social fabric and induce people to manage their unavoidable interdependencies (Schwartz, 1994, 1999, 2004). Cultures vary in their orientation toward egalitarianism versus its conceptual opposite, hierarchy. The latter defines the unequal distribution of power, roles, and resources as legitimate and even desirable.

A culture's relative emphasis on egalitarianism implicates numerous aspects of life that involve the exercise of power and authority. Social scientists in various disciplines have recognized power as a universal, ubiquitous phenomenon and its social institutional regulation as a core issue of culture and societal organization (e.g., Bourdieu, 1973; Schwartz, 1994; compare Russell, 1938). The exercise of power and authority is particularly pertinent in the theory of the firm and corporate governance (Coase, 1937; Hart, 1995; see also Morck, 2008). Consistent with these views, we demonstrate below that egalitarianism relates to certain modes of use (or abuse) of political power and public office, (e.g., corruption). Egalitarianism is linked to corporate governance mechanisms addressing the agency problem in public companies—through greater transparency and more stringent auditing as checks on agents' power. Egalitarianism associates with formal and informal institutions that support fairer competition in the marketplace through antitrust regulation that curbs excessive market power. More broadly, egalitarianism also associates with greater societal care for the weak through social safety nets that support the sick, elderly, and unemployed.

Our findings are in line with prior research showing that other laws, norms, and practices pertaining to firms' operations and finance tend to be consistent with the general level of cultural egalitarianism. For instance, egalitarianism is associated with regulatory restrictions on incentive pay meant to protect industrial workers (Siegel and Larson, 2009). Also, egalitarianism is linked to more attentive and considerate negotiation practices versus negotiation styles that include invoking one's superior power to extract gains from the other party (Brett and Okumura, 1998; Brett, 2001; Tinsley, 2001).

Entering a foreign market—be it through strategic or portfolio investment, or through equity or debt instruments—may entail entry into a very different institutional environment. Cultural distance—and in particular,

egalitarianism distance—represents the degree of institutional (in)compatibility between the home and host markets. The greater the distance on egalitarianism between two countries, the lower the scope of investment between them is likely to be. This is because investors will require higher expected returns in order to compensate for the need to adjust to this new environment. As the distance on egalitarianism increases, assets may become more difficult to price, corporate governance practices may be less acceptable, firm stakeholders (lenders, employees, authorities, etc.), more difficult to deal with, subsidiaries' managements more difficult to control, and negotiations more likely to fail. Beyond a certain point, firms may decide that bridging this distance is not worthwhile.

We therefore expect the effect of egalitarianism distance to be more pronounced in investment modes that are more susceptible to cultural differences—specifically in mergers and acquisitions and syndicated loans versus issuances of bonds and equities. Relative to issuance of tradable securities, mergers and acquisitions and syndicated loans entail a much more intense interaction between the institutional environments—interactions that are less formatted in standard templates of prospectuses, involve more detailed and nuanced negotiations, and require ongoing monitoring by the acquirer or the lead bank.

Crucially, we do not refer to culture as an "unspecified residual" nor to cultural distance merely as a synonym for "otherness." Rather, we point to egalitarianism as a meaningful cultural orientation that is conceptually linked to investment, and to egalitarianism distance as a measure of institutional (in)compatibility. Analyzing the meaningful content of egalitarianism allows one to identify its potential antecedents. We identify three such antecedents: societal fractionalization, countries' dominant religion around 1900, and countries' war experience during the 19th century. These three factors together predict over half of the variance in the level of countries' cultural egalitarianism. Thus, although culture may respond to contemporary socioeconomic conditions, it also has a substantial, stable core.

We analyze international investment flows between country-pairs around the world in both cross-sectional and panel data for 1995–2008, covering bond and equity issuances, syndicated loans, and mergers and acquisitions (M&A). We find a strong negative effect of egalitarianism distance on this broad set of international investment flows. Specifically, we observe this effect when using the above antecedents of egalitarianism as instrumental variables—indicating that egalitarianism distance indeed decreases international investment. This egalitarianism effect is robust while using different regression methodologies. It is robust to an array of control variables including, in particular, measures of distance on investor legal rights and different legal origins. The findings remain robust in specifications with home and host country fixed effects as well as economic and institutional control variables that capture additional mechanisms that might influence international investment, including specific mechanisms related to egalitarianism. These findings are also robust to other proxies of cultural distance that

have been used in the economic literature as measures of familiarity or affinity (Guiso, Sapienza, and Zingales, 2009).

This study contributes to several strands of literature. Studies in international finance suggest that issuers might seek prospective investors in culturally proximate markets to facilitate the flow of information between home and host markets (e.g., Sarkissian and Schill, 2004; Pagano, Randl, Roell, and Zechner, 2001; Pagano, Röell, and Zechner, 2002; see Karolyi, 2006, for a general survey). The "flow-back" phenomenon—in which foreign trading in cross-listed stocks rapidly disappears (Halling, Pagano, Randl, and Zechner, 2008; Pirinsky and Wang, 2006)—suggests that the observed patterns of cultural proximity in cross-listing may actually understate familiarity preferences that investors harbor. Language and culture are mentioned as possible sources of an informational disadvantage for foreign investors that contribute to the home bias (e.g., Tesar and Werner, 1995; Grinblatt and Keloharju, 2001; see Lewis, 1999, for a survey).

Following the use of gravity models in the trade literature, the basic proxy for cultural distance in finance has been geographical distance (see Buch, Kleinert, and Toubal, 2004). Portes and Rey (2005) argue that geographic proximity, as a proxy for cultural affinity, may facilitate cross-border equity portfolio investment flows through reduced informational frictions. Rossi and Volpin (2004) and di Giovanni (2005) use language similarity and geography as proxies for cultural distance in merger and acquisition activity [see also Shen and Lin (2009); compare Grote and Umber (2008) on domestic mergers and acquisitions]. Chan, Covrig, and Ng (2005) follow Sarkissian and Schill (2004) in using variables for common language, geographical proximity, common colonial ties, and bilateral trade to try to capture the causes of the informational disadvantage in the home bias. Mian (2006) finds that cultural/geographical distance deters foreign banks from lending to "informationally difficult" yet fundamentally sound firms (see also Giannetti and Yafeh, 2010). Such studies usually trumpet the importance of culture. Geographical distance captures cultural differences only indirectly, however. Common language and colonial ties (or common religion), too, underscore culture's importance but are silent on which particular aspects of culture might be responsible for the observed effects. The same-language variable is insensitive to the existence of related but non-identical languages (see Fearon, 2003) and the colonial heritage variable, widely considered in the institutions literature, lacks theory for associating culture with investment.

A related line of research is motivated by the notion that "familiarity breeds investment" (Huberman, 2001). The literature is undecided on whether such familiarity preference reflects rational choice or a behavioral bias [see French and Poterba (1991) and Heath and Tversky (1991); for a model of fear of the unknown, see Cao, Han, Hirshleifer, and Zhang (2011)]. Both factors may be at play. Bhattacharya and Groznik (2008) find that the size of the foreign-origin group from a country living in the U.S. is positively correlated with U.S. investments in that country. Bae, Stulz, and Tan (2008) argue that local analysts know more about local firms, especially in countries with lower transparency. Our study contributes to this work by suggesting *what* local analysts and expatriates do know better—namely, the cultural underpinnings that infuse informal institutions, particularly cultural egalitarianism.[1] Importantly, this type of familiarity does not preclude other mechanisms that revolve on likeness—e.g., due to genetic or somatic similarity—or likeability, as the evidence on cross-national sentiment and investment flows indicates (see Guiso, Sapienza, and Zingales, 2009; Gupta and Yu, 2009; compare Felbermayr and Toubal, 2010). However, our egalitarianism results are robust to such mechanisms.

Finally, this study contributes to the literature on the economic outcomes of institutions. Numerous studies have established the significant effect of formal, legal institutions—ranging in specificity from particular rules to legal origins—on investment and other economic outcomes (see La Porta, Lopez-de-Silanes, and Shleifer, 2008, for a survey). More recent work underscores the concomitant importance of informal, cultural institutions (e.g., Guiso, Sapienza, and Zingales, 2006; Tabellini, 2008, 2010). Tabellini (2010) is especially pertinent here as he looks at cultural emphases on obedience in more or less hierarchical societies. The present study points to egalitarianism (vs. hierarchy) as a potent factor in a broad set of investment outcomes.

The paper proceeds as follows. Section 2 provides a brief background on cultural dimensions in general and egalitarianism in particular and reviews egalitarianism's antecedents. Section 3 describes the data. Section 4 presents the empirical findings. Section 5 concludes.

2. Cultural dimensions, egalitarianism, and its antecedents

The inclination to treat culture as a black box is responsible for the paucity of analyses of its content and structure. Theoretical accounts of the content of cultural orientations are few and incomplete [see notable exceptions by Greif (1994) and Tabellini (2010)]. In order to capture cultures' content, some studies have considered countries' dominant religion or percentage of followers of each religion (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 1999; Stulz and Williamson, 2003). Dominant religion is a valid proxy for culture because religions are a primary source of moral injunctions and beliefs. Advantages of using religion are data availability and the fact that the religion variable is considered exogenous due to countries' long histories of religious affiliation. Nevertheless, using religion as a proxy for culture has a number of drawbacks. Religions are exceedingly complex institutions with protracted evolutionary tracks. Many accommodate the coexistence of conflicting views on numerous issues, and degree of religious commitment varies both within and across countries. Moreover, many modern countries are predominantly secular, thus weakening the

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[1] See Beugelsdijk and Frijns (2010) with regard to home bias. See Tihanyi, Griffith, and Russell (2005) for a survey of cultural distance in international business.

direct link between religion and contemporary informal institutions. Finally, simply classifying countries by religion leaves the substantive content of the cultural differences virtually undefined.

A research program in psychology going back several decades suggests how to identify and measure national cultures. The central postulate in this approach is that all societies confront similar basic problems or challenges when they seek to regulate human activity (Kluckhohn and Strodtbeck, 1961). These problems point to dimensions on which cultures can be compared. Societies' responses to these basic challenges constitute their fundamental institutions. As a general social institution, culture affects numerous factors including individual values and beliefs. Psychological theories of culture go beyond current economic accounts in identifying these key issues and dimensions and in observing the differential impacts of societal responses to these issues on psychological factors.

The cultural theory put forward and expanded in the present study was created by Schwartz (1994, 1999, 2004). This theory identifies three key issues that societies must address and derives three corresponding dimensions for cross-cultural analysis. Only one of the latter, egalitarianism vs. hierarchy, exhibits a clear connection to the economic outcomes in the present study. To operationalize nations' cultural profiles, Schwartz analyzes differences in how national populations prioritize a set of universally recognized values. Schwartz's model is currently considered the most advanced for a number of reasons. First, the model is theory-driven, its central elements having been derived from earlier work in the social sciences. Second, and most important, the model uses value measures shown to have cross-culturally equivalent meanings at the individual level to operationalize the cultural dimensions. Finally, validating data for this model were collected relatively recently (see Brett and Okumura, 1998; Mezias, Chen, Murphy, Biaggio, Chuawanlee, Hui, Okumura, and Starr, 2002; Smith, Bond, and Kagitcibasi, 2006). An earlier theory developed by Hofstede (1980) identifies cultural value dimensions derived from audits of employee morale in IBM Corporation. Culture-level dimensions based on the World Values Survey (Inglehart, 1997) are not theory-driven yet exhibit convergence with the Schwartz dimensions.

The egalitarianism/hierarchy dimension addresses the social challenge to guarantee that people behave in a responsible manner that preserves the social fabric. That is, people must engage in the productive work necessary to maintain society rather than compete destructively or withhold their efforts. People must be induced to consider the welfare of others, to coordinate with them, and thereby to manage their unavoidable interdependencies. One polar solution, labeled egalitarianism, seeks to induce people to recognize one another as moral equals who share basic interests as human beings. People are socialized to internalize a commitment to cooperate and to feel concern for everyone's welfare. Important values in such cultures include equality, social justice, responsibility, help, and honesty. The polar alternative, labeled hierarchy, relies on hierarchical systems of ascribed roles to insure

responsible, productive behavior. People are socialized to take the hierarchical distribution of roles for granted, to comply with the obligations and rules attached to their roles, show deference to superiors, and expect deference from subordinates. Values of social power, authority, humility, and wealth are highly important in hierarchical cultures. Note that these mappings are relative. It is not that hierarchical societies fail to acknowledge egalitarian values, but instead their emphasis on these values is lower relative to egalitarian societies.

Having elaborated on the meaning of cultural egalitarianism, we can now expand our theory about its antecedents. Societal fractionalization, whether consequent to historical divisions in ethnicity, language, or religion, is an ecological variable commonly used in the institutions literature as an exogenous factor (e.g., Mauro, 1995; Hall and Jones, 1999). Societal fractionalization is inimical to cultural egalitarianism. Linguistic or ethnic fractionalization have been associated with lower trust and less cooperation in providing public goods (Alesina and La Ferrara, 2005). Religions, because of their proclivity to claim a monopoly on truth and morality, also pose a threat to one another. Such claims (which are less the case with some Eastern religions and at least in the rhetoric of some liberal streams, in Western religions) are at odds with a cultural emphasis on egalitarianism, which views all people as moral equals. Many religions that preach universal concern for others tend, in practice, to promote a sense of their own moral superiority and a preferential commitment to the welfare of fellow religionists (e.g., Batson and Ventis, 1982; Schwartz, 2004).

Fractionalization is an important determinant of egalitarian practices. Numerous studies have associated fractionalization with less investment in public goods across countries (e.g., Easterly and Levine, 1997; Alesina, Baqir, and Easterly, 1999). Within the United States, higher fractionalization is associated with lower investment in public education (Goldin and Katz, 1999), less individual investment in associational activities (Alesina and La Ferrara, 2000), and greater probability of riots and destruction of public goods (DiPasquale and Glaeser, 1998). Given conflicting political demands and a fixed pie of community resources, individuals in a fractionalized society might worry that their public contributions will benefit disproportionately members of groups with which they do not identify (e.g., Poterba, 1997; Alesina, Baqir, and Easterly, 1999; Luttmer, 2001).

The content of religious belief likely exercises a long-term effect on egalitarianism as well. From the time of the Apostles to the 19th century, Christianity has had two opposing internal dynamics, one hierarchical, the other egalitarian (e.g., Brown, 1988; Wilensky, 2002; Woodhead, 2004). But since the late 19th century, both Protestant and Catholic ideologies have been observed by numerous authors to have influenced the formation of egalitarian social beliefs across a wide range of societies.[2] Rimlinger (1971) argues that a Protestant belief system led Prussian governmental elites (themselves often educated by and recruited

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[2] More broadly, Dumont (1970) and Lal (2003) aver that Christianity is more egalitarian than Hinduism.

from the Lutheran church) to embrace pioneering social protections beginning in the latter half of the 19th century. Not only did successive Popes embrace egalitarian governmental protections for the poor, the sick, and the weak [most notably *Rerum Novarum* (1891) and the other encyclicals of Pope Leo XIII], but lay persons, too, turned their "pre-political convictions" (Meier, 1969, p. 13), in other words, cultural values and beliefs, into what is widely considered to have been the most successful post-1949 electoral force in much of Western Europe (Conway, 1996).

These social convictions gave rise to the formation of Christian Democratic parties in European countries including Austria, Belgium, Germany, Italy, Luxembourg, Netherlands, Portugal, Spain, and Switzerland (Irving, 1979) as well as a subset of Latin American countries including Chile, Costa Rica, El Salvador, Guatemala, Mexico, and Venezuela (Mainwaring, 2003). These parties were based on a philosophy of social personalism (Fogarty, 1957), whereby the community shares an obligation to protect the individual from the abuses and excesses of both capitalism and politics (see also Hanley, 1994). This set of egalitarian beliefs has been seen to be responsible for Christian Democratic political parties having had an effect on increasing social welfare spending (e.g., Kersbergen, 1995; Wilensky, 2002). Christian Democratic parties, by appealing across class lines for the support of both working-class, Catholic trade unionists and rural, social conservatives (Fogarty, 1957; Kersbergen, 1995), have won major political victories even during a period of broad secularization (Conway, 1996).

A country's war history also influences the development of egalitarianism. Efforts to raise standing armies during and after the English Civil War of the 1640s and French Revolution of 1789 were, for example, clearly associated with a broad expansion of political and economic rights (Schwartz, 2001, p. 65). Wars, especially those fought during the period of state formation in the 19th century, required actions and expansions of rights that promoted national solidarity (e.g., Holsti, 1991; Tilly, 1993). Elites involved in wars of state formation in the 19th century were persuaded or forced to broaden the definition of social and political rights and share additional resources with the lower classes (e.g., Lasswell, 1941; Hurwitz, 1949; Feldman, 1966; Gouldner, 1970). Building blocks for later policy innovations were enacted in the 19th century, such as the German innovations in social security. These innovations often took place during and just after wars of state formation. Once enacted, these reforms often served as the foundation for subsequent expansion of the social safety net. Thus, our hypothesis is that the experience of wars of state formation during the 19th century may have been associated with an increased level of egalitarianism.[3]

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[3] Although it might at first seem possible that countries that already had higher levels of egalitarianism tended to enter into a greater number of 19th century wars, the available evidence does not support that possibility. Our results are statistically significant for the number of wars in which a country participated but not for the number of wars a country initiated. Likewise, the countries listed as 19th century social welfare pioneers in Lindert (2004) began the 19th century with virtually

3. Data

3.1. Dependent variables

A comprehensive data set on dollar flows of cross-border issuances (capital raising) of bonds and equity, syndicated loans, and merger and acquisition transactions was assembled by the present authors. We utilize two data sources: Thomson Reuters SDC database, which specializes in mergers and acquisitions, bond capital raisings, and equity capital raisings, and newly available data on syndicated loans from Dealogic, a leading Wall Street data provider with a uniquely extensive coverage of syndicated loans (see Giannetti and Yafeh, 2010). Dealogic kindly provided us access to their data. It should be noted, however, that the markets for bond and equity issuances are quite concentrated. According to the SDC data, during the years 1995–2008, the U.S., Switzerland, and the U.K. hosted 91.9% of the cross-border bond capital raising volume, and the U.S., Hong Kong, and the U.K. hosted 89.4% of the cross-border equity capital raising volume.

Our analysis for these four types of transactions is in a panel for the years 1995–2008. To demonstrate robustness, we present the effects in cross-section for the year 2000. We follow La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998) and others in largely confining our sample to the approximately 50 countries with a minimum level of capital market development.

3.2. Culture and cultural distance

Schwartz's (1994, 1999, 2004) large-scale value survey of over 15,000 urban teachers who teach the full range of subjects in grades K-12 in the most common type of school system in countries on every inhabited continent is the original source of our cultural data. We utilize the 2005 release of the data set for the 55 countries surveyed during the years 1988–2004. Table 1 presents the egalitarianism score for each country. In the field of cross-cultural research, using well-matched samples is considered an optimal approach for comparing cultures because it better controls for demographic differences that may affect responses and thus contaminate the data. Focusing on teachers largely from the dominant cultural group in each nation enabled us to obtain samples matched on critical characteristics (e.g., distributions of age, education, and occupation). Teachers, moreover, are particularly appropriate sources for cultural data as they are key transmitters of culture in socialization processes. The robustness of national cultural profiles obtained from the teacher sample was separately confirmed with data obtained from other samples (see Schwartz, 2004; compare Treisman, 2000).

For every pair of countries, we constructed two measures of distance: (sheer) egalitarianism distance, being the

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(*footnote continued*)

no social welfare net, even relative to other countries. These same countries ended the 19th century with pioneering social protections. Taken together, the evidence is consistent with the view that 19th century war experience enhanced egalitarianism but not vice versa.

Table 1
Egalitarianism scores.

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Country	Egalitarianism score
Argentina	5.098
Australia	4.921
Austria	5.059
Bolivia	4.834
Brazil	5.037
Bulgaria	4.249
Canada	4.985
Chile	5.109
China	4.312
Cyprus	5.061
Czech Republic	4.589
Denmark	5.147
Egypt	4.827
Estonia	4.752
Finland	5.026
France	5.183
Georgia	4.742
Germany	5.140
Ghana	4.854
Greece	4.979
Hong Kong	4.612
Hungary	4.507
India	4.494
Indonesia	4.325
Ireland	4.987
Israel	4.857
Italy	5.376
Japan	4.466
Jordan	4.470
Macedonia	4.475
Malaysia	4.497
Mexico	4.774
Namibia	4.599
Nepal	4.703
Netherlands	5.083
New Zealand	5.027
Norway	5.285
Peru	4.984
Philippines	4.603
Poland	4.546
Portugal	5.388
Russia	4.641
Singapore	4.691
Slovakia	4.578
Slovenia	4.581
South Korea	4.471
Spain	5.203
Sweden	4.960
Switzerland	4.979
Taiwan	4.394
Turkey	4.909
United Kingdom	4.998
United States	4.799
Venezuela	4.734
Zimbabwe	4.311

square of the difference between the countries' scores on egalitarianism; and signed egalitarianism distance, being the signed algebraic difference between the countries'

scores on egalitarianism.[4] For the latter measure we took the egalitarianism value for the country of origin of the firm doing the cross-border transaction (i.e., the country of the issuer, the borrower, or the acquirer). We then subtracted from that number the egalitarianism value of the country hosting the cross-border transaction (i.e., the country of the stock exchange, the lead bank, or the target).

3.3. Antecedents of egalitarianism

Our analysis of the antecedents of egalitarianism uses data on societal fractionalization from Alesina, Devleeschauwer, Easterly, Kurlat, and Wacziarg (2003), data on countries' dominant religion circa 1900 from the World Christian Encyclopedia (Barrett, Kurian, and Jhonson, 2001), and data on war experience from the Correlates of War database (Sarkees, 2000). These antecedents serve as instruments for egalitarianism in some of the later analyses.

3.4. Legal distance

A sizable literature holds that legal institutions are a key determinant of financial and economic development. Within this literature, legal origin (family) in particular has been shown to be a powerful predictor of financial development and other major outcomes (La Porta, Lopez-de-Silanes, and Shleifer, 2008). We therefore control for differences in legal origin as a rough proxy for the legal environment as a whole. A dummy is set equal to one when origin and host countries are from different legal families. We started with the data on legal origin reported in La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1999) and then did an enlarged survey of recent changes in civil and commercial code taken by former socialist countries. Classifying some countries' legal systems by legal family has become complicated since the demise of the Soviet bloc and the consequent obsolescence of the socialist legal family (see, for example, Van Hoecke and Warrington, 1998; Zweigert and Kötz, 1998). We conducted an extensive survey to identify the year in which each former socialist country adapted its civil or commercial code to market economy principles, sometimes by reverting to and revamping old pre-socialist versions of the code. We also traced the main source of influence in these reforms, which in most cases was either German or French civil law. Our variable for different legal family is therefore time-contingent, taking into account the year of change in legal code for these countries formerly belonging to the socialist legal family.[5]

As this study deals with social institutions pertaining to the exercise of power, we also look at differences in the legal regimes that regulate self-dealing—the quintessential manifestation of the use of power in corporate governance. Using country scores of self-dealing regulation from Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2008), we construct a (sheer) distance measure of anti-self-dealing

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[4] Taking the absolute value of the difference between two countries' egalitarianism scores yields similar results.

[5] Our main sources were Ajani (1996), Maggs (2003), and Pistor (2000). The egalitarianism distance results are similar when we use alternative definitions of legal family taken from the prior literature.

rules by taking the square of the difference between scores of each country pair. We employ a similar method to construct a distance measure of creditor rights, using country scores from Djankov, McLiesh, and Shleifer (2007), and a distance measure of private litigation rules and disclosure in securities regulation laws drawn from La Porta, Lopez-de-Silanes, and Shleifer (2006)—namely, the rules that these authors identify as ones that "work" against insiders. By holding constant differences in legal incentives regarding various modes of exercising power, we would be able to assess the role of cultural incentives (compare Morck, 2008).

3.5. Other variables

Because we employ a gravity setting, we control for (1) the log product of gross domestic product (GDP) in the origin and host countries as a proxy for the effect of economic "masses," and for (2) the log product of population in the origin and host countries as a proxy for the population masses. The data come from the World Development Indicators (WDI). We also control for (3) distance in corporate taxation (using data from the World Tax Database augmented by data collected and published by the Heritage Foundation), (4) geographic distance, and (5) year dummies where applicable. In many of the panel models, we also control for (6) origin country and (7) host country fixed effects.

We also examine whether egalitarianism distance is associated with larger rates of value destruction in M&A investments. To do this, we collected data on all M&A acquirers with Worldscope data and followed the methodology of Durnev, Morck, and Yeung (2004), in which marginal Tobin's q is the proxy for overinvestment vs. underinvestment. With data from Worldscope, we control for lagged disbursements and lagged average q. All variables are converted to U.S. dollars.

To assess the relative importance of egalitarianism distance and other policy outcomes comprising the institutional environment for international investment, we consider several other factors—namely, average levels of non-corruption in 1996–2002 (from the World Bank Governance Indicators), a measure of antitrust stringency and enforcement compared to the U.S. as a benchmark (from Nicholson, 2007), average of perceived effectiveness of antitrust policy in 1994–2008 (from IMD's World Competitiveness yearbooks[6]), measures of transparency in financial disclosure by public corporations [specifically, a principal component capturing transparency, a measure of timeliness, and a measure of audit quality—all from Bushman, Piotroski, and, Smith (2004)], and finally, measures of social transfers that reflect societal care for weaker members of society [specifically, measures of sickness and health benefits, unemployment benefits, and an aggregate measure of social security laws—all from Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004)].

4. Results

We conduct the empirical analysis in four steps: First, we examine the antecedents of egalitarianism. Second, we consider the role of egalitarianism distance in channeling different types of international investment among origin and destination markets. Third, we investigate the relations between egalitarianism and central policy mechanisms related to corporate governance and the regulation of power in the economic arena. Fourth, we examine whether egalitarianism distance retains explanatory power when differences in such policy outcomes are accounted for.

4.1. Antecedents of egalitarianism

We begin by regressing countries' egalitarianism levels on fractionalization, dominant religion, and historical war experience. Table 2 shows egalitarianism to be in large part determined by these three historical factors. Religious, ethnic, and language fractionalization are shown to be significantly associated with egalitarianism, and the dominant religion is also important. Protestant and Catholic countries tend to rank significantly higher in egalitarianism relative to countries with Orthodox Christianity, Islam, Hinduism, and other historically dominant religions.[7]

As shown in Model 6, the number of wars in which a country was involved during the 19th century is also significantly associated with higher levels of egalitarianism today. Interestingly, Models 7 and 8 show that the number of days a country spent at war during the 19th century and number of military deaths it sustained in wars during that century is also significantly associated with higher levels of egalitarianism. Of those three highly correlated variables, the number of wars a country participated in during the 19th century has the most explanatory power. War experiences in the 20th century are not significantly associated with egalitarianism. This is consistent with the finding in the political science literature that many of these wars had little to do with state formation. Only when national survival was at stake, as in the case of the United Kingdom during World War II, did 20th century wars likely continue to have egalitarian consequences. If we examine a broader time period that encompasses the 19th century through World War II, the coefficient loses its statistical significance. This is in line with the theorizing that egalitarianism was often built progressively on a foundation of 19th century experiences.[8]

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[7] We utilize three different measures of fractionalization in Models 3–5. These measures are highly collinear with one another, and among them the measure of religious fractionalization does the most to explain the variation in egalitarianism. We proceed with the religious fractionalization measure, but we get the same substantive results using any of the three other fractionalization measures.

[8] We also assessed five other potential determinants of egalitarianism. Population density was associated with egalitarianism. Putterman's state antiquity index (the time during which a present-day country has been the site of nation-states, kingdoms, or empires, tested with the current Version 3 of the State Antiquity Index (available at http://www.econ.brown.edu/fac/Louis%5FPutterman/) yielded positive but never statistically significant results in any of its forms. Population size had

Table 2
Antecedents of egalitarianism

This table provides results of an OLS regression of egalitarianism on its possible sources. The religion variables are calculated as of the year 1900 in order to focus on exogenous religious determinants. The reference set for religion below is "Other," which includes Judaism, Confucianism/Chinese Universism, and Ethnoreligionism. Robust standard errors appear below the coefficients. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Independent variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10
Ethnic fractionalization	−0.355**		−0.231*							
	[0.175]		[0.133]							
Language fractionalization				−0.200						
				[0.135]						
Religious fractionalization					−0.318**	−0.330**	−0.309**	−0.300**	−0.313**	−0.311**
					[0.150]	[0.145]	[0.145]	[0.146]	[0.151]	[0.148]
Protestantism is the country's dominant religion		0.472***	0.457***	0.453***	0.465***	0.445***	0.454***	0.445***	0.467***	0.458***
		[0.074]	[0.076]	[0.076]	[0.075]	[0.084]	[0.078]	[0.084]	[0.076]	[0.081]
Catholicism is country's dominant religion		0.368***	0.360***	0.327***	0.289***	0.242**	0.224**	0.251**	0.294***	0.276***
		[0.092]	[0.095]	[0.094]	[0.101]	[0.100]	[0.106]	[0.100]	[0.105]	[0.100]
Orthodox Christianity is country's dominant religion		0.156	0.152	0.141	0.120	0.100	0.103	0.101	0.111	0.086
		[0.136]	[0.130]	[0.137]	[0.128]	[0.138]	[0.134]	[0.136]	[0.133]	[0.144]
Islam is the country's dominant religion		0.140	0.160	0.104	0.029	−0.005	0.002	−0.015	0.018	0.015
		[0.120]	[0.111]	[0.119]	[0.117]	[0.110]	[0.111]	[0.104]	[0.114]	[0.112]
Hinduism is the country's dominant religion		0.063	0.111	0.135	−0.048	−0.029	−0.037	−0.016	−0.047	−0.023
		[0.100]	[0.128]	[0.116]	[0.102]	[0.105]	[0.103]	[0.107]	[0.108]	[0.107]
Number of times a country was at war in the 19th century						0.042***				
						[0.015]				
Total length in days of the wars that a country participated in during the 19th century							8.36e-05**			
							[3.92e-05]			
Log of summed fatalities + 1 during the 19th century								0.015**		
								[0.007]		
Number of times a country participated in war during the 20th century (more specifically, 1901–1979)									0.006	
									[0.013]	
Number of times a country participated in war during 1823–1945										0.014
										[0.009]
Observations	55	55	55	55	55	55	55	55	55	55
p-value	0.047	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
R-Squared	0.072	0.385	0.413	0.406	0.429	0.503	0.473	0.485	0.432	0.458

4.2. Egalitarianism distance and international investment

We now turn to the results that link egalitarianism distance to cross-border flows of international investment. Table 3 presents the summary statistics and correlation matrix. What stands out is that there are no significant issues of collinearity among our independent variables and that the different types of cross-border investment flows each have their own unique distributions as well. Cross-border syndicated loans and cross-border M&A flows are the most related, with a relatively modest correlation of 0.516.

Having shown that collinearity is not an issue, we next move on to describe the results of our model specifications in Tables 4–6. Our specification includes egalitarianism

distance (sheer, signed, and predicted by instruments), legal and other institutional distance, economic and other exogenous factors, time dummies, and country fixed effects where applicable.

Table 4 presents the results for issuances of bonds and equities, Table 5 for syndicated loans, and Table 6 for M&A transactions. Egalitarianism distance emerges as a strong, significant, and negative factor for all of these types of investment. This effect is causal, as indicated by the specifications in which we use societal fractionalization, religion circa 1900, and war history of countries as instrumental variables to predict contemporary egalitarianism levels. The negative effect of egalitarianism distance is robust to the inclusion of time dummies and of country fixed effects,[9] and

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(footnote continued)

an economically trivial association with egalitarianism levels. Average family size was unrelated to egalitarianism. Finally, the use of proportional representation systems is not significantly associated with egalitarianism whether measured with indexes created by Milesi-Ferretti, Perotti, and Rostagno (2002) or by Persson and Tabellini (2003).

[9] When using origin and host country fixed effects, we are not able to include the signed distance control measure because for large and small countries in particular, the signed distance control is an almost perfectly collinear combination of the origin and host country fixed effects. Thus, the signed distance is essentially absorbed into the origin and host country effects. We confirmed that our main variable of interest, egalitarianism distance, is not substantively impacted when

Table 3

Summary statistics and pairwise correlations.

This table presents summary statistics and pairwise correlations for the main variables used throughout the tables. *Note*: Summary statistics in this table are based on the sample in Model 2 of Table 5, which is a representative sample for the overall panel results. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Panel A: Summary statistics

Variable	Variable definition	Mean	Median	Std dev	Min	Max	Obs
[1] Cross-border syndicated loan flows	We take the log of (cross-border syndicated loan flows in millions of dollars + 1). Source: authors' calculations based on primary data from Dealogic.	1.794	0.000	2.717	0.000	12.043	29470
[2] Cross-border bond capital raising flows	We take the log of (cross-border bond capital raising flows in millions of dollars + 1). Source: authors' calculations based on primary data from Thomson-Reuters SDC database.	0.139	0.000	0.946	0.000	10.549	29470
[3] Cross-border equity capital raising flows	We take the log of (cross-border equity capital raising flows in millions of dollars + 1). Source: authors' calculations based on primary data from Thomson-Reuters SDC database.	0.130	0.000	0.861	0.000	10.814	29470
[4] Cross-border merger and acquisition flows	We take the log of (cross-border mergers and acquisition flows in millions of dollars + 1). Source: authors' calculations based on primary data from Thomson-Reuters SDC database.	0.834	0.000	2.027	0.000	12.238	29470
[5] Log of the product of origin and host country GDP	We take the log of the GDPs for each origin country–host country pair for each year. Source: authors' calculations based on primary data from the World Development Indicators (WDI).	51.917	51.933	2.233	44.799	59.351	29470
[6] Egalitarianism distance	The squared difference between a country pair on their cultural egalitarianism score. Source: year 2005 release of Schwartz cultural values data set.	0.175	0.090	0.214	0.000	1.297	29470
[7] Signed egalitarianism distance (origin country first)	The signed difference between each of two countries' scores on cultural egalitarianism, with the origin country first for each transaction. Source: year 2005 release of Schwartz cultural values data set.	0.000	0.000	0.418	-1.139	1.139	29470
[8] Anti-self-dealing index distance	The index of the strength of minority shareholder protection against self-dealing by the controlling shareholder; from Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2008); accessed from http://www.economics.harvard.edu/faculty/shleifer/data set in July 2010.	0.123	0.058	0.156	0.000	0.846	29470
[9] Different legal family	A dummy is set equal to one when origin and host countries are from different legal families. We started with the data on legal origin reported in La Porta et al. (1999) and then did an enlarged survey of recent changes in civil and commercial code taken by former socialist countries. (Further details of authors' analysis are noted in Section 3.4.)	0.711	1.000	0.453	0.000	1.000	29470
[10] Common language	Set equal to 1 if origin and host countries share the same primary language. Set equal to zero otherwise. Source: CIA—The World Factbook, accessed in October 2005 from http://www.cia.gov/cia/publications/factbook/index.html.	0.083	0.000	0.275	0.000	1.000	29470
[11] Geographic distance	Log of minimum geographic distance between capital cities. Source: CShapes data set, accessed in June 2010 from http://nils.weidmann.ws/projects/cshapes; distance data for any missing country pairs was accessed in January 2006 from http://www.airport-accommodation.co.uk/worlddistances.php.	8.598	8.997	0.983	4.025	9.897	29470
[12] Signed corporate tax rate distance	Origin country–host country high corporate tax rate. Source: Heritage Foundation.	0.000	0.000	9.245	−40.000	40.000	29470
[13] Log product of origin-host population	We take the log product of the national populations for each origin country–host country pair for each year. Source: authors' calculations based on primary data from the World Development Indicators (WDI).	34.133	33.953	2.005	30.174	41.859	29470

Panel B: Correlation matrix

Variable	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]	[11]	[12]	[13]
[1] Cross-border syndicated loan flows	1												
[2] Cross-border bond capital raising flows	0.270***	1											
[3] Cross-border equity capital raising flows	0.301***	0.326***	1										
[4] Cross-border merger and acquisition flows	0.516***	0.281***	0.303***	1									
[5] Log of the product of origin and host country GDP	0.585***	0.215***	0.227***	0.432***	1								
[6] Egalitarianism distance	−0.107***	−0.070***	−0.064***	−0.135***	−0.009	1							
[7] Signed egalitarianism distance (origin country first)	−0.104***	0.033***	−0.018***	0.045***	0.000	0.000	1						
[8] Anti-self-dealing index distance	−0.056***	−0.014**	−0.019***	−0.048***	−0.117***	−0.109***	0.000	1					
[9] Different legal family	−0.037***	−0.005	−0.037***	−0.065***	0.033***	0.021***	0.000	0.251***	1				
[10] Common language	0.065***	0.060***	0.113***	0.118***	−0.028***	−0.115***	0.000	−0.067***	−0.381***	1			
[11] Geographic distance	−0.257***	−0.049***	−0.041***	−0.222***	−0.005	0.051***	0.000	0.217***	0.066***	0.060***	1		
[12] Signed corporate tax rate distance	−0.067***	−0.009	−0.017***	0.038***	0.000	0.000	0.082***	0.000	0.000	0.000	0.000	1	
[13] Log product of origin-host population	0.204***	0.065***	0.116***	0.146***	0.609***	0.086***	0.000	−0.179***	−0.073***	0.024***	0.185***	0.000	1

Table 4

Egalitarianism distance and cross-border equity and bond capital raising flows

This table presents the results of regressions in which cross-border equity and then cross-border bond capital raising flows serve as the dependent variables. We start with cross-sectional OLS regressions for year 2000 in which the natural log of (cross-border equity capital raisings in millions of U.S. dollars + 1) and the natural log of (cross-border bond capital raising flows in millions of U.S. dollars + 1) serve as the alternative dependent variables (DV). We then move on to a series of robustness checks using Probit models (where a positive flow is the alternative DV and is set equal to 1; otherwise set equal to zero); Tobit models, and Poisson-logit hurdle models (where this robustness check specification using the "hplogit" command in STATA accepts a continuous DV). We then move on this same table to show the results of panel OLS regressions for years 1995–2008 using those same two dependent variable definitions. In the cross-sectional regressions in Models 1–8, the robust standard errors appear below the coefficients in brackets. In Models 9–14, robust standard errors corrected for clustering at the origin-host-country pair level appear below the coefficients in brackets. In Models 12–14, we also use origin and host country fixed effects. When using predicted egalitarianism distance based on our instruments in Model 6 of Table 2, we utilize bootstrapped standard errors with 500 repetitions and report the adjusted R-squared. The R-squareds are relatively low for cross-border equity and bond flows because the activity is relatively concentrated among three host countries. This is not the case for cross-border syndicated loan and merger and acquisition flows, which have far broader and deeper flows across the globe. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Variable	Model 1 DV: Cross-border equity flows, cross-section for the year 2000	Model 2 DV: Cross-border bond flows, cross-section for the year 2000	Model 3 DV: Cross-border equity flows, cross-section for the year 2000, using Probit temporarily instead of OLS	Model 4 DV: Cross-border bond flows, cross-section for the year 2000, using Probit temporarily instead of OLS	Model 5 DV: Cross-border equity flows, cross-section for the year 2000, using Tobit temporarily instead of OLS	Model 6 DV: Cross-border bond flows, cross-section for the year 2000, using Tobit temporarily instead of OLS	Model 7 DV: Cross-border equity flows, cross-section for the year 2000, using hplogit temporarily instead of OLS	Model 8 DV: Cross-border bond flows, cross-section for the year 2000, using hplogit temporarily instead of OLS	Model 9 DV: Cross-border equity flows, pooled sample for available years 1995–2008	Model 10 DV: Cross-border bond flows, pooled sample for available years 1995–2008	Model 11 DV: Cross-border bond flows, pooled sample for available years 1995–2008	Model 12 DV: Cross-border equity flows, 1995–2008 panel with origin and host country fixed effects and clustering	Model 13 DV: Cross-border bond flows, 1995–2008 panel with origin and host country fixed effects and clustering	Model 14 DV: Cross-border bond flows, 1995–2008 panel with origin and host country fixed effects and clustering
Log product of origin-host GDP	0.112*** [0.017]	0.130*** [0.019]	0.476*** [0.063]	0.933*** [0.134]	3.650*** [0.408]	7.348*** [0.847]	1.037*** [0.141]	1.953*** [0.285]	0.096*** [0.011]	0.118*** [0.014]	0.120*** [0.014]	0.107* [0.057]	0.028 [0.046]	0.031 [0.044]
Egalitarianism distance	−0.261*** [0.051]	−0.167*** [0.048]	−2.706*** [0.595]	−3.159*** [0.878]	−20.743*** [4.501]	−23.886*** [6.216]	−5.809*** [1.308]	−7.235*** [2.077]	−0.167*** [0.034]	−0.217*** [0.038]		−0.061* [0.036]	−0.087*** [0.031]	
Signed egalitarianism distance	−0.047 [0.030]	0.141*** [0.034]	−0.836*** [0.283]	1.703*** [0.473]	−5.974*** [2.108]	13.185*** [3.322]	−1.618*** [0.628]	3.802*** [1.097]	−0.035 [0.023]	0.076*** [0.024]				
Predicted egalitarianism distance											−0.455*** [0.107]			−0.658*** [0.142]
Predicted signed egalitarianism distance											0.005 [0.032]			
Anti-self-dealing index distance	0.049 [0.099]	0.079 [0.114]	0.205 [0.574]	1.070* [0.575]	1.318 [4.501]	7.858* [4.365]	0.103 [1.125]	2.114* [1.263]	0.109* [0.061]	0.043 [0.078]	0.090 [0.087]	−0.425*** [0.141]	0.057 [0.080]	0.088 [0.083]
Different legal family	−0.001 [0.041]	−0.011 [0.044]	−0.122 [0.177]	−0.245 [0.288]	−0.816 [1.338]	−1.934 [2.241]	−0.141 [0.392]	−0.604 [0.592]	−0.005 [0.027]	0.014 [0.028]	0.023 [0.028]	−0.017 [0.027]	−0.032 [0.028]	−0.031 [0.028]
Common language	0.347*** [0.112]	0.213* [0.111]	0.619*** [0.221]	−0.013 [0.429]	4.505*** [1.593]	0.334 [3.238]	1.254** [0.509]	−0.321 [0.810]	0.371*** [0.088]	0.239*** [0.087]	0.261*** [0.086]	0.082 [0.072]	0.051 [0.057]	0.057 [0.060]
Geographic distance	−0.045** [0.023]	−0.016 [0.025]	−0.163** [0.070]	0.049 [0.078]	−1.332*** [0.512]	0.270 [0.572]	−0.235 [0.151]	0.092 [0.155]	−0.040*** [0.015]	−0.034* [0.019]	−0.030 [0.020]	−0.086*** [0.024]	−0.059*** [0.022]	−0.042* [0.023]

Signed corporate tax rate distance	−0.002 [0.002]	0.001 [0.002]	−0.003 [0.007]	−0.007 [0.008]	−0.029 [0.050]	−0.057 [0.059]	−0.012 [0.014]	−0.015 [0.017]	−0.001 [0.001]	−0.001 [0.001]	−0.001 [0.001]	3.335E−04 [0.001]	0.001* [0.001]	0.001** [0.001]
Log product of origin−host population	−0.009 [0.011]	−0.043*** [0.011]	−0.143*** [0.055]	−0.548*** [0.133]	−1.004*** [0.400]	−4.375*** [0.972]	−0.335** [0.132]	−1.202*** [0.305]	−0.009 [0.008]	−0.044*** [0.007]	−0.047*** [0.007]	−0.106 [0.083]	0.104 [0.094]	0.112 [0.089]
Year dummies included	No	No	No	No	No	No	No	No	No	Yes	Yes	Yes	Yes	Yes
Country fixed effects included	No	No	No	No	No	No	No	No	No	No	No	Yes	Yes	Yes
p-value	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
R-squared	0.083	0.079	0.343	0.452	0.228	0.295	N/A	N/A	0.074	0.065	0.063	0.259	0.286	0.286
Obs	2162	2162	2162	2162	2162	2162	2162	2162	29470	29470	29470	29470	29470	29470

to the use of clustering.[10] As another perspective on the robustness of the egalitarianism effects, we present results for cross-section regressions for the year 2000. In these regressions, the negative role of egalitarianism distance continues to be significant.

The predictive power of the regressions for syndicated loans and mergers and acquisitions appears considerably higher than in the regressions for issuances of bonds and equities. This is in line with our hypothesis that the cross-cultural interaction is more intense in the former two investment types than in the latter. The fact that bond and equity issuances are much sparser relative to syndicated loans and mergers and acquisitions may also support this pattern in the results. Specifically, because three exchanges have cornered most of the market for either cross-border bonds or cross-border equities, only about 2–3% of observations for cross-border bonds and cross-border equities are non-zero, nearly by arithmetical necessity. In contrast, the flows of syndicated loans and M&A are much more diffuse—up to 30% and 55%, respectively, being positive observations, with policy controls included.

To address the relative frequency of zero values in the bonds and equity capital raisings data, we deploy as robustness checks a series of alternative statistical models that are often mentioned in connection to samples populated meaningfully by zero observations, namely, Tobit, Probit, and a Poisson-logit hurdle model. It should be borne in mind, however, that the Probit model can only shed light on whether there are any non-zero flows at all, and the Poisson-logit hurdle model is normally meant for deal count data, while we have variables with continuous values. The Tobit model is usually invoked if some of the zeroes are not believed to be true zeroes. This is not the case here, inter alia, because bond and equity issuances take place on organized exchanges such that zero values in these samples are true zeroes. Most importantly, Tobit relies on very stringent distributional assumptions about the data. Econometrics authors thus emphasize that if these assumptions do not hold, the Tobit model is not appropriate.[11] In contrast, Ordinary Least Squares (OLS) estimation does not similarly depend on these assumptions, which makes it far more flexible, especially when

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(footnote continued)

using origin and host country fixed effects by the inclusion or exclusion of the signed distance, since there is no collinearity between them.

[10] The reason for looking at the panel with a time-invariant cultural factor is simple. Because our focal factor is a measure of cultural distance, we are able to control for origin and host country effects and thus control for all other time-invariant characteristics of the origin and host countries. Also, as Stock and Watson (2008) have shown, with the use of clustering we are able to control for serial autocorrelation most effectively. As a result, it is useful in this context to adopt panel analysis with clustering. We think it is important to show that egalitarianism matters over the longer time period even after controlling for important time-varying economic factors such as GDP and taxes.

[11] See, for example, Greene (2008, p. 880) ("It has been shown that if the underlying disturbances are not normally distributed, then the estimator based on (24–13) [Tobit] is inconsistent."), and Cameron and Trivedi (2005, p. 538) ("A very major weakness of the Tobit MLE is its heavy reliance on distributional assumptions. If the error is either heteroskedastic or nonnormal the MLE is inconsistent."). Wooldridge (2003, p. 572) similarly states that if any of the Tobit assumptions fail, then it is difficult to know what the Tobit (MLE) is estimating.

Table 5
Egalitarianism distance and cross-border syndicated loan flows

This table presents the results of regressions in which cross-border syndicated loan flows serve as the dependent variable. We start in Model 1 with a cross-sectional OLS regression for year 2000 in which the natural log of (cross-border syndicated loan flows in millions of U.S. dollars + 1) serves as the dependent variable. We then move on this same table to show the results of panel OLS regressions for years 1995–2008 using that same dependent variable definition. In the cross-sectional regression in Model 1, the robust standard errors appear below the coefficients in brackets. In Models 2–4, robust standard errors corrected for clustering at the origin-host-country pair level appear below the coefficients in brackets. When using predicted egalitarianism distance based on our instruments in Model 6 of Table 2, we utilize bootstrapped standard errors with 500 repetitions and report the adjusted R-squared. In Models 3–4, we also add origin and host country fixed effects. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Variable	Model 1 DV: Cross-border syndicated loans, year 2000 cross-section	Model 2 DV: Cross-border syndicated loans, 1995–2008 panel with clustering	Model 3 DV: Cross-border syndicated loans, 1995–2008 panel with origin and host country fixed effects and clustering	Model 4 DV: Cross-border syndicated loans, 1995–2008 panel with origin and host country fixed effects and clustering
Log product of origin-host GDP	0.851***	0.846***	0.643***	0.640***
	[0.028]	[0.026]	[0.115]	[0.111]
Egalitarianism distance	−0.805***	−0.732***	−1.185***	
	[0.169]	[0.142]	[0.133]	
Signed egalitarianism distance	−0.540***	−0.644***		
	[0.092]	[0.078]		
Predicted egalitarianism distance				−2.746***
				[0.353]
Anti-self-dealing index distance	0.847***	0.973***	−0.666***	−0.497**
	[0.280]	[0.242]	[0.234]	[0.245]
Different legal family	−0.207**	−0.223**	−0.190***	−0.203***
	[0.102]	[0.089]	[0.069]	[0.067]
Common language	0.840***	0.842***	0.093	0.096
	[0.173]	[0.154]	[0.131]	[0.138]
Geographic distance	−0.563***	−0.651***	−0.676***	−0.646***
	[0.048]	[0.041]	[0.042]	[0.044]
Signed corporate tax rate distance	−0.033***	−0.017***	−0.008***	−0.008***
	[0.004]	[0.003]	[0.002]	[0.002]
Log product of origin-host population	−0.259***	−0.223***	−1.488***	−1.438***
	[0.027]	[0.023]	[0.252]	[0.248]
Year dummies included	No	Yes	Yes	Yes
Country fixed effects included	No	No	Yes	Yes
p-value	0.000	0.000	0.000	0.000
R-squared	0.475	0.459	0.672	0.671
Obs	2162	29470	29470	29470

one uses clustering and fixed effects as we do. This enables OLS to fit the data well, yielding unbiased and consistent point estimates even in the presence of many zeroes. Moreover, the fact that we have over 100 clusters is a positive aspect of the data when using clustering to get to reliable standard errors with OLS.

Subject to the above-stated reservations, we nevertheless find a high degree of consistency when we subject the bond and equity capital raising data to Probit, Tobit, and Poisson-logit hurdle models in Appendix Tables A1–A3, respectively (available on the journal's Web site). For readers' convenience, we reproduce typical specifications in columns 3–8 of Table 4. The results are consistent with our hypotheses. The Tobit regressions, for instance, yield significant coefficients for egalitarianism distance and other major factors in line with our theory and with the OLS results. However, for most of the Tobit specifications that we tried, STATA's tobcm diagnostic command showed that the Tobit model's core assumptions do not fit with these data and that the Tobit model is therefore not appropriate for these international investment flows data.

Focusing now on the results for syndicated loans and mergers and acquisitions (Tables 5 and 6), the evidence suggests that in the international market, these investments may tend to flow more from higher egalitarianism countries to lower egalitarianism ones. Thus, the coefficient of signed egalitarianism distance is negative for syndicated loans, where capital flows from the lead bank that resides in the borrower firm's destination market. This sign is positive for mergers and acquisitions, where capital flows from the acquirer firm's origin market to the target's destination market. What may be the particular features of that institutional environment that these large sophisticated investors care about is a point we address further below. Interestingly, there are more bond issuances that go from lower to higher egalitarianism markets, although this observation is subject to the caveat just mentioned, as only three markets host nearly all of such issuances.

Having a different legal origin in the home and host country is generally a drawback for international investment flows, controlling for cultural distance on egalitarianism and for other distance variables. Crude as it may be, the common-law/civil-law distinction arguably

Table 6

Egalitarianism distance and cross-border merger and acquisition flows

This table presents the results of regressions in which cross-border merger and acquisition flows serve as the dependent variable. We start in Models 1–2 with cross-sectional OLS regressions for year 2000 in which the natural log of (cross-border merger and acquisition flows in millions of U.S. dollars + 1) serves as the dependent variable. We then move on this same table to show the results of panel OLS regressions for years 1995–2008 using that same dependent variable definition. In the cross-sectional regressions in Models 1–2, the robust standard errors appear below the coefficients in brackets. In Models 3–6, robust standard errors corrected for clustering at the origin-host-country pair level appear below the coefficients in brackets. When using predicted egalitarianism distance based on our instruments in Model 6 of Table 2, we utilize bootstrapped standard errors with 500 repetitions and report the adjusted R-squared. In Models 5–6, we also add origin and host country fixed effects. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Variable	Model 1 DV: Cross-border mergers and acquisitions, year 2000 cross-section	Model 2 DV: Cross-border mergers and acquisitions, year 2000 cross-section	Model 3 DV: Cross-border mergers and acquisitions, 1995–2008 panel with clustering	Model 4 DV: Cross-border mergers and acquisitions, 1995–2008 panel with clustering	Model 5 DV: Cross-border mergers and acquisitions, 1995–2008 panel with origin and host country fixed effects and clustering	Model 6 DV: Cross-border mergers and acquisitions, 1995–2008 panel with origin and host country fixed effects and clustering
Log product of origin-host GDP	0.540*** [0.027]	0.550*** [0.027]	0.460*** [0.021]	0.469*** [0.022]	0.279*** [0.091]	0.283*** [0.091]
Egalitarianism distance	−0.920*** [0.149]		−0.848*** [0.091]		−0.896*** [0.102]	
Signed egalitarianism distance	0.333*** [0.076]		0.202*** [0.049]			
Predicted egalitarianism distance		−0.960** [0.379]		−0.760*** [0.222]		−2.971*** [0.282]
Predicted signed egalitarianism distance		0.426*** [0.130]		0.291*** [0.074]		
Anti-self-dealing index distance	0.447* [0.250]	0.626*** [0.242]	0.572*** [0.170]	0.735*** [0.171]	−0.572*** [0.190]	−0.407** [0.207]
Different legal family	−0.183* [0.094]	−0.168* [0.099]	−0.167*** [0.062]	−0.155** [0.064]	−0.239*** [0.056]	−0.246*** [0.054]
Common language	0.964*** [0.177]	1.054*** [0.182]	0.930*** [0.138]	1.015*** [0.142]	0.064 [0.119]	0.078 [0.115]
Geographic distance	−0.482*** [0.052]	−0.480*** [0.050]	−0.429*** [0.036]	−0.429*** [0.036]	−0.562*** [0.038]	−0.512*** [0.038]
Signed corporate tax rate distance	0.015*** [0.004]	0.014*** [0.004]	0.008*** [0.002]	0.008*** [0.002]	0.005*** [0.001]	0.005*** [0.001]
Log product of origin-host population	−0.190*** [0.023]	−0.203*** [0.023]	−0.116*** [0.016]	−0.127*** [0.016]	−1.378*** [0.211]	−1.332*** [0.212]
Year dummies included	No	No	Yes	Yes	Yes	Yes
Country fixed effects included	No	No	No	No	Yes	Yes
p-value	0.000	0.000	0.000	0.000	0.000	0.000
R-squared	0.317	0.307	0.283	0.276	0.438	0.443
Obs	2162	2162	29470	29470	29470	29470

captures a general "style" of the legal system as a whole (Zweigert and Kötz, 1998; La Porta, Lopez-de-Silanes, and Shleifer, 2008). A plausible interpretation of this finding is that it reflects higher transaction costs due to the need to adjust to a different legal environment. The results for the distance variable on anti-self-dealing (ASD) laws are more intriguing. In several models of different types of investment, ASD distance exhibits a positive sign, which, at first blush, might appear consistent with regulatory arbitrage on anti-self-dealing rules. We defer the fuller discussion of this factor to Section 4.4 below, where we also consider policy outcomes. We have also examined distance measures for creditor rights and securities laws but obtained unstable and largely non-significant results.

4.3. Policy mechanisms associated with egalitarianism

The theory we advance about the role of cultural distance on egalitarianism differs conceptually from other accounts of cultural distance in economic exchange. Studies in the spirit of Grinblatt and Keloharju (2001) and Portes and Rey (2005) emphasize familiarity and the smooth flow of information, while studies in the spirit of Guiso, Sapienza, and Zingales (2009) and Felbermayr and Toubal (2010) underscore cross-national sentiment. The present account, which does not preclude the former ones, focuses on the social institutional environment pertaining to power and authority. To substantiate this point, we now examine the relations between egalitarianism and more particular institutions at different levels of specificity. We expect to find that countries that are higher on egalitarianism will regulate power differences in a conceptually consistent way.

Table 7 first presents a high positive pairwise correlation between egalitarianism and countries' scores on the absence of corruption. Although corruption usually stands for use of public office for private gain, when corruption is endemic, it adversely affects all aspects of social and economic life, including corporate governance (see Black, Kraakman, and Tarasova, 2000; Fan, Wong, and Zhang, 2007). Next, we present a series of positive correlations between egalitarianism and a set of measures for the years 1994–2008, capturing the extent to which countries support fair competition through antitrust regulation. While the measures vary, the result is uniform: higher egalitarianism associates positively with taking fair competition seriously. Similarly, countries higher on egalitarianism also take transparency in corporate governance seriously. Three different measures of disclosure and auditing in corporate accounting exhibit a positive correlation with egalitarianism. Finally, in line with the basic theoretical definition of egalitarianism as a view of all people as moral equals, we show that higher egalitarianism associates with holding people exercising superior political, market, or corporate power in check. More egalitarian societies also spend more resources on supporting their weaker members such as the sick, the elderly, and the unemployed, as shown in the last set of correlations in Table 7.

The pairwise correlations in Table 7 are only first approximations, obviously, for the relations between

cultural egalitarianism and more specific policy mechanisms. Due to exigencies of scope, in Table 8 we look more rigorously at non-corruption (Panel A) and at social transfers (Panel B). We take You and Khagram's (2005) specification for explaining non-corruption and augment it by adding egalitarianism as a predictor, which exhibits a strong positive coefficient. We repeat this exercise with Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer's (2004) indices of unemployment benefits and social security. Controlling for the independent variables that these authors have considered, which include legal, economic, and structural factors, egalitarianism again exhibits a strong positive coefficient in all the models, in line with our hypothesis. These findings suggest that countries' basic egalitarianism orientation implicates the entire institutional environment in which firms operate.

4.4. The impact of egalitarianism after controlling for policy mechanisms

We begin the final part of the empirical analysis with a brief observation from a different vantage point. The regressions in Tables 4–6 show that firms exhibit a preference for international investment destinations where the egalitarianism distance between the origin and host markets is smaller. But what happens when firms fail to do so? When they make an apparent mistake and try to go "too far" along the egalitarianism distance continuum? To address this question, we utilize a marginal q analysis for international mergers and acquisitions, in which marginal q proxies for overinvestment vs. underinvestment.[12] This approach, introduced in Durnev, Morck, and Yeung's (2004) pioneering study to assess investors' aggregate judgment on companies' capital budget decisions, provides a novel means for taking advantage of the market's wisdom to assess managers' wisdom. The marginal q methodology has been applied in a variety of contexts, including how multinationality connects with corporate budgeting efficiency (Greene, Hornstein, and White, 2009) and how the absence of antitakeover provisions creates incentives to collect private information (Ferreira and Laux, 2007). To our knowledge, this is one of the first cross-country studies to estimate marginal q. We use country*year fixed effects to account for inflation and all country*year-specific accounting factors.

Table 9 presents marginal q analyses when ordering the countries in our sample into quartiles of egalitarianism levels and then examining transactions that cross quartiles. We find that the greater the egalitarianism distance, the greater the rate of overinvestment and even value destruction that follow an M&A transaction. In particular, this value destruction is greatest upon trying to "jump" two or more egalitarianism quartiles. It is widely known from the corporate strategy literature that the vast majority of mergers and acquisitions are value-destroying. However, this is the first study to show that most of the value destruction in cross-border M&A occurs

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[12] We are grateful to an anonymous reader for suggesting this point.

Table 7
Egalitarianism and associated policy outcomes.

This table presents the pairwise correlations between egalitarianism and associated policy outcomes. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Variable	[1]
[1] Egalitarianism: countries' scores on the Schwartz cultural egalitarianism orientation. Source: year 2005 release of Schwartz cultural values data set.	1
[2] World Bank control of corruption index 1996–2002 average: this index represents freedom from corruption because a higher number indicates a lower level of corruption. Source: Kaufmann, Kray, and Mastruzzi (2003).	0.542***
[3] Nicholson measure of antitrust enforcement expenditure: the ratio of budget and staff for the competition agencies in countries, indexed to the level of the United States. Source: Nicholson (2007).	0.468**
[4] World Economic Forum measure of antitrust enforcement stringency. Source: Nicholson (2007).	0.451***
[5] Perceived effectiveness of antitrust policy 1994:	0.347**
[6] Perceived effectiveness of antitrust policy 1995:	0.379**
[7] Perceived effectiveness of antitrust policy 1996:	0.403***
[8] Perceived effectiveness of antitrust policy 1997:	0.457***
[9] Perceived effectiveness of antitrust policy 1998:	0.495***
[10] Perceived effectiveness of antitrust policy 1999:	0.504***
[11] Perceived effectiveness of antitrust policy 2000:	0.526***
[12] Perceived effectiveness of antitrust policy 2001:	0.533***
[13] Perceived effectiveness of antitrust policy 2002:	0.461***
[14] Perceived effectiveness of antitrust policy 2003:	0.407***
[15] Perceived effectiveness of antitrust policy 2004:	0.380**
[16] Perceived effectiveness of antitrust policy 2005:	0.387**
[17] Perceived effectiveness of antitrust policy 2006:	0.437***
[18] Perceived effectiveness of antitrust policy 2007:	0.393***
[19] Perceived effectiveness of antitrust policy 2008:	0.401***

Description for [5]–[19]: A group of senior executives and economic leaders was surveyed for the IMD World Competitiveness yearbooks on the perceived effectiveness of antitrust policy in their country. This group of senior executives and economic leaders grew from 2,800 in 1994 to 4,000 in 2005. From 1994 to 1996, these respondents answered the following survey question: "Do antitrust laws prevent unfair competition in your country?" From 1997 to 2001, these respondents answered a slightly different question: "Do competition laws prevent unfair competition in your country?" In 2002, these respondents answered the following question: "Does competition legislation in your country prevent unfair competition?" From 2003 to 2004, these respondents answered a slightly different question: "Does competition legislation in your economy prevent unfair competition?" From 2005 to 2008, respondents answered a slightly different question: "Is competition legislation in your country efficient in preventing unfair competition?" For all years these respondents assessed the effectiveness of antitrust policy on a scale of 1–6, with the response 1 indicating the most negative perception of the effectiveness of antitrust policy and the response 6 indicated the most positive perception. The responses were then averaged by country and subsequently converted to a 0–10 scale. Source: IMD World Competitiveness yearbooks.

Variable	[1]
[20] Bushman et al. Factor 1: A factor variable produced by Bushman, Piotroski, and Smith (2004) after analyzing an extensive range of measures capturing countries' firm-specific information environments in 1995. This "Factor 1" is selected because it represents financial transparency. More specifically, this variable captures the intensity and timeliness of financial disclosures, and their interpretation and dissemination by analysts and the media. Source: Bushman, Piotroski, and Smith (2004), who constructed this variable using primary data from the International Accounting and Auditing Trends, Center for Financial Analysis and Research, Inc. (IAAT).	0.380**
[21] Bushman et al. Time: Average ranking of the answers to the following interim reporting questions in 1995: Ea (frequency of reports), Ed-Ef (count of disclosed items), and Eb (consolidation of interim reports). Source: Bushman, Piotroski, and Smith (2004), who constructed this variable using primary data from the International Accounting and Auditing Trends, Center for Financial Analysis and Research, Inc. (IAAT).	0.427***
[22] Bushman et al. Audit: Variable indicating the percentage of firms in the country audited by the Big 5 accounting firms in 1995. Audit equals 1, 2, 3, or 4 if the percentage ranges between [0, 25%], (25%, 50%], (50%, 75%], and (75%, 100%], respectively. Source: International Accounting and Auditing Trends, Center for Financial Analysis and Research, Inc. (IAAT) as used in Bushman, Piotroski, and Smith (2004).	0.295*
[23] Botero et al. Sickness and health benefits: An aggregate measure of the level of sickness and health legal benefits, computed as the normalized sum of the following four variables: (1) the number of months of contributions or employment required to qualify for sickness benefits by law; (2) the percentage of the worker's monthly salary deducted by law to cover sickness and health benefits; (3) the waiting period for sickness benefits; and (4) the percentage of the net salary covered by the net sickness cash benefit for a 2-month sickness spell. Source: Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004).	0.296**
[24] Botero et al. Unemployment benefits: This index measures the level of protection of unemployment benefits. Four factors are taken into account: (a) the number of months of contributions or employment required to qualify for unemployment benefits by law; (b) the percentage of the worker's monthly salary deducted by law to cover unemployment benefits; (c) the waiting period for unemployment benefits; and (d) the percentage of the net salary covered by the net unemployment benefits in case of a one-year unemployment spell. Source: Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004).	0.301**
[25] Botero et al. Social security laws: An aggregate measure of social security benefits as the average of: (1) Old age, disability, and death benefits; (2) Sickness and health benefits; and (3) Unemployment benefits. Source: Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004).	0.380***

when the transactions attempt to cross too large a distance on cultural egalitarianism.

The evidence in Table 9 indicates that the deleterious effects of overinvestment on mergers and acquisitions are more severe when traveling two quartiles or more from low to high egalitarianism than when traveling two quartiles or more from high to low egalitarianism. This result is in line with the finding in Table 6 that mergers and acquisitions may tend to flow more from higher to lower egalitarianism markets, all else being equal. Why

Table 8

The effect of egalitarianism on other associated policy outcomes.

Panel A demonstrates through a cross-sectional OLS regressions the association between egalitarianism and the control of corruption after accounting for a battery of alternative explanations. *Note*: Control variables for studying anti-corruption levels in Panel A came from You and Khagram (2005). We added the log of GDP per capita. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Panel B presents a series of cross-sectional OLS regressions in which the Unemployment Benefits Index and the Social Security Laws Index from Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004) serve as alternative dependent variables. Egalitarianism is our main variable of interest, and we also control for variables previously found to be of importance in Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004) for explaining these policy outcomes. We also add the log of GDP per capita for year 1995. Robust standard errors appear below the coefficents in brackets. Note: Henisz's (2000) POLCONIII political constraints index along with pure geographic openness were actually dropped between the penultimate pre-publication version and final version of Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004), but we believed them to be potentially relevant and hence included them. Nevertheless, we get the same egalitarianism distance results with or without their inclusion. Also, we have added the log of GDP per capita as a robustness check. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Panel A: Determinants of anti-corruption levels

Variable	DV: World Bank control of corruption index 1996–2002 average Model 1	DV: World Bank control of corruption index 1998 Model 2	DV: World Bank control of corruption index 1996–1998 average Model 3
Egalitarianism	1.059**	1.102**	0.948**
	[0.474]	[0.443]	[0.465]
Gini coefficient averaged over the years 1971–1996, from You and Khagram (2005)	−1.456	−0.699	−0.687
	[1.377]	[1.407]	[1.140]
Percentage of Protestants in 1980, from La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1999)	0.989	1.199*	1.137
	[0.695]	[0.668]	[0.698]
Percentage of Catholics in 1980, from La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1999)	0.412**	0.486	0.440**
	[0.200]	[0.360]	[0.200]
Percentage of Muslims in 1980, from La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1999)	0.346	0.459	0.476
	[0.360]	[0.482]	[0.335]
Federalism, the sum of five indicators for federalism averaged for 1975–1996, from You and Khagram (2005)	−0.111**	−0.102	−0.119**
	[0.053]	[0.061]	[0.049]
Natural resource abundance, defined as the share of fuel, ore, and metal exports from the total merchandise exports, averaged for 1971–1996, from the World Development Indicators	−0.006	−0.006	−0.006
	[0.005]	[0.004]	[0.004]
Distance from the equator, from You and Khagram (2005) as used in Treisman (2000)	−0.014	0.178	0.191
	[0.952]	[0.681]	[0.884]
Constructed openness, defined as the natural logarithm of predicted trade shares from a bilateral trade equation with "pure" geography variables, computed by Rodrik, Subramanian, and Trebbi (2004)	0.034	0.071	0.022
	[0.096]	[0.124]	[0.093]
Log GDP per capita for year 1995, from World Development Indicators	7.13E−05***	7.87E−05***	7.26E−05***
	[1.48E−05]	[1.35E−05]	[1.55E−05]
Legal origin controls included	Yes	Yes	Yes
Observations	45	45	45
p-Value	0.000	0.000	0.000
R-Squared	0.859	0.814	0.867

Panel B: Egalitarianism and welfare protections for the unemployed and the elderly

Variable	DV: Botero et al. Unemployment Benefits Index			DV: Botero et al. Social Security Laws Index		
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Egalitarianism	0.423***	0.435***	0.420***	0.224***	0.206***	0.210**
	[0.134]	[0.146]	[0.153]	[0.082]	[0.076]	[0.082]
Common law family member	0.003	0.017	0.004	−0.039	−0.059	−0.038
	[0.113]	[0.124]	[0.115]	[0.047]	[0.053]	[0.046]
Socialist legal family member	0.696***	0.735***	0.692***	0.351***	0.292***	0.330
	[0.105]	[0.161]	[0.137]	[0.069]	[0.086]	[0.079]
German legal family member	0.142	0.148	0.141	0.010	3.854E-04	0.007
	[0.114]	[0.125]	[0.117]	[0.071]	[0.068]	[0.072]
Scandinavian legal family member	0.045	0.086	0.036	0.057	−0.005	0.015
	[0.099]	[0.160]	[0.161]	[0.053]	[0.074]	[0.076]
POLCONIII Henisz political constraints index (from Henisz, 2000)	0.009	0.010	0.009	0.015	0.014	0.013
	[0.040]	[0.041]	[0.042]	[0.016]	[0.015]	[0.017]
Pure geographic openness	−0.003	−0.003	−0.003	−0.002	−0.001	−0.002
	[0.002]	[0.003]	[0.003]	[0.001]	[0.001]	[0.001]
Log GDP per capita for year 1995, from World Development Indicators	0.145***	0.141***	0.145***	0.084***	0.091***	0.084***
	[0.044]	[0.048]	[0.045]	[0.018]	[0.020]	[0.019]

Table 8 (continued)

Panel B: Egalitarianism and welfare protections for the unemployed and the elderly

Variable	DV: Botero et al. Unemployment Benefits Index			DV: Botero et al. Social Security Laws Index		
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Proportion of years chief executive of government and largest party in the legislature came from a leftist party during 1928–1995		−0.083 [0.200]			0.126 [0.096]	
Union density			0.017 [0.266]			0.085 [0.113]
Observations	44	44	44	44	44	44
p-value	0.000	0.000	0.000	0.000	0.000	0.000
R-Squared	0.719	0.722	0.720	0.767	0.784	0.770

Table 9

Statistical evidence of how egalitarianism distance is associated with value-destroying cross-border M&A.

This table presents the results of marginal *q* regressions inspired by the work of Durnev, Morck, and Yeung (2004). What is presented is the marginal *q* coefficient, where values below 1.0 indicate overinvestment and possibly value destruction from cross-border M&A. In line with past marginal *q* studies, we control for the same items (lagged disbursements and lagged average *q*) in addition to country*year fixed effects. To reduce the influence of extreme outliers, the dependent variable is winsorized at the 0.001 and 99.999 percent levels. With these extreme outliers included, the results are substantively identical to those below but yet more stark. As seen in prior studies of both within-U.S. M&A and cross-border M&A, a significant amount of M&A appears not to be value-creating. Yet this is particularly the case for cross-border M&A that involves large egalitarianism distance. When traveling from high to low egalitarianism countries, there is evidence of more severe overinvestment. When traveling from low egalitarian to high egalitarian countries, there is evidence from the negative sign of the coefficient of value often being severely dissipated following the cross-border M&A.

Marginal *q* where origin and target nation are in same quartile	0.405
Marginal *q* where transaction moves at least two quartiles in either direction	−3.632
Marginal *q* where transaction moves down two or more quartiles	0.238
Marginal *q* where transaction moves up two or more quartiles	−3.038

there is such an asymmetry in the putative consequences of expanding to markets higher or lower on egalitarianism is a question that warrants further research. This pattern is consistent with the idea that, all else being equal, it is more challenging for a firm based in a low-egalitarianism market to expand to a high-egalitarianism market than to expand in the opposite direction. Consequently, the penalty—in the eyes of market participants as reflected in marginal *q*—is heavier in the former instance than in the latter. Possibly, top executives in more hierarchical societies may be used to receiving unquestioning deference from their underlings and exerting their power in the corporation and in the market with lesser regard to others (see Morck, 2008). The marginal *q* results provide *prima facie* evidence that playing in a more transparent and level playing field may be more challenging and prone to failure than the other way round.

Given that few managers are familiar with the theory and data on cultural egalitarianism, one may wonder what

mechanisms might affect firms' decisions about international investment destinations such that they exhibit a tendency toward smaller egalitarianism distance. To address this question, Table 10 revisits the main regressions from Tables 4–6 and adds distance measures on the policy mechanisms found to be related to egalitarianism in Table 7 as control variables. Table 10 thus examines whether international investment is actually driven by differences in these key institutions rather than by egalitarianism distance. We find that egalitarianism distance continues to exercise an independent association with international investment flows that is robust to the inclusion of these main policy mechanisms.

Table 10 further presents an opportunity to reconsider the role of legal differences in anti-self-dealing regulation. Recall that although the ASD index targets a narrow corporate governance scenario, in Tables 4–6, and now also in Table 10, we enter the ASD distance measure as a control variable for all investment flows. This reflects the possibility that in addition to self-dealing by corporate insiders, a legal system may treat other instances of exercise of power vis-à-vis the corporation in a consistent fashion. In other words, the ASD regime might signify a broader stance in the legal system toward abuse of power in firms. This general conjecture receives support from the fact that ASD distance is significant in some syndicated loans and bond flows even though creditors are presumably much less exposed to the risk of self-dealing than shareholders are. What is highly surprising, however, is the finding of positive coefficients for ASD distance in many models (and non-significance in some equity issuances models).

Taken at face value, the positive coefficients for ASD distance are consistent with a regulatory arbitrage between ASD regimes. That is, irrespective of whether self-dealing is more or less held in check in the other market, firms may gain from entering a market where the ASD regime is either laxer or more stringent than in their home market. This is counter-intuitive because curbing self-dealing should be considered as a positive factor. This puzzle might be resolved by the observation that when country fixed effects are entered in the regressions for syndicated loans and mergers and acquisitions, the sign for ASD distance flips to negative and loses significance (Table 10). This is consistent with the idea that a subset of countries and their fixed characteristics are an omitted

Table 10

The enduring impact of egalitarianism distance on international investment flows even after controlling for associated policies.

This table presents the results of cross-sectional OLS regressions for the year 2000 in which cross-border syndicated loan flows, cross-border bond flows, cross-border equity flows, and cross-border merger and acquisition flows serve as the alternative dependent variables. The only difference between this and prior tables is that we further control for two large-sample variables proxying for key policy mechanisms through which egalitarianism distance impacts international investment flows. We find below that the effect of egalitarianism distance persists even after controlling for these associated policy mechanisms. This suggests that egalitarianism has both a direct cultural effect and an indirect effect via associated policy mechanisms. Robust standard errors appear below the coefficients in brackets. ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Variable	Model 1 DV: Cross-border syndicated loans, year 2000 cross-section	Model 2 DV: Cross-border bonds, year 2000 cross-section	Model 3 DV: Cross-border equity, year 2000 cross-section	Model 4 DV: Cross-border mergers and acquisitions, year 2000 cross-section
Log product of origin-host GDP	0.876***	0.136***	0.115***	0.532***
	[0.029]	[0.019]	[0.017]	[0.027]
Egalitarianism distance	−0.636***	−0.113**	−0.241***	−0.762***
	[0.173]	[0.048]	[0.052]	[0.152]
Signed egalitarianism distance	−0.540***	0.141***	−0.047	0.333
	[0.091]	[0.034]	[0.030]	[0.077]
Anti-self-dealing index distance	0.907***	0.098	0.056	0.497**
	[0.278]	[0.113]	[0.098]	[0.248]
Different legal family	−0.143	0.010	0.007	−0.116
	[0.103]	[0.044]	[0.041]	[0.094]
Common language	0.881***	0.228**	0.352***	1.021***
	[0.176]	[0.112]	[0.113]	[0.176]
Geographic distance	−0.568***	−0.016	−0.046**	−0.459***
	[0.049]	[0.025]	[0.023]	[0.053]
Signed corporate tax rate distance	−0.033***	0.001	−0.002	0.015***
	[0.004]	[0.002]	[0.002]	[0.004]
Log product of origin-host population	−0.284***	−0.049***	−0.012	−0.189***
	[0.029]	[0.012]	[0.012]	[0.024]
Corruption distance (using World Bank control of corruption index 1996–2002 average)	−0.092***	−0.029***	−0.011*	−0.077***
	[0.016]	[0.006]	[0.006]	[0.013]
Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004) unemployment benefits distance	0.522***	0.133***	0.068	−0.038
	[0.149]	[0.050]	[0.052]	[0.110]
p-value	0.000	0.000	0.000	0.000
R-squared	0.483	0.086	0.084	0.325
Obs.	2,162	2,162	2,162	2,162

variable driving the ASD distance result in the cross-sectional analysis. Thus, ASD distance does not have an effect that is robust to the inclusion of country fixed effects.

In Table 11, we find through panel analysis in Models 3–4 that the cross-border syndicated loan and cross-border M&A results are highly robust to the use of instrumental variables and country fixed effects and all four main policy mechanisms, namely differences in corruption levels, social safety nets, corporate transparency, and antitrust regulation (using time-varying data from IMD's World Competitiveness Online database on antitrust distance for respective years). The economic significance of predicted egalitarianism distance is reduced but still substantially persists even after including these related policy controls—likely due to differences in managers' daily business behavior. Prior to including the policy controls but with country fixed effects and instruments, a one-standard deviation in predicted egalitarianism distance is associated with an 0.274 log point decrease (where the mean is 1.794) in cross-border loan flows. This drops to a still economically meaningful 0.155 log point decrease in cross-border loan flows (where the mean is 3.002) for the subsample when all

four policy controls are included. (The policy variables are not available for all countries, and thus, the sample size is smaller and mean cross-border loan flows are larger when all four main policy mechanisms are included in the specification.) Similarly, prior to including the policy controls but with country fixed effects and instruments, a one-standard deviation in predicted egalitarianism distance is associated with an 0.296 log point decrease (where the mean is 0.834) in cross-border M&A flows. This drops to a still economically meaningful 0.186 log point decrease in cross-border M&A flows (where the mean is 1.467) when all four policy controls are included. We attribute the enduring importance of egalitarianism distance to its effect on managers' daily conduct, as illustrated in the experiments of Brett and Okumura (1998), Brett (2001), and Tinsley (2001).

We also submitted the data to robustness checks with the Heckman selection procedure, also reported in Appendix Table A4, available online. Most econometricians today consider this procedure to be invalid without the existence of a valid instrument in the first stage, and so we are cautious when running this robustness check. The problem is the absence of a valid instrument in the literature for predicting the complete absence of flows between a

Table 11
Cross-border syndicated loan and M&A flows with all possible and statistically unique policy mechanisms

This table presents the results of cross-sectional OLS regressions for the year 2000 as well as panel regressions in which cross-border syndicated loan flows and cross-border merger and acquisition flows serve as the alternative dependent variables. The key difference between this and prior models is that we further control for all four main associated policy mechanisms. We find below that the effect of egalitarianism distance persists even after controlling for these associated policy mechanisms. This suggests that egalitarianism has both a direct cultural effect and an indirect effect via associated policy mechanisms. In the cross-sectional specifications shown in Models 1–2, robust standard errors appear below the coefficients in brackets. In the panel regressions shown in Models 3–4, robust standard errors corrected for clustering at the origin-host-country pair level appear below the coefficients in brackets. When using predicted egalitarianism distance based on our instruments in Model 6 of Table 2, we utilize bootstrapped standard errors with 500 repetitions and report the adjusted R-squared. Note: Adjusted R-squared is reported when using predicted egalitarianism distance (as is done throughout the other tables when predicted egalitarianism distance is used). ***, **, and * denote significance at the 1%, 5%, and 10% level, respectively.

Variable	Model 1 DV: Cross-border syndicated loans, year 2000 cross-section	Model 2 DV: Cross-border mergers and acquisitions, year 2000 cross-section	Model 3 DV: Cross-border syndicated loans, 1995–2008 panel with origin and host country fixed effects and clustering	Model 4 DV: Cross-border mergers and acquisitions, 1995–2008 panel with origin and host country fixed effects and clustering
Log product of origin-host GDP	1.428***	0.988***	0.595***	0.747***
	[0.059]	[0.066]	[0.229]	[0.242]
Predicted egalitarianism distance	−1.667**	−2.363***	−1.452***	−1.747***
	[0.678]	[0.690]	[0.478]	[0.442]
Signed predicted egalitarianism distance	−[0.202]**	[0.249]		
Anti-self-dealing index distance	2.344***	1.864***	0.328	0.396
	[0.430]	[0.410]	[0.341]	[0.308]
Different legal family	−0.734***	−0.583***	−0.501***	−0.550***
	[0.178]	[0.182]	[0.108]	[0.106]
Common language	0.819***	1.352***	0.229	0.257
	[0.244]	[0.248]	[0.176]	[0.172]
Geographic distance	−0.891***	−0.756***	−0.870***	−0.787***
	[0.075]	[0.092]	[0.064]	[0.059]
Signed corporate tax rate distance	−0.050***	0.026***	−0.010***	0.008***
	[0.007]	[0.007]	[0.003]	[0.003]
Log product of origin-host population	−0.393***	−0.272***	−1.200***	−2.374***
	[0.056]	[0.053]	[0.515]	[0.539]
Corruption distance (using World Bank control of corruption index 1996–2002 average)	−[0.149]**	−[0.080]**	[0.021]	−[0.015]**
Bushman et al. (2004) audit distance	−0.063**	−0.090***	−0.031*	−0.041***
	[0.030]	[0.025]	[0.017]	[0.015]
Botero et al. (2004) unemployment benefits distance index	0.908***	0.101	0.008	−0.018
	[0.311]	[0.247]	[0.184]	[0.133]
IMD antitrust distance (a time-varying variable)	0.154***	0.023	−0.020**	−0.013
	[0.047]	[0.040]	[0.010]	[0.008]
Year dummies included	No	No	Yes	Yes
Country fixed effects included	No	No	Yes	Yes
p-value	0.000	0.000	0.000	0.000
Adj R-squared	0.570	0.421	0.742	0.528
Obs	992	992	13546	13546

pair of countries. We use an artificially low threshold of log product of origin-host stock market capitalization as a quasi-instrument, but we are well aware that this would not pass all the tests of a valid instrument. In all events, the egalitarianism effects are robust to this procedure.

Other robustness checks, available from the authors, revealed that egalitarianism distance effects are not affected substantively by the simultaneous inclusion of country values on the other two principal cultural dimensions identified by Schwartz—embeddedness/autonomy and harmony/mastery. The egalitarianism distance results are also highly robust to the inclusion of a measure of trust between European nations from Guiso, Sapienza, and Zingales (2009).

5. Conclusion

Cultural scholar Raymond Williams once famously argued:

Culture is one of the two or three most complicated words in the English language. This is so… mainly because it has now come to be used for important concepts in several distinct intellectual disciplines and in several distinct and incompatible systems of thought (Williams, 1983, p. 87).

That culture is such a complicated concept may be among the reasons that prior work in international

finance has treated culture essentially as a black box and cultural distance primarily as a factor that may engender information asymmetry and animosity. Drawing on advances in psychology, this study is among the first to open this black box further in order to understand international investment flows. The cultural value dimension framework enabled us to address directly the content of informal institutions and to identify a particular cultural orientation that exhibits a first-order importance for international investment. This study has shown that a key value component central to culture can be identified and measured, that we can explain the factors that influence the formation of this value component, that this component of culture influences important cross-border investment activity, and that it is of first-order importance when placed in a kind of horse race with other institutional determinants.

Specifically, in a comprehensive data set on debt and equity portfolio investment, syndicated loans, and strategic investment transactions around the world, we find a robust negative role for the distance between origin and destination countries on cultural egalitarianism. In the context of strategic investment, we present evidence based on investors' aggregate judgment as reflected in marginal q, that firms straying too far from the secure base of their home-country egalitarianism level may suffer particularly dire economic consequences.

Countries' stances on egalitarianism constitute their most fundamental informal institution concerned with issues of power and its consequences. This institutional posture is reflected in a broad array of important policy mechanisms that include imposing controls on corruption, regulating market power, curbing agency problems in firms, and mitigating harsh circumstances endured by weaker members of a society. Sources of nations' emphasis on cultural egalitarianism vary as well. Egalitarianism is negatively related to societal fractionalization and positively related to nations' historically dominant religions (Protestantism or Catholicism) and historical war experiences dating back to the 19th century.

Our study suggests several possible extensions. For instance, egalitarianism distance might help explain the home bias in portfolio holdings. Also, egalitarianism may influence cross-border trade just as it influences cross-border financial and strategic investment. On a different level of analysis, cultural egalitarianism/hierarchy may play a role in affecting individuals' economic behavior—in particular, other-regarding behavior and obedience to authority. One hopes, moreover, that this study will encourage scholars to overcome a possible latent reluctance toward dealing with informal institutions and harness the analytical framework of cultural dimensions to address the role of culture in determining a broad array of economic outcomes.

Appendix A. Supplementary tables

Supplementary appendix associated with this article can be found in the online version at doi:10.1016/j.jfineco.2011.05.010.

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