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National culture and private benefits of control☆

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ABSTRACT

Our paper examines the relationship between national culture and private benefits of control. We concentrate on the Hofstede dimensions and analyze their role for a range of instruments that directly relate to the private benefits of control. In this sense, our proxies reflect how power is distributed among shareholders indicating the potential a given shareholder has to extract private benefits. In a cross-country analysis of 36 countries, we show that power distance relates positively to the expropriation of private benefits of control, whereas individualism exhibits a negative relationship. Our results are statistically significant and robust to several alternative specifications.

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1. Introduction

Clearly, most of the investors around the world would try to increase his or her proportion in the company without compensating other investors. Therefore, it is very important to understand the benefits of private control in order to correctly estimate the value of a share for an investor. However, private benefits of control are very difficult to measure, since they are hidden most of the time. The amount of private benefits that controlling shareholders can extract from their companies varies considerably around the world (see, for example, Doidge et al., 2004). Until now, research has mostly focused on how different law systems force companies to implement certain corporate governance measures, which limits the private benefits of control (La Porta et al., 1997).

Besides legal practices, prior literature has also recognized the importance of national culture for the private benefits of control. For instance, Roe (2002) makes a strong case for the role of culture on the protection of minority shareholders. He analyzes theoretically how managers extract rents and how cultural differences are related to these mechanisms. Furthermore, Licht et al. (2005) find that anti-director rights correlate negatively with uncertainty avoidance and positively with individualism. More recently, Griffin et al. (2014) demonstrate that individualism is positively associated with transparent disclosure, whereas uncertainty avoidance is negatively associated with transparent disclosure and minority shareholder protection.

These studies have one thing in common. They all focus only on the impact of cultural values on the expropriation of minority shareholders. Yet, these papers do not analyze this connection directly, as their primary goal is actually to investigate how culture is related to the underlying legal system. Our paper complements previous research by looking at

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the direct and straightforward link between culture and private benefits of control at the firm-level and not at indirect linkages via legal practices. In this sense, our proxies reflect how power is distributed among shareholders which indicate the potential a given shareholder has to extract private benefits.

Our paper extends the previous literature in the growing area of cultural finance. In recent years, scholarship in finance has paid increasing attention to the role of culture in financial decision-making (see, for example, Eun et al., 2015; Nguyen and Truong, 2013; Rieger and Wang, 2012). This literature has recognized how the social context in which a firm operates can influence the ethical quality of corporate conduct and organizational practice (Guiso et al., 2006). Hence, analyzing national culture, which generally reflects the social norms in a country, would increase our understanding of the nature of corporate behavior considerably.

2. Theory and hypotheses

2.1. National culture

The literature highlights the importance of social norms as an important factor to curb the private benefits of control. Coffee (2001) elaborates extensively on this issue and argues that differences in jurisdictions and enforcement mechanisms cannot fit all cases to explain differences in the average private benefits of control across countries. Consistent with Fan et al. (2011), he maintains that social norms arise as most plausible alternative explanation. Norms are generally understood as informal rules how one should behave and that govern individual behavior in certain situations but are not enforced by any authoritative body (Hambrick and Brandon, 1988). We focus on national culture to study the influence of social norms on private benefits of control. Social norms are reflected in the cultural values of a country. Therefore, we utilize values defined in cultural models to empirically understand the relevance of social norms for the private benefits of control. Culture can act as both as constraining and supporting factor (Smith et al., 2002).

Cross-cultural psychologists have developed several frameworks to characterize culture and make it measureable. Our study relies on the well-established Hofstede (1984) model. Hofstede identifies four fundamental questions that all societies are confronted with, and subsequently derives corresponding cultural dimensions: individualism versus collectivism, power distance, masculinity versus femininity, and uncertainty avoidance. Our study focuses on the dimensions of individualism versus collectivism as well as power distance, which should be of principal importance for the magnitude of private benefits, as we explain below.

2.2. Hypotheses

Power distance (*PDI*) is related to strong authorities and steep hierarchies (Hofstede et al., 2010). Countries with high power distance exhibit very high status differences among different classes (Chakrabarty, 2009). When *PDI* is high, organizations tend to be centralized with power concentrated in a few hands and this creates privileges for the top actors (Li and Harrison, 2008). *PDI* also refers to the degree to which the less powerful members of organizations expect and accept that power is distributed unequally. High *PDI* societies comprehend inequality as the basis of societal order where those in power emphasize their position and accentuate authority. Low *PDI* countries perceive inequality in power as a necessary evil that should be minimized (Fidrmuc and Jacob, 2010). Hence, the cultural dimension of power distance appears particularly aligned to discuss private benefits of control, as it elaborates on the unequal distribution of power. Our reasoning suggests that, in countries with high *PDI*, blockholders are expected to have leeway allowing them to reserve private benefits of control for themselves, which leads to our first hypothesis:

Hypothesis 1: Power distance relates positively to the expropriation of private benefits of control.

On the other hand, Individualism (*IDV*) emphasizes equal opportunities among individuals, whereas collectivism emphasizes the group's interest. The norm in individualist countries is universalist, which means that what is good and right applies to everyone (Griffin et al., 2014). The norm in collectivist countries is particularlist, meaning that obligations of relationships rank highest (Trompenaars, 1993). People in *IDV* cultures hence evaluate morality in terms of concepts of equality and fairness (Colby and Kohlberg, 1987), while collectivist cultures are based on relationships and exchanging loyalty (Husted and Allen, 2008). With respect to corporate behavior, individualist values respect the interest and rights of all stakeholders, while collectivist values favor group members over outsiders. In sum, a high *IDV* level implies a higher level of competitive drive and each individual in an individualist society is going to make an effort to protect his or her rights. Hence, we predict that it is more difficult for the controlling shareholders to enjoy the private benefits of control in individualist societies, which leads to our second hypothesis:

Hypothesis 2: Individualism relates negatively to the expropriation of private benefits of control.

3. Data

3.1. Proxies for private benefits of control

We utilize straightforward proxies in our analysis to measure private benefits of control. We rely on proxies similar to those of Doidge et al. (2009) that are mainly concerned with the shareholder structure in a firm. Our variables reflect how

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