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Social capital and family control

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ABSTRACT

I empirically investigate the effect of social capital on family control in a comprehensive data set from Italy. Exploiting historically-driven variations in social capital provided by the experience of self-government during the Middle Ages, I find that when social capital is weak, family control and management of companies are more prevalent. These results provide novel evidence on the pervasive influence of culture on organizational structures.

1. Introduction

The last two decades have seen a surge of empirical research on the importance of cultural values for economic outcomes (Alesina and Giuliano, 2016). Within this literature (see e.g. Tabellini, 2010; Guiso et al., 2004, Guiso et al., 2008a, 2008b), one of the most flourishing strands of investigation has focused on the importance of *social capital*, a broad concept intimately related to generalized trust and altruistic behavior within a community.[1] Existing studies show that individuals living in areas characterized by weak social capital are significantly less willing to cooperate and trust less non-family members; rather, they rely more heavily on close ties and blood relationships (e.g. Banfield, 1958).

The intensity of social capital has major implications not only for individual behaviors but also for business organizations. For instance, it has been shown that social capital facilitates the management of large organizations (La Porta et al., 1997), promotes decentralization practices (Bloom et al., 2012) and, overall, spurs financial development (Guiso et al., 2004). By fostering participation outside close family circles and cementing generalized trust, social capital is also expected to make large owners more willing to open the shareholding structure of their companies to non-family members. I expand the existing literature by investigating the effect of historical variations in social capital on the diffusion of family involvement in ownership and executive positions.

A wealth of empirical studies has shown that family firms are remarkably present both in developed and emerging economies (see Faccio and Lang, 2002; La Porta et al., 1999). At the same time, it has been shown that family involvement in corporate positions has a major influence on firm-level efficiency (Bloom and Van Reenen, 2007) and may even impact aggregate productivity (Caselli and Gennaioli, 2013). Due to these characteristics, the determinants of family control have long been under scrutiny.

Together with traditional factors such as institutional and legal rules (e.g. Burkart et al., 2003), scholars have argued that cultural values can play a major role in the diffusion of family firms. For instance, Bertrand and Schoar (2006) suggest that countries with strong family ties display a greater presence of family firms. However, not knowing the *sources* of cultural

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[1] See Guiso et al. (2011) for a review.

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variations makes it difficult to isolate their causal effect on ownership structures. This problem is particularly relevant in cross-country analyses, given that cultural values are endogenous to several, potentially unobserved, economic and social factors which are hard to fully control for in an empirical setting.

I seek to mitigate these challenges by adopting a single-country setting, i.e. Italy, and exploiting historical variations in social capital across cities as generated by the experience of free city-states during the Middle Ages. Going back to Putnam (1993), it has been argued that free city-states spurred social capital by encouraging participation in public activities (as opposed to family-centric activities) and reducing free-riding behavior. Guiso et al. (2008b, 2016) empirically confirm this notion and further highlight a long-lasting effect of free city-states onto today's level of social capital.[2] A desirable feature of this setting is that the establishment of city-states was not homogeneous within the Center-North of the Italian territory. Thus, I can exploit the presence, even within the same region, of cities that were free city-states and cities that were not, a feature that substantially reduces concerns of omitted factor bias.

Using a comprehensive panel of Italian companies, I find that firm location in cities that were free city-states during the Middle Ages has a significant influence on corporate ownership: being headquartered in former free city-states reduces a firm's likelihood of family control by around 9 percentage points, even after taking into account the role of firm size, industry and other confounding factors. Within the sample of family firms, I further document that being headquartered in former free city-states reduces a family's exclusive representation in the board of directors by 11 percentage points, and family leadership by 7 percentage points.

Caution should be used in interpreting these results causally; indeed, it is hard to fully rule out that the cities that were and were not independent in the Middle Ages are different along a number of unobserved characteristics. While I acknowledge this empirical challenge, I conduct a few additional tests that increase the confidence in the results. For instance, I augment the baseline model with a number of historical and geographic controls at the city level, I use the Etruscan origin of the city and the presence of a bishop in the year 1000 as instruments for the probability of becoming free city-state (Guiso et al., 2008b, 2016), and I show that non-significant results emerge from assigning randomly the free city-state status to firms in a given region.

Contributing to the growing literature on the nexus between cultural values and business structures, my results add to the strenuous research on the motivations behind family control and its geographic heterogeneity, and thus also help explain the enduring variations in economic development across Italian regions, a phenomenon widely investigated but yet poorly understood.

The paper is structured as follows. Section 2 illustrates the institutional context. Section 3 provides a description of data sources and variables. Section 4 presents the main regression results and a battery of robustness checks. Section 5 offers some concluding remarks.

2. Historical background

Dating back to the seminal work of Banfield (1958), Italy has been considered as an ideal laboratory by sociologists and economists because it features significant differences in social capital despite its common legal framework and homogeneity in religion and ethnicity. Empirically, employing a single country reduces endogeneity concerns that arise from factors potentially left unobserved in a cross-country approach. I exploit geographic variations in social capital provided by unique episodes in the Italian medieval history. The idea goes back to Putnam (1993), who argued that the modern differences in economic performance across Italian regions are partly attributable to geographic heterogeneity in social capital triggered by the experience of *Communes* (local sworn associations) and later free city-states in the Center-North of Italy during the Middle Ages.

Italy has had a long history of urban traditions and culture which withstood relatively well the collapse of the Western Roman Empire (Ascheri, 2006). This urban continuity was built on a number of factors such as commercial power, local military activism but also the influence of bishops, who facilitated the coordination of political activities in the urban centers. The tenacious efforts of cities to gain greater independence, mirroring fragmentation and weakening power of the central administration, was the engine of the *communal* movement, an historical period which saw the emergence of a local élite dedicated to self-government, including the management of territories and local business affairs and, later, local taxation. Further flourishing during the XII century, the communal experience gave advent to the free city-states, a more institutionalized version of communes. One milestone in this process was the creation of the Lombard League, an alliance of cities in Northern Italy aimed at opposing the Roman Empire led by Frederick I Barbarossa in the Legnano battle of 1176.

Putnam (1993) conjectures that the constant struggle for freedom together with the experience of self-government strengthened social capital by fostering civic participation in public activities (as opposed to narrow family-centric activities) and reducing opportunistic free-riding behavior. Supporting this notion, Guiso et al. (2008b, 2016) show that the current level of voluntary associations and blood donations (common proxies for civic capital) are substantially higher in cities that were free city-states. Another important feature is that, due to e.g. differences in the strategic location and the presence of bishops, free city-states were not homogeneously distributed in the Northern and Central Italian territories.

[2] See also Guiso et al. (2011, 2008b) for a theoretical model of intergenerational transmission of social capital.