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Culture and the ownership concentration of public corporations around the world ☆

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ABSTRACT

As a country's attitude toward egalitarianism increases, which means a societal preference for the equal as opposed to hierarchical treatment of individuals, the ownership of the public corporations in the country becomes more concentrated. This finding is robust to a wide range of specifications and methodologies. Once egalitarianism is accounted for, there is no evidence that other cultural attitudes, including trust and religion, or legal protections for public market investors, including those laws that figure prominently in the literature, are related to ownership concentration. One explanation for the robust association between egalitarianism and ownership concentration is that large shareholders are valuable when employees have strong legal rights.

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1. Introduction

Over the years many have lamented the separation of ownership from management in American public corporations. The separation theme was introduced, at least to the general public, during the depths of the Great Depression by Adolf Berle and Gardiner Means in *The Modern Corporation and Private Property*.[1] Since the dawn of capitalism, Berle and Means argued, most production had taken place in organizations in which the owners were also the managers. Beginning late in the nineteenth century, however, technological innovation was causing efficient firm scale to increase to the point where no individual, family, or group of managers would have sufficient wealth to own a controlling interest in major firms. As a consequence, enterprises faced "the dissolution of the old atom of ownership into its component parts, control and beneficial ownership" (Berle and Means, 1932, p. 8). They further warned (pp. 8 and 9) that the separation of ownership and control "destroys the very foundation on which the economic order of the past

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[1] When the book was published Professor Charles Beard (1933) wrote: "In the time to come this volume may be proclaimed as the most important work bearing on American statecraft between the publication of the immortal 'Federalist' by Hamilton, Madison and Jay and the opening of the year 1933." For an overview of the enduring influence of Berle and Means, including its role in leading to the establishment of the SEC, please see the 1983 *Journal of Law and Economics* symposium celebrating the 50th anniversary of the book's publication.

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three centuries has rested" because top managers and directors "own so insignificant a fraction of the company's stock that the returns from running the corporation profitably accrue to them in only a very minor degree."

Economists eventually took up the separation theme and on the whole they shared Berle and Means's concern. Paul Samuelson (1970, pp. 90–91), for instance, wrote, "barring blatant incompetence, management can count on remaining in office." Carl Kaysen (1965) went further and concluded that the managers of public corporations were no longer concerned with creating wealth for shareholders.

The thinking of Armen Alchian (in my assessment, the premier micro-economist of the second half of the 20th Century) on the separation issue was different. The book written by Berle and Means was the textbook for Alchian's first course in graduate school in 1934. Initially, he thought that the book was correct in "that separation of ownership from control destroys the legitimacy of corporate private property rights and of the modern corporation as an acceptable means of social control." His assessment, however, was to change over time: "I was much impressed by it. I believed it. I taught if for a long time. I now believe it is completely wrong."[2]

Observing that Berle and Means and their followers' "pronouncements lack empirically refutable content, their emotional impact rivals that of a national anthem," Alchian (1969) instead posed a series of fundamental questions: What exactly do these often emotional and vague statements about the separation of ownership from management actually mean? What are the supposed negative consequences of diffuse ownership and where is the supporting evidence? If ownership is in fact diffuse and if diffuse ownership creates so many problems, why do so many public corporations flourish? In sum, Alchian (1969, p. 233) observed, "although absence of a theory does not prove that phenomena are absent, the concomitance of unspecified implications, little evidence and inadequate logic is certainly not conducive to confidence."

In the ensuing decades, the economics profession took up Alchian's challenge and produced an impressive body of empirical evidence and theory about the ownership of the modern public corporation. Although there is much that we still do not know, a few things have been established that confirm Alchian's original skepticism about the "dangers" of the separation of ownership from management. First, we now know that corporation ownership is far less diffuse than was originally believed, either because the original pronouncements were based on unreliable data or because corporate ownership has become more concentrated over time. La Porta et al. (1999) call diffuse ownership in most foreign countries a "myth," and Holderness (2009) reaches a similar conclusion about corporate ownership in the United States.[3] Second, although ownership varies both within and across countries, there is little systematic evidence that either diffuse ownership or concentrated ownership is value enhancing in some universal sense. If it were, Alchian would be the first to point out that all firms would gravitate to the value-maximizing ownership concentration. Although there is some evidence of increases in ownership concentration over time, there is no evidence of convergence on any particular ownership level. The likely explanation, advanced by Demsetz and Lehn (1985), is that the differing circumstances of individual corporations call for different value-maximizing levels of ownership concentration.

One question that remains open is why the ownership concentration of public corporations varies across countries. In many respects national boundaries are artificial. Newton's laws of physics are the same in France as in the United States. Why should economic forces be any different? Some economists, indeed, espouse a "country irrelevance proposition," but the empirical evidence to support this proposition is at the best mixed (Stulz, 2005).

There are two major considerations that do vary by country—laws and culture. Economists to date have focused exclusively on the first consideration, concluding that corporate ownership is more concentrated when legal protections for public market investors are weak.[4] Holderness (2014a,b), however, raises doubts about this conclusion. When he analyzes firm-level observations (in contrast to the existing literature which analyzes country averages exclusively); controls for firm-level determinants of ownership concentration, including size (none of which are considered in the existing literature because of the use of country averages); and uses a broad sample of firms from 32 countries, none of 16 widely accepted measures of legal protections for public market shareholders is systematically related to ownership concentration. He further explains that the two theories linking the law and ownership concentration are inconsistent with each other and inconsistent with well-known empirical regularities.

No one to date has investigated for a possible connection between culture and the ownership concentration of public corporations. This is surprising given that understanding cross-country differences in ownership concentration is of considerable interest. It is a focus of the paper that launched the hugely influential law and finance literature (La Porta et al., 1998), and it is the focus of Stulz's (2005) presidential address to the American Finance Association. Economists have also long been intrigued by the possible impact of culture on human activity. Adam Smith, for instance, attributed differences in the wealth of nations in part to religion.[5] Max Weber (1905/2002) sought to understand the wealth implications of Protestantism as opposed to Roman Catholicism, the two primary religions of his native Germany. There is now a rapidly growing body of research linking topics of traditional interest to financial economists, such as dividend policy and investment policy, to culture.[6]

In this paper I investigate whether there is a relation between key measures of a nation's culture and the ownership concentration of its public corporations. In so doing, I marry two of Armen Alchian's deepest interests—the impact of culture on human behavior and

[2] Alchian (2006, Vol. II, p. 638). ("Private Rights to Property," Lecture presented at the Southern Economic Association Convention, November 9, 1978.)

[3] In contrast, Samuelson (1970, p. 90) wrote, "studies show that in the typical giant corporation all management together—officers and directors—holds only about 3% of the outstanding common stock." Although Samuelson does not define what constitutes a "giant" corporation, Holderness (2009) reports that in 1995 directors and officers of randomly selected exchange-listed domestic corporations on average owned 24% (median 17%) of the common stock. Directors, officers, and 5% or greater blockholders on average owned 43% (median 43%) of the common stock.

[4] La Porta et al. (1998), La Porta et al. (1999, 2006, 2008), Beny (2005), Djankov et al. (2008), Li et al. (2006), Roe (2006), and Mueller and Philippon (2011).

[5] Anderson (1988).

[6] Fidrmuc and Jacob (2011) identify a relation between several cultural variables and dividends. Siegel et al. (2011) identify a relation between culture and international investment flows.

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