Research in International Business and Finance 31 (2014) 101–111

Contents lists available at ScienceDirect

Research in International Business and Finance

journal homepage: www.elsevier.com/locate/ribaf

Editorial

Culture, institutions, and financing choices: How and why are they related?

1. Introduction

The study of financing choices has traditionally focused on data in financial statements. However, in examining international variations in firm financing, it becomes clear that explaining these variations involves softer variables such as cultural norms, social trust, and institutional quality in addition to traditional economic factors such as financial development and wealth levels. However, traditional finance (and even international business) literature on firm financing has paid inadequate attention to these softer national characteristics (Aggarwal, 2008). This issue is designed as an attempt to fill that gap by bringing together in one place a number of contributions on culture, trust, institutions, and firm financing.

The papers in this issue all deal with the impact of culture, trust, and institutions on firm financing. These papers do not ignore traditional economic factors influencing firm financing. The distinctive nature of the papers in this issue is that they all supplement the traditional economic and financial factors influencing firm financing with softer measures reflecting culture and institutional qualities to better explain the nature of firm financing. As the readers of this issue will see, this is a significant advance and a source of fresh insights.

There are many reasons for considering softer factors such as culture and institutions in assessing firm financing. There are both good theoretical and practical reasons. In practical terms, as noted above, the consideration of such factors can provide better explanation and fresh insights. However, there are also important theoretical reasons. Fundamentally, all contracts are incomplete in practice and so they leave a great deal of room for interpretation with the implications and their interpretations depending on the softer qualities of ethics, cultural norms, and extra-legal institutions in a country.

2. Culture, trust, institutions, and transactions cost economics

2.1. Culture and transactions cost economics

According to North (1990), the costliness of information needed for measurement and enforcement of exchanges creates “transaction costs.” In fact, since Coase (1937) the transaction cost approach to the study of firms and other governance structures has become recognized as a major theory. Transaction Cost Economics (TCE) suggests that the overall costs of market exchange have a significant impact on respective financial systems (Williamson, 1975). As noted by Williamson (1988) and many

0275-5319/$ – see front matter © 2013 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.ribaf.2013.09.002

others (for instance, Aggarwal and Zhao, 2009; Aggarwal and Goodell, 2009a; Hart, 1995, 2001), the primary transactions costs of market exchanges stem from the uncertainties of contracts. Therefore it is expected that firms' choice of financing will reflect actual and perceived transactions costs of resolving asymmetric information. As noted by Aggarwal and Goodell (2009a,b), when the transaction costs are higher, market financing is favored over bank financing.

As shown by Coase (1960), in a theoretically ideal financial system it would make no difference whether financial intermediation was done privately through banks or publicly through markets. However, in reality other factors must also be considered. According to North (1990), transaction costs involve costs of defining property rights and costs of enforcing contracts—including costs of information. "Transformation costs" are the costs associated with using technology and the efficiency of factor and product markets and are reflected in transactions costs. Whether institutions lower or raise overall transactions costs has to do in part with the ability of participants to be informed and to understand the nature of the particular institutional environment. This includes not just understanding the nature of contracts and their enforceability, but also the temperament and motivations of other participants.

Hart (1995, 2001) recognize that from the point of view of the equity investor, as an example of contracting, obtaining reliable information about firms is to some degree fallible and innately costly. These costs are shared with the supplier of equity, causing equity financing to be more costly for the firm. This view is supported by Bhattacharya and Thakor (1993) who suggest that a unifying thread amongst a great number of papers on banking is that "intermediation is a response to the inability of market-mediated mechanisms to efficiently resolve informational problems."

Additionally, central to the need for resolving asymmetric information is identifying that there is a genuine pecuniary cost to not resolving uncertainties. Since Williamson (1975), opportunistic behavior of individuals has been identified as an important and fundamental component of transaction costs. Williamson (1975) suggests that under conditions of imperfect information, all transactions are affected by the problem of "self-interest seeking with guile." He later offered the alternative definition of opportunistic behavior as the "incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse." Clearly, what this means is that, given the opportunity, agents are likely to serve their own interests rather than those of the other party to the contract (see also Jensen and Meckling (1976); Fama (1980) on agency costs). Therefore, the potential for opportunistic behavior is inherently a primary cause of the need to reconcile the asymmetric information central to contracts. It is then the subsequent cost of reconciling asymmetric information that is the central cost of contracting (Hart, 1995, 2001). Absent the likelihood of opportunistic behavior there would be little consequent pecuniary need to expensive information gathering; similarly, in countries with (culturally determined) lower probabilities of opportunistic behavior, transactions cost would be lower.

Thus, given the incompleteness of all contracts and the need to constrain opportunistic behavior by contracting parties, it is useful to recognize the important role of culture, ethics, and other behavioral norms in reducing transactions costs including the need and cost of enforcing firm financing contracts. As discussed next, a similar role is played by another soft measure, social trust.

2.2. Social trust and transactions costs

Social trust has always been an important component of business and finance. For example, most business contracts are based primarily on a handshake (sometimes an important supplement to simple written documents primarily to help clarify dimming memories)—the handshake signifying trust between the parties. In colonial America certain groups like the Quakers did extremely well trading in frontier towns as they were the most trustworthy merchants in such towns.

Given the inherent complexity of contracts and the incomplete nature of all contracts, social trust clearly continues to be an important factor. We define social trust as does the *World Values Survey*: How far can you trust a stranger? We consider here specifically the possibility of national culture affecting firm financing through the conduit of social trust. Social trust is integral to establishing the transactions costs of resolving the asymmetric information inherent in financial transactions (Guiso et al., 2005).

Download English Version:

https://daneshyari.com/en/article/1003141

Download Persian Version:

https://daneshyari.com/article/1003141

Daneshyari.com