Culture and Law in Corporate Governance

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Abstract

Understanding the role of culture in corporate governance has become a subject of growing importance. Today, no institutional analysis of corporate governance systems would be complete without considering the cultural environment in which such systems are embedded. This chapter provides an overview of different accounts on how culture interacts with the law - especially corporate law - to shape corporate governance and on how this may help explain diversity and persistence in corporate governance. Basic concepts in cultural analysis are first presented, together with prevalent theories of cultural dimensions and of social networks as social capital. Relying on this analytical framework, this chapter reviews current research on culture's consequences for corporate governance on issues such as legal transplants, the objectives of the corporation (corporate social responsibility), relations with investors and other stakeholders by way of disclosure and dividend distribution, executive compensation, and the operation, composition, and network structure of the board of directors.

Keywords: corporate governance, culture, corporate law, social institutions, social networks, board of directors, stakeholders, earnings management, dividend payouts, executive compensation

JEL Classifications: D85, G02, G3, G34, G35, G38, K22, L2, L21, L26, Z1, Z13

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CHAPTER 6

CULTURE AND LAW IN CORPORATE GOVERNANCE

AMIR N. LICHT[1]

1 INTRODUCTION

UNDERSTANDING the role of culture in corporate governance has been a subject of growing importance since the latter concept emerged in the late 1980s and even more so since the advent of research on comparative corporate governance during the 1990s.[2] In the beginning, references to culture—when they were made—tended to be impressionistic. Even those references, however, evinced a newly found awareness of the idea that corporate governance is a complex system whose structure and functioning depend on more than law and economics. Today, no institutional analysis of corporate governance systems would be complete without considering the potential role of the cultural environment in which such systems are embedded. This sea change is largely due to the adoption of dimensional models of culture—an analytical framework developed primarily in social psychology. This chapter provides an overview of the different accounts of how culture interacts with the law (especially corporate law) to shape corporate governance and of how this may help explain diversity and persistence in corporate governance.

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[2] See Edward B. Rock, "America's Shifting Fascination with Comparative Corporate Governance", 74 Wash. U. L.Q. 367 (1996); Donald C. Clarke, "'Nothing but Wind'? The Past and Future of Comparative Corporate Governance", 59 Am. J. Comp. L. 75 (2011).

To motivate the discussion, consider the People's Republic of China. Better yet, consider China together with its Hong Kong SAR, and then Taiwan, South Korea, Japan, and Vietnam for good measure. These countries, on whose significance in today's world economy one need not elaborate, share a deepseated Confucian tradition which goes back up to twenty-five hundred years ago. With inevitable differences and to various degrees, Confucian values and beliefs—namely, culture—permeate all aspects of life in this region of the world. Notwithstanding past attempts to suppress Confucian traditions in China, Confucianism is on the rise and is taken pride in.[3] Numerous questions thus may warrant analysis. First, are Confucian values also liable to affect the working of corporate governance?[4] Does the all-important concept of *guanxi* ("relationship" is an imprecise translation) entail implications similar to those that director networks have in US and UK firms?[5] What to make of the fact that both South Korea and China have introduced US-inspired "fiduciary duties" of board

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[3] See generally, Ruiping Fan, ed., The Renaissance of Confucianism in Contemporary China (2011); Daniel A. Bell, China's New Confucianism: Politics and Everyday Life in a Changing Society (2008); Selusi Ambrogio, "Moral Education and Ideology: The Revival of Confucian Values and the Harmonious Shaping of the New Chinese Man". 5 Asian Stud. 113 (2017).

[4] For recent brief discussions with good references, see Kun L.A. Lau & Angus Young, "Why China Shall Not Completely Transit from a Relation Based to a Rule Based Governance Regime: A Chinese Perspective", 21 Corp. Governance: Int'l. Rev. 577 (2013); Lilian Miles & Say Hak Goo, "Corporate Governance in Asian Countries: Has Confucianism Anything to Offer?", 118 Bus. & Soc'y Rev. 23 (2013); Colin Hawes & Angus Young, "The Dao of CSR: Towards a Holistic Chinese Theory of Corporate Social Responsibility", 18 European J. East Asian Stud. 165 (2019).

[5] See, e.g., Chao C. Chen, Xiao-Ping Chen, & Shengsheng Huang, "Chinese *Guanxi*: An Integrative Review and New Directions for Future Research", 9 Mgmt. & Org. Rev. 167 (2013). For further discussion, see note 143 and accompanying text.

members into their corporate laws?[6] Should one expect legally mandated independent directors in these countries to resemble their American counterparts—if not immediately then after some period of adjustment?[7] In tandem, what to make of recent research that argues that in regions in China, in which Confucianism is more popular, there is lower incidence of expropriation of minority shareholders and of disclosure obfuscation?[8]

The list of questions could go on. In addressing such issues of culture, law, and corporate governance, two kinds of responses are helpful only to a degree. On the one hand, one may point out that "even Confucian managers respond to incentives," as Bernard Black has noted with regard to South Korea.[9] On the other hand, a common admonition emphasizes "the need to adapt implementation to varying legal economic and cultural circumstances," as

[6] See Rebecca Lee, "Fiduciary Duty Without Equity: 'Fiduciary Duties' of Directors Under the Revised Company Law of the PRC", 47 Va. J. Int'l. L. 897 (2007); Hwa-Jin Kim, "Living With the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea", 17 Berkeley J. Int'l. L. 61 (1999); see also Hideki Kanda & Curtis J. Milhaupt, "Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law", 51 Am. J. Comp. L. 887 (2003).

[7] See Donald C. Clarke, "The Independent Director in Chinese Corporate Governance", 31 Del. J. Corp. L. 125 (2006); Kyung-Hoon Chun, "Korea's Mandatory Independent Directors: Expected and Unexpected Roles", in Independent Directors in Asia 176 (Dan Puchniak ed., 2017); Xin Tang, "Independent Directors in China Facts and Reform Proposals", in Independent Directors in Asia 208 (Dan Puchniak ed., 2017); Sang Yop Kang, "The Independent Director System In China: Weaknesses, Dilemmas, And Potential Silver Linings", 9 Tsinghua China L. Rev. 151 (2017); Min Gong, Yanan Wang, & Xiandong Yang, "Do Independent Directors Restrain Controlling Shareholders' Tunneling? Evidence from a Natural Experiment in China", 94 Econ. Modelling 548 (2021).

[8] See, respectively, Xingqiang Du, "Does Confucianism Reduce Minority Shareholder Expropriation? Evidence from China", 132 J. Bus. Ethics 661 (2015); Wei Yu et al.. "Does Confucianism Influence Corporate Earnings Management?", 56 Res. Int'l Bus. Fin. 101390 (2021).

[9] Bernard S. Black et al., "Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness", 26 J. Corp. L. 199, 545 (2000).

the OECD does with regard to its Principles of Corporate Governance.[10] Both points are well taken, but they do not inform policy- and law-makers as to *how* to take culture into account short of ignoring it or just paying it some lip service. The OECD's statement thus repeated itself as an obligatory incantation in the 1999, 2004, and 2015 editions of the Principles and is planned to repeat verbatim in the 2023 edition, too, without any further details.[11] What is needed for a meaningful consideration of cultural factors in corporate governance analysis is a tractable framework for comparing cultures. Such an analytical framework could indicate, for instance, whether board members' affiliation with a social network of school alumni may entail similar implications for deeming them independent directors in different countries.[12] Without such a framework, cultural analysis of corporate law and governance runs the risk of being little more than mere hand waving or telling "just-so stories."[13]

2 What is Culture and How Do We Know It?

2.1 Basic Concepts

Social scientist Raymond Williams has noted that "[c]ulture is one of the two or three most complicated words in the English language."[14] A definition proposed by the pioneering scholar Geert Hofstede considers culture as "the collective level of mental programming that

[10] Organisation for Economic Co-operation and Development, G20/OECD Principles of Corporate Governance 9 (2015).

[11] Organisation for Economic Co-operation and Development, Public Consultation on Draft Revisions to the G20/OECD Principles of Corporate Governance 7 (2022).

[12] Compare Jordan Siegel, "Contingent Political Capital and International Alliances: Evidence from South Korea", 52 Admin. Sci. Q. 621 (2007); Kelly Shue, "Executive Networks and Firm Policies: Evidence from the Random Assignment of MBA Peers", 26 Rev. Fin. Stud. 1401 (2013).

[13] Amir N. Licht, "Social Norms and the Law: Why Peoples Obey the Law", 4 Rev. L. & Econ. 715 (2008); compare Rudyard Kipling, Just So Stories (1902).

[14] Raymond Williams, Keywords: A Vocabulary of Culture and Society 76 (rev. ed. 1985).

is shared with some but not all other people" or the "software of the mind."[15] Another simple yet insightful definition of culture would hold that culture defines "what goes with what." This definition reflects the fact that culture refers to implicit knowledge that people have about a wide variety of social practices, ranging from the conduct of leaders and lay people to clothing and food. Only rarely can one find reliable advice on "what goes with what" in guidebooks or in other formal sources.[16] What is "not done" ("faux pas") belongs in the unwritten and unspoken but still widely known in the society.

These definitions may suggest intuitions about what culture is, yet they do not provide an analytical framework for cross-cultural analysis of law and governance. According to a definition by the preeminent anthropologist Clifford Geertz, culture "denotes an historically transmitted pattern of meaning embodied in symbols, a system of inherited conceptions expressed in symbolic forms by means of which men communicate, perpetuate, and develop their knowledge about and attitudes toward life."[17] But what are these "symbolic forms"? Social scientists usually mention values, beliefs, and norms as the major components that constitute culture. Shalom Schwartz thus defines culture as "the latent, normative value system, external to the individual, which underlies and justifies the functioning of societal institutions."[18]

With a meaningful definition of culture at hand, the next step is to identify the ways in which culture may influence individual conduct and social structure. The literature has

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[15] See, respectively, Geert H. Hofstede, Culture's Consequences: Comparing Values, Behaviors, Institutions and Organizations Across Nations 2 (2d ed., 2001) (hereinafter "Hofstede 2001"); Geert H. Hofstede, Cultures and Organizations: Software of the Mind (3d ed. 2010) (hereinafter "Hofstede 2010").

[16] Compare top chef Thomas Keller, What Goes with What, Esquire (Feb. 28, 2013) (six tips on how to pair your food).

[17] Clifford Geertz, The Interpretation of Cultures: Selected Essays 89 (1973).

[18] Florence R. Kluckhohn & Fred L. Strodtbeck, Variations in Value Orientations (1973).

pointed out two major mechanisms: constraints and motivations. The view of culture as a source of constraints is shared by economists and psychologists. The economic approach deserves some elaboration.[19]

Culture became an issue of central interest with the advent of New Institutional Economics.[20] In a canonical definition of social institutions, Douglas North states: "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction."[21] Oliver Williamson has elaborated this notion with a model of stratified social institutions.[22] The analysis of culture and law deals with the informal institutions (culture) located at Level 1 and their relations with formal institutions (law) at Level 2 in his model. According to Williamson, "Level 1 is taken as given by most institutional economists." He further postulates that Level 1 informal institutions are

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[19] For an insightful survey, see Sjoerd Beugelsdijk & Robbert Maseland, Culture in Economics: History, Methodological Reflections, and Contemporary Applications (2011); see also Licht, *supra* note 11. In psychology, see, e.g., Michael Harris Bond & Peter B. Smith, "Cross-Cultural Social and Organizational Psychology", 47 Ann. Rev. Psychol. 205, 209 (1996) (Culture is "shared constraints that limit the behavior repertoire available to members of a certain . . . group."); see also Clifford Geertz, The Interpretation of Cultures: Selected Essays 89 (1973) (defining culture as the values, orientations, and underlying assumptions that are prevalent among the members of a society).

[20] A line of scholarship on institutional theory, infused with insights from sociology, has evolved largely in parallel, though there is some recent convergence. I abstract from it for scope limits. See Paul J. DiMaggio & Walter W. Powell, "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields", 48 Am. Soc. Rev. 147 (1983); W. Richard Scott, Institutions and Organizations (2d ed. 2001); W. Richard Scott, Institutions and Organizations: Ideas, Interests, and Identities (4th ed. 2014).

[21] Douglass C. North, Institutions, Institutional Change, and Economic Performance 3 (1990).

[22] Oliver E. Williamson, "The New Institutional Economics: Taking Stock, Looking Ahead", 38 J. Econ. Lit. 595 (2000).

"pervasively linked with complementary institutions," both formal and informal. The resulting institutions "have a lasting grip on the way a society conducts itself."[23]

In this view, the constraining effect of informal institutions is exogenous. Alternatively, informal institutions are modeled as endogenously appearing self-enforcing rules that are the equilibrium of a repeated game, in which the content of such institutions is common knowledge.[24] Social players thus interact with counterparties assumed to share the same priors (beliefs) and to be guided by a similar set of motivational goals (values). The constraining effect of culture as societal common knowledge in equilibrium stems from the shared conviction that it is in everybody's self-interest to adhere to these values and beliefs unless and until an exogenous shock upsets the equilibrium.

Level 3 in Williamson's model (governance) deals with the choice between contract and Coasian-Williamsonian governance structures – where, among other things, the boundaries of the firm are determined. This economic approach conceptualizes the firm as a subeconomy.[25] Claudine Gartenberg and Todd Zenger recently advanced an expanded theory of firms as subsocieties, in which employees grant authority to a central actor, expecting that this authority will be used in ways consistent with espoused principles of purpose and justice.[26] This theory holds great potential for integrating a large literature on corporate

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[23] Williamson, *supra* note 20, at 597.

[24] See Gérard Roland, "Understanding Institutional Change: Fast-Moving and Slow-Moving Institutions", 38 Stud. Comp. Int'l. Dev. 109 (2004); Masahiko Aoki, Towards a Comparative Institutional Analysis (2001); Avner Greif & David D. Laitin, "A Theory of Endogenous Institutional Change", 98 Am. Pol. Sci. Rev. 633 (2004).

[25] Bengt Holmstrom "The Firm as a Subeconomy", 15 J. Law Econ. Organ. 74 (1999).

[26] Claudine Gartenberg & Todd Zenger, "The Firm as a Subsociety: Purpose, Justice, and the Theory of the Firm", Org. Sc. (2022).

culture.[27] This literature is currently unclear, however, in terms of the level of analysis that is appropriate for this concept – namely, whether corporations are better conceptualized as societies writ small (“subsocieties”) or as individuals writ large, or maybe both.[28]

2.2 Cultural Value Dimensions

The thorniest challenge perhaps in introducing culture into institutional analysis stems from its complexity, which makes it difficult to derive tractable, and testable, hypotheses about its role. Cultures are rich, multi-faceted institutions with protracted histories. On the one hand, this richness enables everyone to find, in a particular culture, something to their liking and to tell a just-so story about it. On the other hand, culture’s complexity may lead an observer to avoid the details and treat culture as a “black box” but such an approach is, at bottom, similar to the former. A meaningful, rigorous analysis of informal institutions requires a methodology for operationalizing culture, i.e., identifying factors with which cultures could be represented and compared.

Cross-cultural psychology has made considerable progress toward developing an analytical framework for comparing cultures. A common postulate in cross-cultural psychology is that all societies confront similar basic issues or problems when they come to regulate human activity. The cultural responses to the basic problems that societies face are

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[27] See Gary Gorton, Jillian Grennan & Alexander K. Zentefis, “Corporate Culture”, 14 Annual Rev. Fin. Econ. (2022); Jillian Grennan & Kai Li, Corporate Culture: A Review and Directions for Future Research, working paper (2022); see also Kai Li et al. “Measuring Corporate Culture Using Machine Learning”, 34 Rev. Fin. Stud. 3265 (2021).

[28] See Lilach Sagiv, Shalom S. Schwartz, & Sharon Arieli, “Personal Values, National Culture and Organizations: Insights Applying the Schwartz Value Framework”, in The Handbook of Organizational Culture and Climate (Neal M. Ashkanasy, Celeste P.M. Wilderom, & Mark F. Peterson Eds. 2011); Sharon Arieli, Lilach Sagiv, & Sonia Roccas, “Values at Work: The Impact of Personal Values in Organisations”, 69 Applied Psych. Int’l Rev. 230 (2020).

reflected, among other things, in prevailing value emphases of individuals.[29] Because values vary in importance, it is possible to characterize societies by the relative importance attributed to these values in society using dimensional models. This yields unique cultural profiles for societies or countries.[30]

Among the dimensional models for cross-cultural analysis, by far the more important ones are the models advanced by Hofstede and by Schwartz. Hofstede's pioneering and still influential dimensional framework for characterizing cultures was first published in 1980 using data that were collected from IBM employees around the world during 1968–1973.[31] Hofstede identified four, and later five, value dimensions: individualism/collectivism, power distance, uncertainty avoidance, masculinity/femininity,[32] and long-term orientation.[33] His

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[29] See, e.g., Milton Rokeach, The Nature of Human Values (1973); Kluckhohn & Strodtbeck, *supra* note 16.

[30] I use "cultural" and "societal" interchangeably because the present focus is on national societies. However, it is possible to implement the value dimension framework to study sub-national groups. See Heather M. Coon & Markus Kemmelmeier, "Cultural Orientations in the United States: (Re-)examining Differences Among Ethnic Groups", 32 J. Cross-Cultural Psychol. 348 (2001); Michael Minkov, Cross-Cultural Analysis: The Science and Art of Comparing the World's Modern Societies and Their Cultures (2012); compare Andriy Boytsun, Marc Deloof, & Paul Matthyssens, "Social Norms, Social Cohesion, and Corporate Governance", 19 Corp. Governance: Int'l. Rev. 41 (2011).

[31] Geert H. Hofstede, Culture's Consequences: International Differences in Work-Related Values (1980); Hofstede 2001, *supra* note 13.

[32] This label has elicited negative responses. Writing originally in 1980, Hofstede nonetheless kept this term, arguing that it reflects a positive reality that is independent of its normative implications. Hofstede 1980, *supra* note 25, at 189–90. In the 2001 edition, Hofstede follows the modern distinction between sex and gender and uses the latter term when referring to social function. Hofstede 2001, *supra* note 13, at 280; see also Geert H. Hofstede & Willem A. Arrindell, Masculinity and Femininity: The Taboo Dimension of National Cultures (1998).

framework has been used in hundreds of studies; it is widely used in studies on management and accounting and, in recent years, it has gained traction in economics. Table 6.1 provides definitions of the cultural value dimensions distinguished by Hofstede.

Schwartz developed a cultural-level theory during the 1990s and validated it in survey data that covered some 67 nations.[34] Schwartz derives three bipolar cultural value dimensions from three basic issues he identifies as confronting all societies: embeddedness/autonomy, hierarchy/egalitarianism, and mastery/harmony. In coping with these issues, societies exhibit greater or lesser emphasis on the values at one or the other pole of each dimension. Seven value orientations on which cultures can be compared derive from the analysis of the bipolar dimensions (due to a distinction between intellectual autonomy and affective autonomy). The theory also specifies the structure of relations among these types of values. Table 6.2 provides definitions of the cultural value dimensions distinguished by Schwartz. Figure 6.1 presents graphically the relations among the value dimensions and orientations as well as values that are prominent in each orientation.

Table 6.1

The Hofstede Cultural Value Dimensions

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[33] Hofstede added this dimension in 1991 in the first edition of Hofstede 2010, *supra* note 13, in light of a study led by Michael Bond. There, it was named "Confucian work dynamism." See Chinese Cultural Connection, "Chinese Values and the Search for Culture-Free Dimensions of Culture", 18 J. Cross-Cultural Psychol. 143 (1987). Drawing on Michele Gelfand's work, Hofstede, together with Gert Jan Hofstede and Michael Minkov, in Hofstede 2010, *supra* note 13, also derived synthetically a sixth dimension dubbed indulgence/restraint, which respectively emphasizes pleasure vs. duty in life. See below note 37.

[34] See Shalom H. Schwartz, "Cultural Value Differences: Some Implications for Work", 48 Appl'd Psychol. Int'l. Rev. 23 (1999); Shalom H. Schwartz, "A Theory of Cultural Value Orientations: Explication and Applications", 5 Comp. Soc. 137 (2006) (hereinafter "Schwartz 2006"); Shalom H. Schwartz, Culture Matters: National Value Cultures, Sources and Consequences, in Understanding Culture: Theory, Research and Application 157 (Chi-Yue Chiu et al. eds., 2009).

Individualism/Collectivism	Valuing loosely knit social relations in which individuals are expected to care only for themselves and their immediate families versus tightly knit relations in which they can expect their wider in-group (e.g., extended family, clan) to look after them in exchange for unquestioning loyalty
Power Distance	Accepting an unequal distribution of power in institutions as legitimate or illegitimate
Uncertainty Avoidance	Feeling uncomfortable or comfortable with uncertainty and ambiguity and therefore valuing or devaluing beliefs and institutions that provide certainty and conformity
Masculinity/Femininity	Valuing achievement, heroism, assertiveness, and material success versus relationships, modesty, caring for the weak, and interpersonal harmony
Long-Term Orientation	Having a long-term time orientation; emphasizing traits of Confucian work ethic, such as thrift and persistence

Both the Hofstede and Schwartz models retain their usefulness notwithstanding a generation gap between them. The dimensions of each model bear some conceptual similarity and empirical convergence yet they do not fully overlap. Individualism might exhibit significant relations in a particular study while autonomy would not, whereas in another study egalitarianism may feature highly while power distance would not.[35] Each dimension thus likely captures a somewhat different social institutional feature. Between the two models, Schwartz's model is currently considered more 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

[35] See, e.g., Yuriy Gorodnichenko & Gerard Roland, "Which Dimensions of Culture Matter for Long Run Growth?", 101 Am. Econ. Rev. 492 (2011); Mariko J. Klasing, "Cultural Dimensions, Collective Values and their Importance for Institutions", 41 J. Comp. Econ. 447 (2013); Jordan I. Siegel, Amir N. Licht, & Shalom H. Schwartz, "Egalitarianism and International Investment", 102 J. Fin. Econ. 621 (2011).

cross-culturally equivalent meanings at the individual level to operationalize the cultural dimensions. Finally, validating data for this model were collected more recently.[36] In addition to the Hofstede and Schwartz frameworks, a handful of other dimensional models and datasets that share a similar impetus also allow for cross-cultural analysis. Because they are less frequently used and suffer from various limitations that cannot be discussed in the present scope, I abstract from them here.[37]

Table 6.2

The Schwartz Cultural Value Dimensions

Embeddedness/Autonomy	This dimension concerns the desirable relationship between the individual and the group. Embeddedness represents a cultural emphasis on maintenance of the status quo, propriety, and restraint of actions or inclinations that might disrupt the solidary group or the traditional order. The opposite pole describes cultures in which the person is viewed as an autonomous, bounded entity who finds meaning in his or her

[36] See Peter B. Smith, Michael Harris Bond, & Cigdem Kagitcibasi, Understanding Social Psychology across Cultures: Living and Working in a Changing World (2006); Beugelsdijk & Maseland, *supra* note 17. Hofstede's framework has met a series of criticisms. For a review and responses to these criticisms, see Hofstede 2001, *supra* note 13.

[37] See, in particular, Ronald Inglehart & Wayne E. Baker, "Modernization, Cultural Change, and the Persistence of Traditional Values", 65 Am. Soc. Rev. 19, 24 tbl. 1 (2000); for details and data, see World Values Survey, available at http://www.worldvaluessurvey.org (last visited Feb. 13, 2014). For a comparative discussion, see Schwartz 2006, *supra* note 28; see also Global Leadership & Organizational Behavior Effectiveness (GLOBE), Project, Culture, Leadership, and Organizations: The GLOBE Study of 62 Societies (Robert J. House et al. eds., 2004); Charles M. Hampden-Turner & Fons Trompenaars, Building Cross-Cultural Competence: How to Create Wealth from Conflicting Values (2000); Michael Harris Bond et al., "Culture-Level Dimensions of Social Axioms and Their Correlates Across 41 Cultures", 35 J. Cross-Cultural Psychol. 548 (2004); Michele J. Gelfrand, Lisa H. Nishii, & Jana L. Rayer, "On the Nature and Importance of Cultural Tightness-Looseness", 91 J. Applied Psychol. 1225 (2006); Michele J. Gelfrand, et al., "Differences between Tight and Loose Cultures: A 33-Nation Study", 332 Sci. 1100 (2011).

	own uniqueness.
Hierarchy/Egalitarianism	This dimension refers to guaranteeing responsible behavior that will preserve the social fabric. Hierarchy represents a cultural emphasis on obeying role obligations within a legitimately unequal distribution of power, roles, and resources. Egalitarianism represents an emphasis on transcendence of selfish interests in favor of voluntary commitment to promoting the welfare of others.
Mastery/Harmony	This dimension refers to the relation of humankind to the natural and social world. Mastery stands for a cultural emphasis on getting ahead through active self-assertion whereas Harmony represents an emphasis on fitting harmoniously into the environment.

2.2.1 Social Capital

A different vantage point for considering culture and corporate governance draws on social capital theory. While there is no agreed upon definition of social capital, much of the discourse about it is dominated by the views of James Coleman and Robert Putnam.[38] Social capital consists of shared values, beliefs, and norms—hence their conceptual proximity to culture. The most prominent norm in the literature is a norm of generalized trust, defined as the shared belief that most others are trustworthy and therefore have benign intentions or, more technically, the probability that two randomly chosen people will trust each other in a one-time interaction. According to Coleman, a group within which there is extensive trustworthiness and extensive trust is able to accomplish much more than a comparable group that lacks them. A social norm of generalized trust entails wide-ranging implications,

[38] James S. Coleman, "Social Capital in the Creation of Human Capital", 94 Am. J. Soc. S95 (1988); Robert D. Putnam, Making Democracy Work: Civic Traditions in Modern Italy (1993); Robert D. Putnam, Bowling Alone: The Collapse and Revival of American Community (2000); see also Pierre Bourdieu, The Forms of Capital, in The Handbook of Theory: Research for the Sociology of Education 241 (John G. Richardson ed., 1986). For a historical survey, see James Farr, "Social Capital: A Conceptual History", 32 Pol. Theory 6 (2004).

including implications for corporate governance, as this norm implies lesser concern with, and perhaps lesser incidence of, opportunistic behavior in firms. This, in turn, may be conducive to economic growth and other beneficial effects.[39]

FIGURE 6.1

The Schwartz Model of Relations among Cultural Orientations.

Operationalizing and measuring generalized trust—especially with the "generally speaking question" in Inglehart's World Values Survey and in similar surveys in Europe and the United States—is not free of issues, however.[40] Indeed, the very notion of trust is currently debated and is anything but stable even as a concept.[41] Nevertheless, social capital theory goes beyond theories of cultural value dimensions in pointing out the centrality of social networks, in which social relationships and interactions are embedded.[42] Ties in social networks function as information channels for observing, monitoring, advising, and consulting with others, etc.

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[39] See Stephen Knack & Philip Keefer, "Does Social Capital Have an Economic Payoff? A Cross-Country Investigation", 112 Q. J. Econ. 1251 (1997); Paul J. Zak & Stephen Knack, "Trust and Growth", 111 Econ. J. 295 (2001); Roman Horváth, "Does Trust Promote Growth?", 41 J. Comp. Econ. 777 (2013); Christian Bjørnskov, "Social Trust and Economic Growth", in Oxford Handbook of Social and Political Trust 536 (Eric M. Uslaner, ed. 2017).

[40] Specifically, the question is: "Generally speaking, would you say that most people can be trusted, or that you cannot be too careful in dealing with people?"

[41] See Ken Newton & Sonja Zmerli, "Three Forms of Trust and their Association", 3 Eur. Pol. Sci. Rev. 169 (2011); Eric M. Uslaner, "The Study of Trust", in Oxford Handbook of Social and Political Trust 3 (Eric M. Uslaner, ed. 2017).

[42] See Mark Granovetter, "Economic Action and Social Structure: The Problem of Embeddedness", 91 Am. J. Soc. 481 (1985); Mark Granovetter, "The Impact of Social Structure on Economic Outcomes", 19 J. Econ. Persp. 33 (2005).

These observations point to various structural features of social networks as factors that may affect their functioning, including in corporate governance. For example, a network's density, defined as the number of ties between actors in a network, may positively affect the flow of information. Dense networks thus may discourage opportunistic behavior within the network because defection is more likely to be observed due to lower information asymmetry. A separate line of social network scholarship initiated by Ronald Burt emphasizes a structural feature dubbed "structural holes." A structural hole denotes weaker connections between groups that impede the flow of information between them, while providing those who can bridge a hole with opportunities to derive private benefits from such brokerage.[43]

2.2.2 Causality

Culture used to have a bad name among economists. It was not particularly popular among lawyers either. One reason probably was that culture is very difficult to observe. One may therefore fear that people would resort to cultural explanations when they run out of good ones, as the former would be impossible to disprove—what was referred to above as "just-so stories." This problem can be addressed by using data on cultural dimensions that derive from rigorous operationalization methodologies. Integrating cultural factors into institutional analyses faces another challenge, however—of showing causality. Because culture comprises values and beliefs and these factors are usually assessed using survey data, one might fear

[43] See Amir Barnea, Cesare Fracassi, & Ilan Guedj, "Director Networks", Working Paper (2013); Ronald S. Burt, Martin Kilduff, & Stefano Tasselli, "Social Network Analysis: Foundations and Frontiers on Advantage", 64 Ann. Rev. Psychol. 527 (2013); Thomas C. Omer, Marjorie K. Shelley, & Frances M. Tice, "Do Director Networks Matter for Financial Reporting Quality? Evidence from Audit Committee Connectedness and Restatements", 66 Mgmt. Sc. 3361 (2020); Siyuan Li, Tianshu, Charlotte Qu, & Yingri Julia Yu, "Outside Director Social Network Centrality and Turnover before Stock Performance Crash: A Friend in Need?", 76 J. Corp. Fin. 102280 (2022).

that cultural observations might be either merely epiphenomenal—namely, reflections of more fundamental factors—or endogenous with other institutional factors or policy outcomes. These concerns are well taken.

To argue that "culture matters" one therefore needs to go beyond showing significant correlations to adducing evidence for causal effects of culture. Using panel data that include observations over time may not be informative because, barring major shocks, cultures evolve over very long timespans, ranging from decades to millennia. To assess the causal role of culture on institutions and policy outcomes, scholars thus have relied on a different approach that employs instrumental variables, some of them quite imaginative. Briefly, a good instrument should relate to culture in a meaningful way and relate to the dependent factor only through its relation to culture.[44] Luigi Guiso, Paula Sapienza, and Luigi Zingales used historical data on wars and genetic data to gauge the impact of trust on economic exchange.[45] In a joint study with Chanan Goldschmidt and Shalom Schwartz, we introduced linguistic variables on grammar of the dominant language to establish an effect of embeddedness/autonomy on the rule of law, corruption, and democratic accountability in nations.[46] Another joint study, with Jordan Siegel and Shalom Schwartz, used past war experience, religion, and societal fractionalization to assess the role of egalitarianism on international investment.[47] Recent studies exploit data on the natural environment such as parasite and pathogen prevalence and on rainfall as instruments for individualism.[48]

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[44] See Robert Nash & Ajay Patel, "Instrumental Variables Analysis and the Role of National Culture in Corporate Finance", 48 Fin. Mgmt 385 (2019).

[45] Luigi Guiso, Paola Sapienza, & Luigi Zingales, "Does Culture Affect Economic Outcomes?", 20 J. Econ. Persp. 23 (2006).

[46] Amir N. Licht, Chanan Goldschmidt, & Shalom H. Schwartz, "Culture Rules: The Foundations of the Rule of Law and Other Norms of Governance", 35 J. Comp. Econ. 659 (2007).

[47] Siegel et al., *supra* note 29.

During the last few years, there has been a remarkable change of heart among economists and other social scientists, as a growing number of them have come to acknowledge that culture exhibits substantial persistence over generations and that it causally affects policy outcomes.[49] For example, Samuel Bazzi, Martin Fiszbein, and Mesay Gebresilasse show how the westward shift of the frontier in the United States created a culture of "rugged individualism," which affects political attitudes to this day.[50] The COVID-19 pandemic that swept the globe in 2020 ampliphied this observation. These authors and others thus associated the frontier culture with less social distancing and mask use as well as weaker local government effort to control the virus, and, more broadly, with weak collective response to public health risks, including a lack of civic duty, partisanship, and distrust in

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48 See Robbert Maseland, "Parasitical Cultures? The Cultural Origins of Institutions and Development", 18 J. Econ. Growth 109 (2013); Lewis Davis, "Individual Responsibility and Economic Development: Evidence from Rainfall Data", 69 Kyklos Int'l. Rev. Soc. Sci. 426 (2016); Yuriy Gorodnichenko & Gérard Roland, "Culture, Institutions and Democratization", 187 Public Choice 165 (2021).

49 See Paola Giuliano & Nathan Nunn, "Understanding Cultural Persistence and Change", 88 Rev. Econ. Stud. 1541 (2021); see also Alexandra Cirone & Thomas B. Pepinsky, "Historical Persistence", 25 Ann. Rev. Pol. Sc. 241 (2022); Hans-Joachim Voth, "Persistence – Myth and Mystery", in The Handbook of Historical Economics 243 (Alberto Bisin and Giovanni Federico. Eds. 2021); Luigi Guiso, Paola Sapienza, & Luigi Zingales, "Long Term Persistence", 14 J. Eur. Econ. Ass'n 1401 (2016). Note, however, that there is no claim that culture is immutable or uniquely determinative. See Kyriaki I. Kafka & Pantelis C. Kostis, "Post-Materialism and Economic Growth: Cultural Backlash, 1981–2019", 49 J. Comp. Econ. 901 (2021); Jacob A. Jordaan, Bogdan Dima, & Ionuț Goleț, "Do Societal Values Influence Financial Development? New Evidence on the Effects of Post Materialism and Institutions on Stock Markets", 132 J. Econ. Behav. & Org. 17 (2016).

50 Samuel Bazzi, Martin Fiszbein, & Mesay Gebresilasse, "Frontier Culture: the Roots and Persistence of "Rugged Individualism" in the United States", 88 Econometrica 2329 (2020); see also Martin Fiszbein, Yeonha Jung, & Dietrich Vollrath, Agrarian Origins of Individualism and Collectivism, NBER Working Paper No. 29643 (2022).

science.[51] Furthermore, studies in the United States, Italy, and Germany have associated lower levels of individualism and higher level of civic capital with a more sustained level of social distancing, a higher tendency to use protective face masks, and other prosocial behaviors that would have affected mortality rates.[52] Using more rigorous measures of individualism and collectivism and power distance from cross-cultural psychology, studies in global samples of multiple countries report consistent findings.[53]

3 CULTURE'S CONSEQUENCES FOR CORPORATE GOVERNANCE

3.1 Relevance

So culture matters. But (how) does it matter for corporate governance? (How) does it interact with corporate laws to affect corporate governance? According to Beugelsdijk and Maseland, "many scholars struggle with the concept of culture. It is unclear whether legal origin is seen as culture (it is, just like culture, an exogenous factor) or whether there is a relationship between legal origin and culture."[54]

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[51] Samuel Bazzi, Martin Fiszbein, & Mesay Gebresilasse, "Rugged Individualism and Collective (In)action during the COVID-19 Pandemic", 195 J. Pub. Econ. 104357 (2021); Bo Bian *et al.*, "Individualism during Crises", 104 Rev. Econ. Stats. 368 (2022).

[52] Chinchih Chen, Carl Benedikt Frey, & Giorgio Presidente, "Culture and Contagion: Individualism and Compliance with COVID-19 Policy", 190 J. Econ. Behav. Organ. 190 (2021); John M. Barrios et al., "Civic Capital and Social Distancing during the Covid-19 Pandemic", 193 J. Pub. Econ. 104310 (2021); Ruben Durante, Luigi Guiso, & Giorgio Gulino, "Asocial Capital: Civic Culture and Social Distancing During COVID-19", 194 J. Pub. Econ. 104342 (2021); see also Shinobu Kitayama, Nicholas P. Camp, & Cristina E. Salvador "Culture and the COVID-19 Pandemic: Multiple Mechanisms and Policy Implications", 16 Soc'l Issues Pol'y Rev. 164 (2022).

[53] See, e.g. Rajiv Kumar, "Impact of Societal Culture on Covid-19 Morbidity and Mortality across Countries", 52 J. Cross-Cultural Psychol. 643 (2021). Kumar cites numerous additional studies that found similar results.

[54] Beugelsdijk & Maseland, *supra* note 17, at 254.

The key insight here is that culture as an informal institution can address the very issues that governance, including corporate governance, calls for regulating. Defined as the institutional framework that regulates the division and exercise of power in the corporation,[55] corporate governance addresses the multiple relations among corporate stakeholders, including shareholders, managers, employees, creditors, and others. While a good deal of these relations is governed by formal institution and contracts (namely, Levels 2 and 3 in Williamson's model), much of it—possibly the lion's share—is not. This is because formal rules and contracts are hopelessly finite and/or vague at the margins due to information asymmetries and transaction costs. Where laws and contacts cease to provide clear guidance—as they must at some point—there is room for exercising discretionary power and a concomitant need for regulating such exercise to mitigate the risk of abusing such power opportunistically. This is where informal institutions exert their influence in guiding all parties as to the accepted and expected modes of exercising power. This is the realm of culture (Level 1 in Williamson's model).

Formal social institutions and formal private arrangements thus must rely on shared understandings among societal members about persons and property, about interpersonal relations, or about the dynamics of life. I have argued that in a corporate governance setting, cultural orientations regarding these issues would bear on a broad set of questions, including

[55] Amir N. Licht, Corporate Governance, in Handbook of Financial Globalization 369, 369 (Gerard Caprio ed., 2013). For similarly spirited definitions, see Jean Tirole, "Corporate Governance", 69 Econometrica 1, 4 (2001) ("[I] define corporate governance as the design of institutions that induce or force management to internalize the welfare of stakeholders."); Luigi Zingales, Corporate Governance, in The New Palgrave Dictionary of Economics (Steven N. Durlauf & Lawrence E. Blume eds., online 2d ed. 2008) ("I define corporate governance as the complex set of constraints that shape the ex post bargaining over the quasi-rents generated by a firm."); Aguilera & Jackson, *supra* note 43 ("Corporate governance may be defined broadly as the study of power and influence over decision making within the corporation.").

modes of corporate finance, primary approaches to stakeholders, shareholding structures, self-dealing, executive compensation, disclosure, and so forth.[56] The cultural value dimension framework allows for opening the "black box" of culture and forming testable hypotheses about which cultural orientation may be related to a particular corporate governance issue in light of the content meaning of that issue.[57] Moreover, with an appropriate methodology, causal claims about culture's consequences for corporate governance can be made and tested.

To get a flavor of how culture might impact corporate governance, consider CEO succession—one of the most significant challenges faced by every company, its board, and its shareholders. Early references to culture in this regard tended to be highly impressionistic.[58] Granted, the culture of some countries may engender rather idiosyncratic practices for ensuring the quality of controlling persons. For instance, Vikas Mehrotra et al. report that, in Japan, controlling families may adopt a brilliant executive with an average pedigree with a view to handing him (it's him all right) the family firm.[59] This is a fascinating example that

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[56] For a detailed theory, see Amir N. Licht, "The Mother of all Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems", 26 Del. J. Corp. L. 147 (2001); for discussion and review, see Ruth V. Aguilera & Gregory Jackson, "Comparative and International Corporate Governance", 4 Acad. Mgmt. Annals 485 (2010).

[57] Licht, *supra* note 43.

[58] See, e.g., Lucian Arye Bebchuk & Mark J. Roe, "A Theory of Path Dependence in Corporate Governance and Ownership", 52 Stan. L. Rev. 127, 169 (1999) ("American culture, for example, resists hierarchy and centralized authority more than, say, French culture. German citizens are proud of their national codetermination. Italian family firm owners may get special utility from a longstanding family-controlled business, while an American family might prefer to cash the company earlier and run the family scion for the U.S. Senate.").

[59] See Vikas Mehrotra et al., "Adoptive Expectations: Rising Sons in Japanese Family Firms", 108 J. Fin. Econ. 840 (2013).

powerfully drives home the point that culture matters for corporate governance, but it is hard to generalize from it a lesson for other countries. Drawing on Hofstede's dimensions, these authors propose in a separate study that the spread of marriage for love helps undermine the family firm as a dominant business institution in many countries by depriving those firms of suitable heirs. This tendency is linked to cultural emphases on power distance, collectivism, and uncertainty avoidance.[60] These authors further find that family firm dominance in the economy interacted with arranged marriage norms also correlates with lower economic development, suggesting that cultural inertia may impede convergence to more efficient economic organization. More systematically yet, Joseph Fan, Qiankun Gu, and Xin Yu find robust relations between differing collectivist cultures within China and the emergence of family firm organizations, consistent with the idea that cultures and norms are fundamental forces shaping the governance structures of firms and contractual relationships in general.[61]

At the most general level of analysis of the structure of economic systems—sometimes referred to as "varieties of capitalism"[62]—culture has been linked to large-scale variation in such structures. Using the Schwartz dimensions, Frederic Pryor has shown that certain combinations of cultural orientations match the particular economic systems of OECD

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[60] See Vikas Mehrotra et al., "Must Love Kill the Family Firm? Some Exploratory Evidence", 35 Entrepreneurship Theory & Prac. 1121 (2011).

[61] Joseph P. H. Fan, Qiankun Gu, & Xin Yu, "Collectivist Cultures and the Emergence of Family Firms", 65 J. L. Econ. S293 (2022).

[62] See Varieties of Capitalism: The Institutional Foundations of Comparative Advantage (Peter A. Hall & David Soskice eds., 2001); see also Curtis J. Milhaupt & Katharina Pistor, Law & Capitalism (2008); Stav Fainshmidt, et al., "Varieties of Institutional Systems: A Contextual Taxonomy of Understudied Countries", 53 J. World Bus. 307 (2018).

countries and in fact exert a causal effect on these systems.[63] Wolfgang Breuer and Astrid Salzmann observe that stronger cultural emphases on embeddedness, egalitarianism, and harmony in the Schwartz model correlate with bank-based corporate governance systems, whereas opposite cultural emphases correlate with market-based systems.[64] Their results are robust to legal origin, which has separately been linked to varieties of capitalism.[65] Chuck Kwok and Solomon Tadesse have related the prevalence of bank-based versus market-based corporate governance systems to cultural emphases on Hofstede's uncertainty avoidance.[66]

3.2 General Relations between Law and Culture

The following sections review the relations between cultural orientations and particular subjects of corporate governance. Prior to that, this section discusses the general relations between culture and law, especially corporate law. As Williamson's model of social institutions explicates, in a standard setting, culture and law may interact. Culture sets informal constraints and provides motivations for developing the law in a culturally compatible fashion. In tandem, societal patterns of compliance with, or deviance from, culturally compatible laws inculcate in societal members the value emphases that these laws reflect.

On a deeper level than formal legal rules there lies the institution of legality—the rule of law or, more roughly, property rights, quality of institutions, or simply institutions. A

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[63] See Frederic L. Pryor, "Culture Rules: A Note on Economic Systems and Values", 36 J. Comp. Econ. 510 (2008).

[64] Wolfgang Breuer & Astrid Salzmann, National Culture and Corporate Governance, in Corporate Governance: Recent Developments and New Trends 369 (Sabri Boubaker et al. eds., 2012).

[65] See, e.g., Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, "The Economic Consequences of Legal Origins", 46 J. Econ. Lit. 285 (2008).

[66] Chuck C. Y. Kwok & Solomon Tadesse, "National Culture and Financial Systems", 37 J. Int'l. Bus. Stud. 227 (2006).

social norm of legality functions as an interface between the informal and formal institutional level. For any law, including corporate law, to operate as designed there must exist a widely shared social norm of law abidingness and law enforcement. Such a norm of legality means that the legal entitlements of societal members are respected—namely, their personal safety, tangible and intangible property (e.g., shares and other cash-flow rights in firms), and other legal interests (e.g., voting rights). Every legal system by definition calls on people to obey the law, yet countries vary greatly in the degree to which laws are followed. A social norm of legality can ensure that formal laws are followed by drawing its injunctive force from its compatibility with certain cultural values—in particular, values that underscore the legitimacy of personal interests and the moral equality of individuals.[67]

A study with Goldschmidt and Schwartz confirms that cultural emphases primarily on Schwartz's autonomy and on Hofstede's individualism cause countries to have higher levels of legality and lower levels of corruption (which are related).[68] A follow-up study with Amnon Lehavi extends this finding to greater protection of both tangible property and intellectual property in countries.[69] Claudia Williamson and Carrie Kerekes show that when both formal and informal institutional components are included in the analysis, the impact of formal constraints in explaining the security of property is greatly diminished, while informal constraints are highly significant.[70] Nikolaos Papageorgiadis and colleagues find that informal institutions connected to the enforcement of intellectual property in a country

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[67] See Licht, *supra* note 11.

[68] See Licht, Goldschmidt, & Schwartz, *supra* note 39.

[69] See Amnon Lehavi & Amir N. Licht, "BITs and Pieces of Property", 36 Yale J. Int'l. L. 115 (2011).

[70] See Claudia R. Williamson & Carrie B. Kerekes, "Securing Private Property: Formal versus Informal Institutions", 54 J. L. & Econ. 537 (2011). These authors use measures for culture from the World Values Survey, Schwartz, and Hofstede. See also Meina Cai et al., "Individualism and Governance of the Commons", 184 Public Choice 175 (2020).

directly affect outcomes and enhance the effect of formal legal aspects of IP law on FDI flows.[71]

Exogenous shocks may take place at either or both levels of institutions. For example, a major war or conquest experience can affect cultural orientations. Such is the case, for example, with regard to a heritage of state-formation wars during the nineteenth century that promoted an ethos of equality of sacrifice, which today associates positively with egalitarianism.[72] This is also the case with regard to a communist-rule experience, which is negatively linked to egalitarianism.[73] The level of egalitarianism in a country in turn may affect, among other things, legally mandated board representation of non-shareholder constituencies such as employees and more gender-balanced boards as well as other features that are conceptually compatible with egalitarianism. At the formal institutional level, the most well-known exogenous shock in the social institutions and corporate governance literature is British rule, either colonial or in other modes, which nearly invariably entailed the transplantation of a common law legal system; other colonial powers tended to implement

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[71] Nikolaos Papageorgiadis *et al*. "The Characteristics of Intellectual Property Rights Regimes: How Formal and Informal Institutions Affect Outward FDI Location", 29 Int'l Bus. Rev. 101620 (2020).

[72] Siegel et al., *supra* note 29.

[73] See Shalom H. Schwartz, Anat Bardi, & Gabriel Bianchi, Value Adaptation to the Imposition and Collapse of Communist Regimes in East-Central Europe, in Political Psychology: Cultural and Cross-Cultural Foundations 217 (Stanley A Renshon & John Duckitt eds., 2000); Jordan I. Siegel, Amir N. Licht, & Shalom H. Schwartz, "Egalitarianism, Cultural Distance, and Foreign Direct Investment: A New Approach", 24 Org. Sci. 1174 (2013); compare Sascha O. Becker et al. "The Empire is Dead, Long Live the Empire! Long-Run Persistence of Trust and Corruption in the Bureaucracy", 126 Econ. J. 40 (2016).

a similar transplantation approach with regard to their home legal system. This heritage has affected a massive set of legal rules, including those on investor rights.[74]

In an exploratory study with Goldschmidt and Schwartz, we observe that countries' affiliation with a common-law origin is associated with lower uncertainty avoidance in Hofstede's model, and with lower harmony (and higher mastery) in Schwartz's model. Moreover, the scores of legal rules of investor protection constructed by La Porta, Lopez-de-Silanes, Shleifer, and Vishny (LLSV) correlate negatively with these cultural orientations, whereas LLSV's scores of formalism in the court system correlate positively with these orientations.[75] These results are consistent with the view that a history of British rule has left an impact on both the culture and on the general "legal style," with the result that these nations are more receptive to uncertain and open-ended, even entrepreneurial, mechanisms. Another set of analyses shows that classifications of countries according to legal origin and cultural region correlate with one another, in line with Williamson's theory.

In a joint study with Siegel and Schwartz, we document positive correlations between egalitarianism and a set of legal rules that support the weak in the society, especially employees, the sick, and the elderly, thus reflecting a societal stance against abuse of power.[76] Hao Liang and Luc Renneboog show that an index of country-level regulatory framework in relation to sustainability correlates robustly with countries' legal origin and also with their scores on some of Hofstede's dimensions.[77] This finding is especially

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[74] This literature is too broad to cite here. For a survey see, La Porta et al., *supra* note 51; see also in this volume, chapters 6, 11, and 12.

[75] See Amir N. Licht, Chanan Goldschmidt, & Shalom H. Schwartz, "Culture, Law, and Corporate Governance", 25 Int'l. Rev. L. & Econ. 229 (2005).

[76] Siegel et al., *supra* note 29.

[77] See Hao Liang & Luc Renneboog, "On the Foundations of Corporate Social Responsibility", 72 J. Fin. 853 (2017).

noteworthy, since sustainability and environmental protection more generally are compatible with cultural harmony in Schwartz's model – an orientation that Western European countries tend to emphasize. These findings together indicate that neither legal nor cultural classifications, when considered in isolation, may sufficiently account for variations in countries' legal regimes of corporate governance. Both levels of social institutions should be taken into consideration.[78]

3.2.1 A Note on Legal Transplants

The idea that formal laws and the functioning of the entire legal system may depend on cultural values in turn implicates the transplantation of legal rules—possibly the most prominent means for policy reform, especially in corporate governance. Legal transplantation is explored in detail in other chapters of this volume. Here, it will suffice to make a brief note on the role of culture.

Legal transplantation may occur through different channels. Transplantation may occur involuntarily, as already noted, consequent to colonial occupation. Japan thus received a version of the Illinois business corporation law because the legal team at the headquarters of General Douglas MacArthur, the Supreme Commander of the Allied Powers after World War II, comprised of lawyers from Chicago.[79] Legal transplantation often takes place voluntarily through importation of legal mechanisms by legislators—as Korea did with

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[78] This point thus calls into question the attempt of La Porta et al., *supra* note 51, to disprove an argument that "legal origins [are] merely proxies for cultural variables." Beyond certain shortcomings of their empirical approach, which considers a very limited set of legal rules and cultural orientations, the very hypothesis looks dubious in light of current theory and findings.

[79] See Mark D. West, "The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States", 150 U. Pa. L. Rev. 527 (2001).

regard to independent directors and US-like fiduciary duties of board members[80]—or by courts—as Israel did with regard to US-like fiduciary duties of controlling shareholders.[81]

Whatever may be the channel of legal transplantation, the cultural environment of the receiving country plays a significant role in determining the manner and extent to which the transplant integrates with the receiving legal system.[82] People are more likely to comply with the law voluntarily to the extent that a social norm of legality prevails in general and to the extent that the transplant is conceptually compatible with the values that the local law reflects. Young Jeong, and Robert Rhee in separate sober assessments of Korea's corporate governance reform program, thus implicate different facets of Korea's Confucian culture for the limited success with which the US-oriented legal amendments have met.[83] In a nuanced analysis of Japanese corporate governance, Masayuki Tamaruya and Mutsuhiko Yukioka

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[80] See *supra* note 6 and accompanying text. The Korean corporate governance reform was not entirely voluntary, however, in that it came in the wake of the 1997 Asian financial crisis which forced Korea to apply for support from international financial institutions. See Hwa-Jin Kim, "Living with the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea", 17 Berkeley J. Int'l. L. 61 (1999).

[81] C.A. 817/79 *Kossoy v. Y.L. Feuchtwanger Bank Ltd*., 38(3) P.D. 253. See Amir N. Licht, "David's Dilemma: A Case Study of Securities Regulation in a Small Open Market", 2 Theoretical Inquiries L. 673 (2001). The rule in *Kossoy* was judicially abolished in 2020, however.

[82] I abstract from a related question dealing with the source from which a country may want to import a legal transplant. Cultural proximity would be beneficial here, too. See John Armour et al., "How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor, and Worker Protection", 57 Am. J. Comp. L. 579 (2009).

[83] See Young-Cheol David K. Jeong, "Charting Corporate and Financial Governance in Korea in the New Decade", 2 Jindal Global L. Rev. 99 (2011); Robert J. Rhee, "The Political Economy of Corporate Law and Governance: American and Korean Rules under Different Endogenous Conditions and Forms of Capitalism", 55 Wake Forest L. Rev. 649 (2020); see also Amir N. Licht, "Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform", 22 Berkeley J. Int'l. L. 195 (2004).

point out that although the terms "fiduciary" and "duty of loyalty" were not part of the Japanese legal lexicon, fiduciary norms have evolved as their multiple strands of sources interacted with each other, or even came into conflict with each other.[84] A similar rejection of a legal transplant could take place even when the graft is synthetic rather than harvested from a real legal-system donor. Bernard Black, Reinier Kraakman, and Anna Tarassova thus attributed the colossal failure of a corporate law statute for Russia, which was designed to be more immune to the weaknesses of the court system there, to the country's culture of extreme self-dealing and corruption.[85] One may note that the latter two norms reflect lower autonomy and egalitarianism.

3.3 The Objectives of the Corporation

The debate over the objectives of the business corporation is one of the oldest and probably the most fundamental in corporate law. The proposition that shareholders are the primary beneficiaries of the corporation and hence directors' duties run to them is generally interpreted as calling on corporate fiduciaries to maximize (long-term) shareholder value.[86] The literature often refers to this proposition in shorthand as the "shareholder primacy norm" or the "shareholder wealth maximization norm." In contrast to shareholder primacy there stands an opposite view—the "stakeholder approach"—which calls on corporate fiduciaries to take into account, in addition to shareholders' interest, also the interests of other

[84] Masayuki Tamaruya & Mutsuhiko Yukioka, "The Japanese Law of Fiduciaries from Comparative and Transnational Perspectives", 3 UC Irvine J. Int'l Transnational Comp. L. 136 (2020); see also Kon Sik Kim, "Related Party Transactions in East Asia", in The Law and Finance of Related Party Transactions 285 (Luca Enriques & Tobias Tröger, eds., 2019).

[85] See Bernard Black, Reinier Kraakman, & Anna Tarassova, "Russian Privatization and Corporate Governance: What Went Wrong?", 52 Stan. L. Rev. 1731 (2000).

[86] See, e.g., Michael P. Dooley, Fundamentals of Corporation Law 97 (1995); D. Gordon Smith, "The Shareholder Primacy Norm", 23 J. Corp. L. 277 (1998).

constituencies, including employees, creditors, customers, and the community.[87] This debate has been taking place with ebbs and flows for generations, with little change in the substance of the polar views yet with changing titles. Most recently, "purpose" is used to capture either view of the corporate objective, while the stakeholderist approach is dubbed ESG, for Environment, Social, and Governance; previously, it was fashionable to refer to it as CSR, for Corporate Social Responsibility. From the perspective of institutional investors, a stakehoderist approach in their investment strategy is called SRI, for Socially Responsible Investment, which encompasses both their portfolio composition and their interaction (or lack thereof) with portfolio companies.

Common law and civil law jurisdictions often have been characterized as, respectively, shareholder-oriented and stakeholder-oriented, especially by management scholars and economists.[88] Reality is more complex, however, and features inter-relations

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[87] See Cynthia A. Williams, "Comparative and Transnational Developments in Corporate Social Responsibility", in Comparative Corporate Governance 92 (Afra Afsharipour & Martin Gelter, eds. 2021); Amir N. Licht, "Varieties of Shareholderism: Three Views of the Corporate Purpose Cathedral", in Research Handbook on Corporate Purpose and Personhood 387 (Elizabeth Pollman & Robert Thompson, eds., 2021) (hereinafter: Licht, Varieties); Martin Gelter, "Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light", 7 N.Y.U. J.L. & Bus. 641 (2011); Amir N. Licht, "The Maximands of Corporate Governance: A Theory of Values and Cognitive Style", 29 Del. J. Corp. L. 649 (2004); Michael Bradley et al., "The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads", 62 L. & Contemp. Probs. 9 (1999).

[88] See, e.g., Bradley et al., *supra* note 71; Dan S. Dhaliwal et al., "Nonfinancial Disclosure and Analyst Forecast Accuracy: International Evidence on Corporate Social Responsibility Disclosure", 87 Acct. Rev. 723 (2012); Liang & Renneboog, *supra* note 77; Alexander Dyck et al., "Do Institutional Investors Drive Corporate Social Responsibility? International Evidence", 131 J. Fin. Econ. 693 (2019); Andrew Marshall et al., "Mandatory Corporate Social Responsibility and Foreign Institutional Investor Preferences", 76 J. Corp. Fin. 102261 (2022).

between law and culture. In an attempt to generalize these observations, Renée Adams and I polled corporate law professors around the world about their perceived levels of shareholderism in the laws of some thirty countries.[89] The observations are indeed scattered along a continuum rather than bi-modal, and the (rough) results exhibit a somewhat higher average of doctrinal shareholderism in common law jurisdictions.

The decades-long debate on this subject shows no sign of abating. Meanwhile, recent research provides several insights with regard to the role of values and culture that shed new light on it. First, whatever the law might say on the objectives of the corporation, board members and top executives may adopt strategies that stray from that injunction. A joint study with Renée Adams and Lilach Sagiv finds that in Sweden, a social-democratic economy with a shareholder-oriented company law, board members and CEOs vary systematically in their willingness to endorse strategic actions that benefit shareholders at the expense of other stakeholders or balance the interests of several stakeholders.[90] This individual "shareholderism" stance is linked to directors' personal value profile; the more one endorses entrepreneurial values as guiding principles in one's life, the more one supports shareholder-oriented strategies, and vice versa. Managers apparently draw on their personal values in deciding what is the right thing for the firm, the law notwithstanding.

This finding at the individual level of analysis points to culture at the societal level of analysis as an institution that, in tandem with the law, can exert substantial influence on corporations' strategic behavior in shareholder–stakeholder dilemmas. The cultural orientations that prevail in a country may affect the individual value preferences of managers

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Note, however, that limitations of Liang & Renneboog's data sources, which are used by other authors as well (mainly Asset4 by Thomson Reuters) make such inference tentative at best.

[89] See Licht, Varieties, *supra* note 87.

[90] See Renée B. Adams, Amir N. Licht, & Lilach Sagiv, "Shareholders and Stakeholders: How Do Directors Decide", 32 Strategic Mgmt. J. 1331 (2011).

and thus tilt their strategic decisions in a culturally compatible direction. In addition, and regardless of their personal values, managers may also assess the public expectations of the surrounding social environment, what would be considered publicly legitimate, and so forth, and opt for compatible strategies.[91] Specifically, firms in more egalitarian societies would endorse more stakeholderist strategies, as this cultural orientation expresses a moral equality of all people. Higher harmony may also be related to stakeholderist strategies as it reflects lesser tolerance toward exploitation of the social and natural environment. In the Hofstede model, individualism may relate to shareholderism as the former connotes selfishness at the expense of others, but this conjecture is qualified by the fact that the opposite orientation, collectivism, focuses on the in-group.

Recent empirical studies provide growing support for the general view that culture and law both affect shareholder/stakeholder strategies and also for these particular hypotheses. Several studies have leveraged the common-law/civil-law divide as a proxy for shareholderism/stakeholderism to argue that national culture, loosely defined, plays a significant role in strategic behavior of market players. Dan Dhaliwal et al. thus find that the improvement in forecast accuracy following CSR disclosure is stronger among countries with more stakeholder orientation, suggesting that the relevance of the same type of disclosure for investors depends on the business culture and institutional environment.[92] Dyck et al., in a study of institutional investors around the world (namely, from an SRI perspective), show that institutional investors carry their home-country cultural attributes in the form of stakeholderist social norms to firms when they invest abroad, transplanting their social norms

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[91] See Licht, *supra* note 43; Ruth V. Aguilera & Gregory Jackson, “The Cross-National Diversity of Corporate Governance: Dimensions and Determinants”, 28 Acad. Mgmt. Rev. 447 (2003); Dirk Matten & Jeremy Moon, “‘Implicit’ and ‘Explicit’ CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility”, 33 Acad. Mgmt. Rev. 404 (2008).

[92] Dhaliwal et al. *supra* note 88.

there.[93] In a similar spirit, Andrew Marshall *et al.* find that Indian firms subject to mandatory CSR regulation are more attractive to foreign institutional investors domiciled in civil law origin jurisdictions, who arguably harbor an outsized familiarity with and preference for stakeholderism.[94]

In a more rigorous cultural dimension framework, a study by Siegel and Barbara Larson finds that subsidiaries of a large multinational company adjust their employment practices to the host countries' egalitarianism levels.[95] In a study with Siegel and Schwartz, we show positive correlations between cultural egalitarianism and national averages of a series of firm-level CSR practices such as paying greater firm surplus to employees, voluntary (i.e., non-legally mandated) nonfinancial (CSR) disclosure, and organizational practices that consider human rights in the process of selecting or terminating suppliers or sourcing partners and which take the general community into consideration more generally.[96] Kurt Desender and Mircea Epure have presented a more systematic analysis, finding robust relations between egalitarianism and a set of indexes for corporate social performance (CSP).[97] Although highly suggestive, limitations of current data on CSR, among other things,

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[93] Alexander Dyck et al., "Do institutional investors drive corporate social responsibility? International evidence", 131 J. Fin. Econ. 693 (2019).

[94] Andrew Marshall et al., "Mandatory Corporate Social Responsibility and Foreign Institutional Investor Preferences", 76 J. Corp. Fin. 102261 (2022).

[95] See Jordan I. Siegel & Barbara Z. Larson, "Labor Market Institutions and Global Strategic Adaptation: Evidence from Lincoln Electric", 55 Mgmt. Sci. 1527 (2009).

[96] Siegel et al., *supra* note 29.

[97] Kurt A. Desender & Mircea Epure, "Corporate Governance and Corporate Social Performance", Working Paper (2014); see also Gijs van den Heuvel, Joseph Soeters, & Tobias Gössling, "Global Business, Global Responsibilities: Corporate Social Responsibility Orientations Within a Multinational Bank", 53 Bus. Soc. 378 (2014).

continue to render many of these findings tentative at this stage.[98] Finally, in joint study with Renée Adams, we observe that personal shareholderism levels of directors from all around the world are negatively moderated by cultural egalitarianism and harmony in Schwartz's framework, above and beyond the role played by their personal value preferences and controlling for legal measures relevant to corporate governance.[99] These results suggest that in assessing strategic decisions that trigger the shareholderism/stakeholderism tension, board members may be guided both by their personal notions and by cultural norms about the desirable conduct—i.e., in line with the proposition set forth above, that culture regulates the exercise of discretionary power.

3.4 Relations with Investors and Other Stakeholders

Drawing on the framework set forth above, this section demonstrates the role that culture may play with regard to certain key issues in the relations with investors and other stakeholder—namely, earnings management, as a facet of the informational regime that governs public companies, and dividend policy, as a facet of firms' financial relations with its stakeholders.

3.4.1 Disclosure: Earnings Management

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[98] On the role of social networking see David Diaz, Babis Theodoulidis, & Azar Shahgholian, "Social Networking Influence on Environmental and Corporate Performance", Working Paper (2012). Evidence using Hofstede dimensions is somewhat inconclusive. See Ioannis Ioannou & George Serafeim, "What Drives Corporate Social Performance? The Role of Nation-Level Institutions", 34 J. Int'l. Bus. Stud. 834 (2012); Foo Nin Ho, Hui-Ming Deanna Wang, & Scott J. Vitell, "A Global Analysis of Corporate Social Performance: The Effects of Cultural and Geographic Environments", 107 J. Bus. Ethics 423 (2012); Olga Hawn & Vanessa Burbano, National Culture and Corporate Sustainability, working paper (2018).

[99] Amir N. Licht & Renée B. Adams, Shareholders and Stakeholders around the World: The Role of Values, Culture, and Law in Directors' Decisions, working paper (2022).

Information asymmetry is pivotal in engendering agency problems. Societies, firms, and individual actors may respond to the challenge posed by agency problems through different measures of disclosure with a view to mitigating these information asymmetries. A disclosure regime regulates the way in which firms communicate with their stakeholders and with market participants more generally. Much of this communication takes place through highly structured financial statements that are regulated by formal legal rules and accounting standards. Within this formal straitjacket, insiders may still have some wiggle room to massage the financial statements a little bit (short of cooking the books). At the heart of this endeavor lies the financial bottom line—the firm's earnings numbers. Since accounting scholars pioneered the implementation of the cultural value dimension framework, we now have a good deal of research on culture's consequences for various accounting issues,[100] including earnings management.

Earnings management is the practice of exercising judgment in financial reporting to mislead some stakeholders about firm performance or to influence contractual outcomes.[101] Corporate insiders may want to manage earnings numbers in order to be eligible to contingent remuneration, or to meet financial covenants in debt instruments, or to meet analysts' expectations to avoid an embarrassment, and so forth. Earnings can be managed to reduce

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[100] See Sidney J. Gray, "Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally", 24 Abacus 1 (1988); Stephen B. Salter & Frederick Niswander, "Cultural Influence on the Development of Accounting Systems Internationally: A Test of Gray's (1988) Theory", 26 J. Int'l. Bus. Stud. 379 (1995); Timothy S. Doupnik & George T. Tsakumis, "A Critical Review of the Tests of Gray's Theory of Cultural Relevance and Suggestions for Future Research", 23 Acct'g Lit. 1 (2004); Joshua K. Cieslewicz, "Relationships between National Economic Culture, Institutions, and Accounting: Implications for IFRS", 25 Critical Perspectives on Acct'g 511 (2014).

[101] See Paul M. Healy & James M. Wahlen, "A Review of the Earnings Management Literature and Its Implications for Standard Setting", 13 Acct. Horizons 365 (1999).

intertemporal variability in reported earnings ("smoothing") or to meet certain targets. In a study of earnings management around the world, Christian Leuz, Dhananjay Nanda, and Peter Wysocki have found a significant negative relation between earnings management and two measures of investor protection through the legal system—namely, legal enforcement (rule of law) and outside investor rights, proxied with LLSV's index.[102] This finding is consistent with the idea that legal systems that better protect investor rights do this also through increasing transparency about "unpleasant" information and reducing insiders' discretion in their communication with the market.

Against this backdrop, Timothy Doupnik has found that Hofstede's uncertainty avoidance correlates positively and individualism correlates negatively with earnings management across a broad cross-section of countries. Culture was found to have greater explanatory power with regard to earnings smoothing and to explain more variation than Leuz et al.'s legal factors.[103] Several subsequent studies corroborate Doupnik's results and also document a negative relation between earnings management and Schwartz's egalitarianism, with some observing that formal legal measures lose significance altogether as predictors for earnings management when culture is entered in the regressions.[104]

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[102] See Christian Leuz, Dhananjay Nanda, & Peter D. Wysocki, "Earnings Management and Investor Protection: An International Comparison", 69 J. Fin. Econ. 505 (2003).

[103] See Timothy S. Doupnik, "Influence of Culture on Earnings Management: A Note", 44 Abacus 317 (2008).

[104] See Liming Guan & Hamid Pourjalali, "Effect of Cultural Environmental and Accounting Regulation on Earnings Management: A Multiple Year-Country Analysis", 17 Asia-Pac. J. Acct. & Econ. 99 (2010); Jeffrey L Callen, Mindy Morel, & Grant Richardson, "Do Culture and Religion Mitigate Earnings Management? Evidence from a Cross-Country Analysis", 8 Int'l. J. Disclosure & Governance 103 (2011); Kurt A. Desender, Christian E. Castro, & Sergio A. Escamilla de Léon, "Earnings Management and Cultural Values", 70 Am. J. Econ. Soc. 639 (2011); Xu Zhang, Xing Liang, & Hongyan Sun, "Individualism–Collectivism, Private Benefits of Control, and Earnings Management: A Cross-Culture Comparison", 114 J. Bus. Ethics 655 (2013); Krista B.

More recently, the adoption of the International Financial Reporting Standards (IFRS) by countries around the world enables further investigation of the role of culture. Unlike Generally Accepted Accounting Principles (GAAP), which are a rules-based system that (purports to) allow for little discretion in financial reporting, the IFRS is principled-based and thus gives accountants more leeway and, hence, more power to managements to exercise discretion in financial reporting. In line with this notion, Hussein Halabi, Ahmad Alshehabi, and Idlan Zakaria report that, controlling for formal institutions, firms domiciled in countries with high-power-distance cultures prefer to manage their earnings 'upwards' through real activities rather than accruals in the wake of IFRS adoption.[105]These findings suggest that societies whose culture emphasizes individual initiative and responsibility to one's actions would channel corporate managers to communicate with stakeholders in a way that does not obfuscate information. Importantly, managers exercise this discretion in reporting above and beyond the call of legal duty. The positive correlation with egalitarianism similarly expresses a shared view that all stakeholders and market participants deserve candor. The findings for uncertainty avoidance suggest that in cultures that perceive uncertainty as threatening,

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Lewellyn & Shuji 'Rosey' Bao, "The role of national culture and corruption on managing earnings around the world" 52 J. World Bus. 798 (2017). Desender et al. report also for egalitarianism. One study, however, finds the opposite for individualism and uncertainty avoidance—a point that deserves a separate analysis. See Sam Han et al., "A Cross-Country Study on the Effects of National Culture on Earnings Management", 41 J. Int'l. Bus. Stud. 123 (2008).

[105] Hussein Halabi, Ahmad Alshehabi, & Idlan Zakaria, "Informal Institutions and Managers' Earnings Management Choices: Evidence from IFRS-Adopting Countries", 19 J. Contem'y Acct'g Econ. 100162 (2019); see also Krista B. Lewellyn & Shuji 'Rosey' Bao, "The Role of National Culture and Corruption on Managing Earnings around the World" 52 J. World Bus. 798 (2017); Joseph C. Ugrin, Terry W. Mason, & Anna Emley, "Culture's Consequence: The Relationship between Income-Increasing Earnings Management and IAS/IFRS Adoption across Cultures", 37 Advances in Acct'g 140 (2017), who fail to control for formal institutions, however.

managers may have a stronger inclination to present financial results in a way that conceals actual variability and conveys an image of stability and control. Others in the market tolerate and even expect such behavior as they share the same discomfort with random fluctuations.

When the findings for formal and informal institutions are considered together, the picture that emerges is one of institutional affinities and complementarities, consistent with Williamson's model. Neither law nor culture alone is sufficient for understanding how corporate governance systems function with regard to the informativeness of financial disclosure. Leuz, in another study that uses cultural groupings of countries based on Schwartz dimensions, generalizes this point with regard to investor protection and self-dealing regulation.[106] The upshot is that regulatory regimes that appear similar or even identical, such as IFRS accounting standards or EU directives, may nonetheless exert a differential impact depending on the cultural environment.

3.4.2 Distribution: Dividend Policy

Several theories purport to explain dividend policies.[107] Agency theory holds that dividends may serve to discipline insiders from behaving opportunistically by denying them free funds that could be extracted as private benefits or allow for managerial slack. In this view, discretionary dividend payouts may substitute for legal rights that ensure investor protection. LLSV, however, have documented a positive relation between shareholder rights and dividend payouts around the world.[108] This finding arguably supports an outcome theory of

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[106] See Christian Leuz, "Different Approaches to Corporate Reporting Regulation: How Jurisdictions Differ and Why", 40 Acct. Bus. Res. 229 (2010); see also Zhang et al., *supra* note 92; Stephen Salter & Philip A. Lewis, "Shades of Gray: An Empirical Examination of Gray's Model of Culture and Income Measurement Practices Using 20-F Data", 27 Advances Acct. 132 (2011).

[107] See Alon Brav et al., "Payout Policy in the 21st Century", 77 J. Fin. Econ. 483 (2005).

[108] See Rafael La Porta et al., "Agency Problems and Dividend Policies Around the World", 55 J. Fin. 1 (2000).

dividends—namely, that minority shareholder rights support pressures to release free cash to shareholders. Dividend payout increases default risk and might limit future investment such that it affects additional stakeholders like creditors and employees.

Jana Fidrmuc and Marcus Jacob have used empirical specifications similar to LLSV's, which they augmented by entering variables for cultural dimensions from Hofstede and Schwartz in addition to the legal environment variables.[109] These tests revealed strong relations between culture and dividend payouts—specifically, positive for individualism and negative for power distance and uncertainty avoidance, and positive for autonomy and egalitarianism (negative for embeddedness and hierarchy). Among the legal factors, only some exhibited significant relations—namely, public enforcement of securities laws and (weakly) an anti-self-dealing index from Djankov et al.'s study.[110]

Several other studies have looked at the relations between culture and dividend payouts, with some obtaining results in line with Fidrmuc and Jacob and others finding differently. Unfortunately, certain studies raise methodological issues that make it difficult to compare their findings, such that the empirical evidence on this subject is in some disarray. Due to scope limitations, I refer to these studies only briefly.

Dara Khambata and Wei Liu, indeed pioneering this line of inquiry, have reported that a propensity to pay dividends in the Asia-Pacific region associates negatively with uncertainty avoidance and long-term orientation.[111] Sung Bae, Kiyoung Chang, and Eun Kang find that dividend payout in general correlates negatively with uncertainty avoidance, masculinity, and long-term orientation, but the signs flip to significantly positive in a

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[109] Jana P. Fidrmuc & Marcus Jacob, "Culture, Agency Costs, and Dividends", 38 J. Comp. Econ.321 (2010).

[110] Simeon Djankov et al., "The Law and Economics of Self-Dealing", 88 J. Fin. Econ. 430 (2008).

[111] See Dara Khambata & Wei (Wendy) Liu, "Cultural Dimensions, Risk Aversion and Corporate Dividend Policy", 6 J. Asia-Pac. Bus. 31 (2005). Beside its small sample, this study fails to consider other Hofstede dimensions, primarily individualism.

subsample of countries with a high anti-self-dealing legal regime (which is significant but unstable).[112] Liang Shao, Chuck Kwok, and Omrane Guedhami report negative relations with dividend payouts for mastery but, in contrast to other studies, positive relations for embeddedness; shareholder rights, per LLSV's early anti-director rights index, are positively related to dividends only in firm-level tests.[113] Julie Byrne and Thomas O'Connor find that in individualist traditions, creditors continue to restrict dividend payouts under weak creditor rights.[114] Woo Sung Kim, Halil Kiymaz, and Sekyung Oh observe that the average payout ratio is higher in Asian countries adopting common law, practicing a more robust corporate governance, and having higher long-term orientation and uncertainty avoidance.[115] Finally, in an interesting paper, Wolfgang Breuer, Oliver Rieger, and Can Soypak introduce behavioral measures intended to capture patience, loss aversion, and ambiguity aversion to explain

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[112] See Sung C. Bae, Kiyoung Chang, & Eun Kang, "Culture, Corporate Governance, and Dividend Policy: International Evidence", 35 J. Fin. Res. 289 (2012). These authors fail to consider individualism/collectivism in light of its very high correlation with long-term orientation. The latter thus might crudely proxy for collectivism.

[113] See Liang Shao, Chuck C.Y. Kwok, & Omrane Guedhami, "National Culture and Dividend Policy", 41 J. Int'l. Bus. Stud. 1391 (2010). These authors use an early release of the Schwartz data and a 21-country sample; they erroneously consider egalitarianism and harmony versus hierarchy and mastery as belonging to a single dimension and report separately for all orientations.

[114] Julie Byrne & Thomas O'Connor, "Creditor Rights, Culture and Dividend Payout Policy", 39 J. Multinational Fin. Mgmt. 60 (2017)

[115] Woo Sung Kim, Halil Kiymaz, & Sekyung Oh, "Do country-level legal, corporate governance, and cultural characteristics influence the relationship between insider ownership and dividend policy?", 64 Pac.-Basin Fin. J. 10457 (2020).

dividend policies.[116] For robustness checks, these authors enter some dimensions from Hofstede and Schwartz and various legal protection measures, with uneven results.

The decidedly mixed empirical findings on culture, the legal environment, and dividends, combined with the theoretical puzzle that such policies still pose, defy any coherent interpretation of culture's role in this setting at this stage.[117] One thing is sufficiently clear, though: When corporate insiders use their discretion to decide on dividend distributions, they comply with implicit injunctions of informal cultural institutions just as much, and perhaps even more strongly, as they respond to formal legal constraints.

3.5 Executive Compensation

Few issues of corporate governance trigger heated debates and (sometimes frenzied) regulatory intervention in the way that executive compensation does. Executive compensation is a complex issue and corporate governance is only one aspect of it.[118] Whether one subscribes to the "managerial power" theory of executive pay or to the "optimal contracting" theory, there is no denying that executive compensation is set by corporate insiders who enjoy discretionary power. This may call for institutional regulation. This section focuses on the role that culture may play in this setting.

In a speech given by the Governor of the Bank of England, Mark Carney, at the World Economic Forum's annual meeting in Davos, stated: "[W]hile regulators . . . can determine the appropriate split of remuneration between fixed and variable elements to limit

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[116] See Wolfgang Breuer, M. Oliver Rieger, & K. Can Soypak, "The Behavioral Foundations of Corporate Dividend Policy: A Cross-Country Analysis", 42 J. Banking & Fin. 247 (2017). Using individual-level and societal-level factors interchangeably, as these authors occasionally do, calls for elaboration.

[117] See Claudia Nadler & Wolfgang Breuer, "Cultural Finance as a research field: an evaluative survey", 89 J. Bus. Econ. 191 (2019).

[118] For a survey, see Kevin J. Murphy, Executive Compensation: Where We Are, and How We Got There, in Handbook of the Economics of Finance 211 (George Constantinides, Milton Harris, & René Stulz eds., 2013).

risks to financial stability, only society, not regulators, can determine whether the absolute and relative levels of compensation are acceptable."[119] Like a good shepherd, Mr. Carney knows his flock. Based on in-depth interviews with UK FTSE100 CEOs, John Hendry observes that these CEOs emphasize values of professional achievement and competitiveness more than the wealth aspects of their pay, which they do not consider as an incentive.[120] Anna Zalewska has found that in British companies, the greater the pay dispersion within the board, the worse firm performance is, in contrast with findings for the US—a result she relates to British boards being less individualistic and hierarchical then their American counterparts.[121]

Separately from asking whether firms pay their top executives for performance, the debate over executive compensation revolves around the question whether managers are paid "too much." As Carney's remarks indicate, societal stances may implicate both the level of pay and, perhaps more acutely, the relative level of executive pay in comparison to some benchmark. Cultural orientations may influence executive pay packages through the channels discussed in this chapter: first, through individual value preferences and beliefs about the "right" pay of the people who are parties to the bargain—namely, the executive herself, the

[119] Mark Carney, Speech, Davos CBI British Business Leaders Lunch, Jan. 24, 2014, available at http://www.bankofengland.co.uk/-/media/boe/files/speech/2014/remarks-given-by-mark-carney-at-davos-cbi-british-business-leaders-lunch.pdf.

[120] See John Hendry, "CEO Pay, Motivation and the Meaning of Money", Working Paper (2012).

[121] See Anna Zalewska, "Gentlemen Do Not Talk about Money: Remuneration Dispersion and Firm Performance Relationship on British Boards", 27 J. Empirical Fin. 40 (2013); see also Martin J. Conyon & Kevin J. Murphy, "The Prince and the Pauper? CEO Pay in the United States and the United Kingdom", 110 Econ. J. F640 (2000).

board, the board's compensation committee, and compensation consultants;[122] second, through widely shared beliefs and values about what is acceptable in executive pay, such that straying too far from that consensus would instigate public reaction adverse to the firm;[123] third, indirectly, through culturally compatible legal regulation that affects executive pay.[124] Director networks work to disseminate information (namely, beliefs) about pay practices among connected firms.[125]

There is now substantial evidence that cultural orientations are indeed associated with the structure of executive compensation, in line with the hypothesized mechanisms. Henry Tosi and Thomas Greckhamer have found that total CEO pay, the proportion of variable pay to total compensation, and the ratio of CEO pay to the lowest level employee pay correlate positively with power distance. The first two factors also related positively with individualism.[126] Greckhamer later expanded that analysis, observing more nuanced relations between configurations of cultural dimensions from Hofstede and differences in

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[122] See Adam J. Wowak & Donald C. Hambrick, "A Model of Person-Pay Interaction: How Executives Vary in Their Responses to Compensation Arrangements", 31 Strategic Mgmt. J. 803 (2010); see also Terence R. Mitchell & Amy E. Mickel, "The Meaning of Money: An Individual-Difference Perspective", 24 Acad. Mgmt. Rev. 568 (1999).

[123] See Camelia M. Kuhnen & Alexandra Niessen, "Public Opinion and Executive Compensation", 58 Mgmt. Sci. 1249 (2012); John E. Core, Wayne Guay, & David F. Larcker, "The Power of the Pen and Executive Compensation", 88 J. Fin. Econ. 1 (2008).

[124] See Stephen Bryan, Robert Nash, & Ajay Patel, "How the Legal System Affects the Equity Mix in Executive Compensation", 39 Fin. Mgmt. 393 (2010); Marc van Essen et al., "An Institution-Based View of Executive Compensation: A Multilevel Meta-Analytic Test", 43 J. Int'l. Bus. Stud. 396 (2012).

[125] See Shue, *supra* note 10; see also Trevor Buck & Azura Shahrim, "The Translation of Corporate Governance Changes Across National Cultures: The Case of Germany", 36 J. Int'l. Bus. Stud. 42 (2005).

[126] See Henry L. Tosi & Thomas Greckhamer, "Culture and CEO Compensation", 15 Org. Sci. 657 (2004).

compensation level and compensation inequality.[127] Consistently with these findings, in a joint study with Siegel and Schwartz, we document negative correlations between egalitarianism and the ratio between CEO wage and average production worker wage.[128] Natasha Burns, Kristina Minnick, and Laura Starks find that CEO tournament pay structure—measured by the gap or ratio between CEO pay and the pay of the next highest-paid executives—associates positively with power distance and with measures of a society's perceived desirability of income inequality and competition from the World Values Survey.[129] Stephen Bryan, Robert Nash, and Ajay Patel examine another prominent feature of executive compensation that focuses on incentivizing executives.[130] These authors observe, while controlling for the legal environment, that the relative use of equity-based compensation associates with individualism (positively) and with uncertainty avoidance (negatively)—namely, with a cultural environment that is compatible with shareholders' interests and entrepreneurship more generally. More recently, Kiridaran Kanagaretnam, Abdul-Rahman Khokhar, Amin Mawani report that firms pay their CEOs higher levels of compensation as well as higher proportion of equity-based compensation in countries with higher levels of individualism, uncertainty avoidance, and masculinity.[131]

3.6 The Board of Directors

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[127] See Thomas Greckhamer, "Cross-Cultural Differences in Compensation Level and Inequality Across Occupations: A Set-Theoretic Analysis", 32 Org. Stud. 85 (2011).

[128] See Siegel et al., *supra* note 29.

[129] See Natasha Burns, Kristina Minnick, & Laura Starks, "CEO Tournaments: A Cross-Country Analysis of Causes, Cultural Influences, and Consequences", 52 J. Fin. Quant. Anal. 519 (2013).

[130] See Stephen Bryan, Robert Nash, & Ajay Patel, "The Effect of Cultural Distance on Contracting Decisions: The Case of Executive Compensation", 33 J. Corp. Fin. 180 (2015).

[131] Kiridaran Kanagaretnam, Abdul-Rahman Khokhar, Amin Mawani, "Linking Societal Trust and CEO Compensation", 151 J. Bus. Ethics 295 (2018).

The board of directors is the epicenter of power relations in the corporation. It is therefore a key component in firms' corporate governance. At first glance, the board is a universal phenomenon. Companies have invariably had boards at least since the East India Company was chartered in 1600. Doctrinally, the board of directors holds the power to manage or direct the management of the company's business. With various secondary differences, this is the law in virtually all common-law jurisdictions as well as in other legal systems.[132] The OECD Principles of Corporate Governance provide a modern rendition of the board's dual mission—namely, to provide strategic advice and monitor the management.[133] Although they lack legal force and may not precisely reflect the corporate laws of all countries, the OECD Principles do reflect a universal consensus on the board's responsibilities.[134]

This image of universality may be misleading, however. When one examines national laws in more detail, numerous differences emerge, especially with regard to the structure of the board (e.g., unitary or two-tiered) and its composition (e.g., worker representation in the board).[135] Recent research indicates that formal legal differences, regardless of whether they

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[132] See Franklin A. Gevurtz, "The Historical and Political Origins of the Corporate Board of Directors", 33 Hofstra L. Rev. 89 (2004); Franklin A. Gevurtz, "The European Origins and the Spread of the Corporate Board of Directors", 33 Stetson L. Rev. 925 (2004).

[133] Organisation for Economic Co-operation and Development, OECD Principles of Corporate Governance 24 (2015) ("VI. The Responsibilities of the Board. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders."). This mission description is likely to remain unchanged in the forthcoming 2023 edition of the Principles. See *supra* note 11.

[134] See Amir N. Licht, "State Intervention in Corporate Governance: National Interest and Board Composition", 13 Theoretical Inquiries L. 597 (2012).

[135] See, e.g., Paul L. Davies & Klaus J. Hopt, "Corporate Boards in Europe: Accountability and Convergence", 61 Am. J. Comp. L. 301 (2013); Martin Gelter & Mathias Siems, "Letting Companies Choose between Board Models: An Empirical Analysis of Country Variations", 43 U. Penn. J. Int'l L. 137 (2021).

are consequential or not, may be just the tip of the iceberg. Both the functioning of the board and its structure may also be shaped by informal, cultural orientations. This section reviews current evidence on these issues.

3.6.1 Operation: Board–CEO Relations

Of the two limbs that constitute the board's dual mission, the responsibility to monitor the management has attracted more scholarly attention than strategic advice has. This special interest in monitoring likely stems from the prominence of agency theory, which underscores the need to monitor corporate insiders lest they utilize their discretionary power opportunistically for their personal benefit. Other theories, however, provide different accounts of the relations between the board of directors and the top management team. These theories adopt perspectives beyond agency, including perspectives based on resource dependence, upper echelons, stewardship, social networks, and institutional.[136] Among the latter, several theories draw on insights from behavioral science and institutional analysis to highlight the role of values, shared beliefs, social norms, and, at bottom, cultural orientations in molding the interactions between the board and the CEO with regard to both monitoring and strategy setting.

Craig Crossland and Donald Hambrick have examined the impact that formal and informal institutions exert on discretion at the top management team, particularly by CEOs.[137] Managerial discretion exists when managers can choose a line of action from a set

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[136] See Brian K. Boyd, Katalin T. Haynes, & Fabio Zona, "Dimensions of CEO–Board Relations", 48 J. Mgmt. Stud. 1892 (2011); Sam Garg & Kathleen M. Eisenhardt, "Unpacking the CEO–Board Relationship: How Strategy Making Happens in Entrepreneurial Firms", 60 Acad. Mgmt Rev. 466 (2017).

[137] See Craig Crossland & Donald C. Hambrick, "Differences in Managerial Discretion across Countries: How National-Level Institutions Affect the Degree to which CEOs Matter", 32 Strategic Mgmt. J. 797 (2011); see also Craig Crossland & Donald C. Hambrick, "How National Systems Differ in their Constraints on Corporate Executives: A Study of CEO Effects in Three Countries", 28 Strat. Mgmt. J. 767 (2007); David B. Wangrow,

of viable options. It is a joint product of stakeholder open-mindedness about executive actions and stakeholder inability to block objectionable actions. The scope of discretion thus is affected by what firm stakeholders perceive as expectable and acceptable—in other words, on shared beliefs about "what goes with what" or what is "done" or "not done."

Crossland and Hambrick's results indicate two underlying institutional factors ("themes") that are positively linked to managerial discretion. One factor consists of individualism and looseness; the other factor combines informal and formal institutions as well as factual circumstances—namely, uncertainty tolerance (reversed uncertainty avoidance), common law legal origin, employer flexibility, and ownership dispersion. These factors reflect the degree to which a country allows individuals to take unilateral, idiosyncratic actions and the degree to which a country tolerates bold, deviant, and risky actions.[138]

Drawing on these insights, Crossland and Guoli Chen examine the institutional factors that may lead to greater executive accountability in the form of CEO dismissal in the wake of poor financial performance.[139] These authors find that CEOs are more likely to be thus dismissed in countries where managerial discretion is higher, where financial performance measures are more meaningful—for example, due to lower earnings management—and also where the legal system has a common-law origin. In the same spirit, Gang Want et al. conducted a meta-analysis of 297 studies from 32 countries/regions to investigate the influence of country-level managerial discretion, gauged in Crossland and Hambrick's methodology, on the effect of CEOs' dual position as chair of the board, finding that the

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Donald J. Schepker, & Vincent L. Barker III, "Managerial Discretion: An Empirical Review and Focus on Future Research Directions", 41 J. Mgmt. 99 (2015).

[138] The authors refer to "risk" but conceptually these institutions deal with uncertainty.

[139] See Craig Crossland & Guoli Chen, "Executive Accountability Around the World: Sources of Cross-National Variation in Firm Performance–CEO Dismissal Sensitivity", 11 Strat. Org. 78 (2013).

institutional environment—formal and informal (using measures from Hofstede and Gelfand)—indeed moderates the effect of CEO duality.[140]

These findings weave together several threads that this chapter has identified. Corporate governance functions differently in different institutional environments in one of its most important tasks. Post-failure CEO dismissal is a particular social norm of accountability that serves to regulate agency problems in firms, in a context that is notoriously resilient to formal legal regulation.[141] This norm depends on another social norm regarding managerial discretion, on yet another social norm dealing with earnings management, and on the general style of the legal system. The latter institutions in turn draw on fundamental cultural orientations that promote entrepreneurship as they emphasize individual autonomy and tolerance of uncertainty. Thus, we have here a pyramid of norms in which each stratum interacts with and is conceptually compatible with strata above and below it.[142]

3.6.2 Composition: Board Diversity

Until not too long ago, a typical US board was dominated by white, mid-fifties, wealthy male executives who were predominantly Protestant and Republican.[143] From a contemporary comparative perspective, however, boards around the world today exhibit at least some diversity in terms of non-executive (independent) members, gender composition, or employee

[140] Gang Wang et al., "Board Antecedents of CEO Duality and the Moderating Role of Country-Level Managerial Discretion: A Meta-Analytic Investigation" 56 J. Mgmt. Stud. 172 (2019).

[141] See chapter 37 on private enforcement, and chapter 40 on liability standards.

[142] See Williamson, *supra* note 20; Licht, *supra* note 11.

[143] James D. Cox, "Changing Perceptions into Reality: Fiduciary Standards to Match the American Directors' Monitoring Function", 1 Bond L. Rev. 218, 218 (1989); Marleen A. O'Connor, "Women Executives in Gladiator Corporate Cultures: The Behavioral Dynamics of Gender Ego, and Power", 65 Md. L. Rev. 465, 468 (2006).

representation, often due to legal requirements. The composition of boards has attracted special attention, and diversity in board composition is subject to heated debates. Social activists have been calling for even greater gender and ethnic diversity, and policy makers have not been oblivious to these calls, especially in Europe. In a comprehensive survey, Sarah Haan observes that current research lends little support to a business case for gender diversity in boards - namely, that increasing such diversity would enhance firm performance.[144] Rather, it is a matter of social values and political preferences. To paraphrase von Clausevitz on war, legal regulation of board composition has been and remains the continuation of politics by other means.[145] Legal reforms in Europe with regard to gender diversity in fact were not confined to boards but have also encompassed political parties.

Culture's role in shaping board composition should be analyzed against this backdrop. Extensive research, both theoretical and empirical, shows that the ways boards fulfill their mission are endogenous. What the board in fact does and how it is structured in a particular firm may be both a cause and an outcome of other factors, including the firm's industry, its stage of development, its financial needs, the individuals in the top management team and on the board itself, and so forth.[146] Informal institutions would be a potentially important part of this setting—again, functioning both as constraints and as motivators ("isomorphic pressures"

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[144] Sarah C. Haan, "Exclusion in Corporate Law and Governance" (this volume); see also Deborah L. Rhode & Amanda K. Packel, "Diversity on Corporate Boards: How Much Difference Does Difference Make?", 39 Del. J. Corp. L. 377 (2014).

[145] See Licht, *supra* note 116.

[146] See Benjamin E. Hermalin & Michael S. Weisbach, "Endogenously Chosen Boards of Directors and Their Monitoring of the CEO", 88 Am. Econ. Rev. 96 (1998); see also Renée B. Adams et al., "The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey", 48 J. Econ. Lit. 58 (2010); Scott G. Johnson, Karen Schnatterly, & Aaron D. Hill, "Board Composition Beyond Independence: Social Capital, Human Capital, and Demographics", 39 J. Mgmt. 232 (2013); Renée B. Adams, "Boards, and the Directors Who Sit on Them", in The Handbook of the Economics of Corporate Governance 291 (Benjamin E. Hermalin & Michael S. Weisbach, eds 2017).

in the sociological parlance) for molding board composition to accommodate shared values and beliefs.

From a comparative vantage point, cultural orientations thus stand out as factors that may exert a differential effect on board composition in different countries. For example, a cultural emphasis on egalitarianism likely will buttress social norms on gender equality that would facilitate a higher female presence on boards as well as in other institutions—e.g., parliaments. Western Europe indeed provides a good example for such an institutional environment, as it scores particularly high on egalitarianism on average and boasts several interventionist pro-gender-diversity initiatives. Similarly, higher egalitarianism may encourage employee representation in boards as a constituency that is also vulnerable to firm performance, in addition to shareholders. Western Europe again comes to mind.[147] In societies that emphasize entrepreneurship more, which would be reflected in higher individualism, lower uncertainty avoidance, and lower harmony, we would expect board composition to be aligned with (outside) shareholder interests—e.g., by having more independent directors.

Plausible as these hypotheses may seem and notwithstanding the importance and saliency of the debate over board gender diversity, until recently, relatively little research has addressed the role that culture might play in determining board composition.[148] Jiatao Lee and Richard Harrison find that the percentage of outside directors in boards of multinational firms from 15 countries correlates positively with uncertainty avoidance, individualism,

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[147] See Aline Conchon, Board-Level Employee Representation Rights in Europe: Facts and Trends, European Trade Union Institute Report (2011); see also, in a within-country setting, Pascal Gantenbein & Christophe Volonté, "Is Culture a Determinant of Corporate Governance?", Working Paper (2013).

[148] See Cathrine Seierstad et al., "Increasing the Number of Women on Boards: The Role of Actors and Processes", 141 J. Bus. Ethics 289 (2017).

femininity, and power distance.[149] (Except for femininity, similar links were observed for a tendency to consolidate the CEO and Chair positions.) Consistent with the view of boards as endogenous institutions, these findings suggest that the structure of the corporate leadership body also conforms to cultural orientations. These authors did not control for legal requirements, however. That the observed correlations differ from those hypothesized above may suggest that in the sample firms, outside directors do not care solely for outside shareholders but rather for a broader set of stakeholders, who might be less enthusiastic about entrepreneurial strategies.

Johanne Grosvold reports that the percentage of women in the boards of firms from some 50 countries correlates positively with power distance and negatively with uncertainty avoidance, controlling for a set of country- and firm-level factors, though not for legal ones.[150] Grosvold and Stephen Brammer separately examine national average percentages of women on boards across regions classified by culture, legal origin, or other institutions.[151] Although these authors claim that cultural and legal factors appear to play the most significant role in shaping board diversity, their findings do not lend themselves to coherent interpretation. Laura Cabeza-García, Esther Del Brio, and Carlos Rueda argue, in a simple setting, that gender diversity tends to triggered by the adoption of positive laws rather than by soft recommendations and that gender diversity policies are more commonly promoted in countries where governments, corporations and institutions are characterized by less

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[149] See Jiatao Lee & J. Richard Harrison, "National Culture and the Composition and Leadership Structure of Boards of Directors", 16 Corp. Governance: Int'l. Rev. 375 (2008).

[150] See Johanne Grosvold, "Where Are All the Women? Institutional Context and the Prevalence of Women on the Corporate Board of Directors", 50 Bus. & Soc. 531 (2011).

[151] See Johanne Grosvold & Stephen Brammer, "National Institutional Systems as Antecedents of Female Board Representation: An Empirical Study", 19 Corp. Governance: Int'l. Rev. 116 (2011).

masculinity and lower power distance.[152] More generally, Mansoor Afzali, Hanna Silvola, and Siri Terjesen observe that firms headquartered in counties with higher levels of social capital have higher percentages of women directors and that female directors in firms located in high social capital counties are more likely to achieve a critical mass; attain membership of audit, compensation, and/or nomination committees; and serve as chair of audit and nomination committees.[153] María Consuelo Pucheta-Martínez et al. argue that proportion of female directors on boards correlates positively with Hofsetede's power distance, individualism and indulgence, negatively with masculinity and long-term orientation, and show no correlation with uncertainty avoidance.[154]

These diverse reported findings obviously call for further, deeper analysis. Krista Lewellyn & Maureen Muller-Kahle indeed advance a sophisticated multi-method approach to investigating this question, motivated by the fact that board gender diversity likely results from complex interaction between various social factors, formal and informal.[155] They observe that power distance and masculinity are negatively related to female board

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[152] Laura Cabeza-García, Esther B. Del Brio, & Carlos Rueda, "Legal and Cultural Factors as Catalysts for Promoting Women in the Boardroom", 22 Bus. Res. Q. 56 (2019)

[153] Mansoor Afzali, Hanna Silvola, & Siri Terjesen, "Social Capital and Board Gender Diversity", 30 Corp. Governance: Int'l Rev. 461 (2021).

[154] María Consuelo Pucheta-Martínez, Isabel Gallego-Álvarez, & Inmaculada Bel-Oms, "Cultural Environments and the Appointment of Female Directors on Boards: An Analysis From a Global Perspective", 28 Corp. Soc'l Responsibility Env. Mgmt. 555 (2021).

[155] Krista B. Lewellyn & Maureen I. Muller-Kahle, "The Corporate Board Glass Ceiling: The Role of Empowerment and Culture in Shaping Board Gender Diversity", 165 J. Bus. Ethics 329 (2020); see also Cynthia Saldanha Halliday, Samantha C. Paustian-Underdahl, & Stav Fainshmidt, "Women on Boards of Directors: A Meta-Analytic Examination of the Roles of Organizational Leadership and National Context for Gender Equality", 36 J. Bus. Psychol. 173 (2021).

representation but in particular, that these cultural factors negatively moderate the positive effect of women's economic and political empowerment.

3.6.3 Structure: Director Networks

In recent years, there has been a flurry of studies on corporate governance and social capital as embodied in social networks.[156] Research thus far has focused on director networks, in which board members also serve as CEOs or as board members in additional companies.[157] It appears that director networks work as advertised, according to social capital theory, to facilitate information exchange as well as mutual commitment and trust.[158] In some cases this may prove helpful for attaining strategic resources such as information on growth opportunities, innovation, or outside managerial talent.[159] More extensively connected, and

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[156] See Daniel J. Brass, "New Developments in Social Network Analysis", 9 Ann. Rev. Psychol. Org. Behav. 225 (2022).

[157] See Luc Renneboog & Yang Zhao, The Governance of Director Networks, in The Oxford Handbook of Corporate Governance 200 (Mike Wright et al. eds., 2013); see also Johnson et al., *supra* note 130.

[158] See, e.g., Christa H. S. Bouwman, "Corporate Governance Propagation through Overlapping Directors", 24 Rev. Fin. Stud. 2358 (2011); Fabio Braggion, "Managers and (Secret) Social Networks: The Influence of the Freemasonry on Firm Performance", 9 J. Eur. Econ. Ass'n. 1053 (2011); Cesare Fracassi, "Corporate Finance Policies and Social Networks", 63 Mgmt. Sci. 2420 (2012); Shue, *supra* note 10; Vincent Intintoli, Kathleen M. Kahle, & Wanli Zhao, "Board Connectedness and Board Effectiveness", working paper (2015).

[159] See, e.g., Luc Renneboog & Yang Zhao, "Us Knows Us in the UK: On Director Networks and CEO Compensation", 17 J. Corp. Fin. 1132 (2011); Joanne Horton, Yuval Millo, & George Serafeim, "Resources or Power? Implications of Social Networks on Compensation and Firm Performance", 39 J. Bus. Fin. & Actg. 399 (2012); David F. Larcker, Eric C. So, & Charles C.Y. Wang, "Boardroom Centrality and Firm Performance", 55 J. Acct. & Econ. 225 (2013); Benjamin Balsmeier, Achim Buchwald, & Stefan Zimmermann, "The Influence of Top Management Corporate Networks on CEO Succession", 7 Rev. Mgmt. Sci. 191 (2013); Thomas C. Omer, Marjorie K. Shelley, & Frances M. Tice, "When Do Well-Connected Directors Affect Firm Value?", 2014 J. Applied Fin. 1 (2014); see also Luc Renneboog & Yang Zhao, "Director Networks and Takeovers", 28 J. Corp.

hence more powerful, independent directors are economically and statistically positively correlated with shareholder valuations and with firm value, possibly because more socially powerful independent directors have better information and more influence.[160]

The upshot may also be detrimental to the interest of the company and of its outside shareholders, however. Several studies have associated more extensive director interlocks with higher CEO pay and with less performance-sensitive CEO pay and tenure, indicating reduced monitoring.[161] Among other things, social acquaintances may engender these adverse effects through compromising the efficacy of formally though not actually

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Fin. 218 (2014); Tuugi Chuluun, Andrew Prevost, & Arun Upadhyay, "Firm Network Structure and Innovation", 44 J. Corp. Fin. 193 (2017); Peter Iliev, & Lukas Roth, "Learning from Directors' Foreign Board Experiences", 51 J. Corp. Fin. 1 (2018); Stephen P. Ferris, David Javakhadze, & Yun Liu, "The Price of Boardroom Social Capital: The Effects of Corporate Demand for External Connectivity", 111 J. Banking Fin. 105729 (2020).

[160] See Kathy Fogel, Liping Ma, & Randall Morck, "Powerful Independent Directors", 50 Fin. Mgmt. 935 (2021); Tor-Erik Bakke et al., "Director Networks and Firm Value", working paper (2022); see also Jay Cai, Tu Nguyen, & Ralph Walkling, "Director Appointments: It Is Who You Know", 35 Rev. Fin. Stud. 1933 (2022).

[161] See, e.g., Renneboog & Zhao, *supra* note 137; Erik Devos, Andrew Prevost, & John Puthenpurackal, "Are Interlocked Directors Effective Monitors?", 38 Fin. Mgmt. 861 (2009); Rayna Brown et al., What are Friends for? CEO Networks, Pay and Corporate Governance, in Corporate Governance: Recent Developments and New Trends 287 (Sabri Boubaker et al. eds., 2012); Bang Dang Nguyen, "Does the Rolodex Matter? Corporate Elite's Small World and the Effectiveness of Boards of Directors", 58 Mgmt. Sci. 236 (2012); Amir Barnea, Cesare Fracassi, & Ilan Guedj, "Director Networks", Working Paper (2013); Joseph Engelberg, Pengjie Gao, & Christopher A. Parsons, "The Price of a CEO's Rolodex", 26 Rev. Fin. Stud. 79 (2013).

independent directors[162] or through propagation of undesirable practices such as option backdating and implementing management entrenchment mechanisms.[163]

Assessing the relations between culture and board structure in terms of social network configuration begins with the observation that social networks undergird groups. Social networks constitute one's location in the group and one's linkages with other group members. Social networks, however, are merely a structural concept. They are devoid of content meaning, shorn of any normative implications. In the corporate governance context of board structure, individual board members have power that calls for social regulation. They can follow several lines of action that may sustain multiple equilibriums. This is where culture comes into play. When one is embedded in a particular cultural environment, one takes for granted "what goes with what" in light of the values and beliefs that one shares with other societal members and the constraints that norms and culture exert. Holding a position with a high level of centrality in a network of board members or being located in a structural hole of such a social network thus may entail different implications in different cultures. In sum, social capital is also culturally contingent for board members.

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[162] See Byoung-Hyoun Hwang & Seoyoung Kim, "It Pays to Have Friends", 93 J. Fin. Econ. 138 (2009); see also Udi Hoitash, "Should Independent Board Members with Social Ties to Management Disqualify Themselves from Serving on the Board?", 99 J. Bus. Ethics 399 (2011).

[163] See, e.g., John Bizjak, Michael Lemmon, & Ryan Whitby, "Options Backdating and Board Interlocks", 22 Rev. Fin. Stud. 4821 (2009); Cesare Fracassi & Geoffrey Tate, "External Networking and Internal Firm Governance", 67 J. Fin. 153 (2012); Vikramaditya S. Khanna, E. Han Kim, & Yao Lu, "CEO Connectedness and Corporate Frauds", 70 J. Fin. 1203 (2015); Pouyan Foroughi et al., "Peer Effects in Corporate Governance Practices: Evidence from Universal Demand Laws", 35 Rev. Fin. Stud. 132 (2022); compare Richard A. Benton, "The Decline of Social Entrenchment: Social Network Cohesion and Board Responsiveness to Shareholder Activism", 28 Org. Sc. 262 (2017).

The relations between the individual and the group are the primary issue that every society needs to address. Societal stances on this issue constitute the most fundamental social institution. These stances are captured by their location on Hofstede's individualism/collectivism dimension and in Schwartz's autonomy/embeddedness. As noted, the autonomy/embeddedness and individualism/collectivism dimension overlap conceptually to a degree. Both concern relations between the individual and the collective and both contrast an autonomous with an interdependent view of people. However, the dimensions also differ. For instance, individualism implies self-interested pursuit of personal goals while selfishness is not a characteristic of cultural autonomy. Collectivism more than embeddedness highlights ingroup boundaries as delineating the scope of unquestioning loyalty. The correlation between these dimensions is substantial but far from complete.[164]

Research on culture's consequences for social networks is in its infancy at this stage. Scholars have pointed out the importance of individualism versus collectivism for social network analysis, contrasting Western (usually North American) culture with East Asian (usually Chinese) culture. A related concept is the elaborate set of relational norms known as guanxi, which traces its roots to Confucian philosophy and calls on individuals to cultivate the right guanxi through extensive, continuing exchanges.[165] For instance, the scope of people that one might trust seems to be substantially narrower in Confucian countries than in Western countries.[166] This is consistent with a collectivist view of ingroup members only as

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[164] See Schwartz 2006, *supra* note 28. There is less conceptual overlap between other dimensions of the two frameworks.

[165] See Chen et al., *supra* note 5.

[166] See Jan Delhey, Kenneth Newton, & Christian Welzel, "How General Is Trust in 'Most People'? Solving the Radius of Trust Problem", 76 Am. Soc. Rev. 785 (2011).

trustworthy, whereas people in individualistic cultures are less likely to hold such a bifurcated view of "most others" for purposes of the "generally speaking question" on trust.[167]

Business organization scholars are beginning to investigate whether the wisdom of social capital in terms of centrality and structural holes (or similar concepts from the current terminological thicket) applies equally in collectivist cultures.[168] The basic idea, as Zhixing Xiao and Anne Tsui put it, is that "[p]eople who stay at the boundary of two ingroups tend to be distrusted by both groups—both ingroups are likely to regard them as outgroup members who do not deserve ingroup treatment . . . Simple and dense networks that represent clear group membership, rather than networks full of structural holes, constitute resources for social actors."[169] Two meta-analysis of studies in business and management recently yielded consistent findings. Hongjuan Zhang et al. argue that that the benefits of network centrality are stronger in China than in the West and that structural holes contribute to individual performance in the West more than in China, which they relate to higher collectivism and power distance in China.[170] Haifeng Wang et al. argue that the positive impacts of both network centrality and structural holes on competitive advantage are higher in loose cultures than in tight cultures in Gelfand's theory (indulgence/restraint in the extended Hofstede

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[167] See *supra* text to note 51.

[168] See Johnson et al., *supra* note 130; Sun-Ki Chai & Mooweon Rhee, "Confucian Capitalism and the Paradox of Closure and Structural Holes in East Asian Firms", 6 Mgmt. & Org. Rev. 5 (2010).

[169] Zhixing Xiao & Anne S. Tsui, "When Brokers May Not Work: The Culture Contingency of Social Capital", 52 Admin. Sci. Q. 1, 5 (2007); see also Rong Ma, Yen-Chih Huang, & Oded Shenkar, "Social Networks and Opportunity Recognition: A Cultural Comparison between Taiwan and the United States", 32 Strat. Mgmt. J. 1183 (2011); compare Jennifer Merluzzi, "Social Capital in Asia: Investigating Returns to Brokerage in Collectivistic National Cultures", 42 Soc. Sci. Res. 882 (2013).

[170] Hongjuan Zhang, Liang Wang, & Rong Han, "The China-West Divide on Social Capital: A Meta-Analysis", 36 Asia Pac. J. Mgmt. 745 (2019).

framework), namely, the West and China, respectively. They also find that the positive impacts of both network centrality and structural holes on competitive advantage are higher in individualist cultures than in collectivist cultures, again, the West and China.[171]

Applying these insights to corporate governance implications of board structure may require careful consideration before extant evidence of the sort mentioned above could be extended to other cultural settings. This point remains largely overlooked despite its relevance to comparative corporate governance analysis.[172] In doing so, attention should be paid to the dual mission of the board—namely, of strategic advice and of monitoring. The strategy task revolves around board members serving as sources of out-of-firm information and similar resources thanks to external background or linkages. The monitoring task crucially hinges on a certain detachment between directors—especially independent directors—and firm insiders. As the very notion of being "independent" or "external" entails different repercussions in cultures high on collectivism and embeddedness, we should expect such directors to fulfill their tasks differently. Furthermore, since boards are endogenous institutions, we should expect their composition too to reflect the different cultural environment. Outside board members with multiple directorships may not be able to provide valuable information because nobody will supply them with such information, which is reserved for ingroup members. The Japanese family firm practice of adopting adult executives suggests the extent to which societies might go to "familiarize" managers with the firm and its controlling shareholders.[173] On the other hand, such board members might prove

[171] Haifeng Wang, Longwei Tian, & Yuan Li, "A Tale of Two Cultures: Social Networks and Competitive Advantage", 36 Asia Pac. J. Mgmt. 321 (2019).

[172] See Rosa Caiazza et al., "An Institutional Contingency Perspective of Interlocking Directorates", 21 Int'l J. Mgmt. Rev. 277 (2019); see also Justyna Światowiec-Szczepańska & Łukasz Małys, "Board Interlocks as a Diffusion of Strategic Information –Does it Work? A Polish Case", 26 J. East Eur. Mgmt. Stud. 589 (2021).

[173] See *supra* text to note 63.

to be better monitors if they feel less pressure to socialize within the firm and become part of the ingroup.[174]

The above conjectures are preliminary hypotheses that warrant further theoretical development and empirical testing. The meta-analysis findings lend some support to these ideas but they derive from a business context, whereas the responsibilities of the board are intended to achieve commercial success but differ markedly from doing business. In tandem, these cultural differences call for careful assessment of legal measures intended to improve corporate governance by imposing "true and tested" fiduciary duties inspired by common-law sources.[175] A standard common-law duty of loyalty requires any fiduciary, directors included, in the strongest of terms, to act in absolute disinterestedness. Practical issues of implementation aside, such a duty is premised on a view of people as autonomous entities, in line with cultural individualism and autonomy. Such a legal duty may not sit well with a social norm of guanxi in a board whose members maintain extensive relations with other members in the company.

4 CONCLUSION

This chapter has surveyed the literature on culture, law, and corporate governance with a view to establishing the importance of considering both formal (legal) and informal (cultural) institutions in the analysis of corporate governance systems. It is hoped that that goal has been met with some success. In an early paper that called for adopting the cultural value dimension framework for such analyses, I referred to culture as "the mother of all path dependencies."[176] The body of scholarship that has since accumulated seems to support the

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[174] See Yunsen Chen, Yutao Wang, & Le Lin, "Independent Directors' Board Networks and Controlling Shareholders' Tunneling Behavior", 7 China J. Actg. Res. 101 (2014).

[175] See *supra* text to note 6 et seq.

[176] Licht, *supra* note 43, at 204.

contention made at that time: "At the risk of stretching the mother metaphor a little bit, it can be argued that culture may indeed be perceived as an old mother. It knows a lot, but some of this knowledge might be obsolete today; it is sometimes nagging; it will resist change unless absolutely required. Most importantly, it must not be ignored."

More work can be done toward revealing additional facets of the relations between corporate governance and culture. Institutional environments in Asia (again, think China) and even in Europe differ markedly from those that prevail in English-speaking countries. Understanding these environments will help policy- and lawmakers to develop corporate governance systems more effectively. To achieve this goal, we will need to advance our knowledge beyond observing correlations of the sort that was reviewed here toward a more elaborate understanding of the relations between law and culture. Looking to the road ahead, it is fitting to conclude with a contemporary quotation from Michael Bond, who together with Hofstede and Schwartz, is among the founders of modern cross-cultural research:

> Hypothesizing that this or that Chinese population should be higher (or lower) than mainstream Western norms on this or that construct because this particular Chinese societal context is higher (or lower) than that other comparison context on Hofstede's, House's, Schwartz's, Inglehart's, or Leung and Bond's national-level "cultural" dimension of X will not make the cut—there are simply too many ways to challenge such results, even if confirmed. . . This kind of simplistic, straightforward work informed the earlier cataloguing period of diverse phenomena, which was characterized as the "Aristotelean" era of the cross-cultural discipline. . . That was a time for documenting differences in organizational phenomena across cultural groups, a time for establishing the potential of the cross-cultural enterprise. That agenda was met and, in our opinion, that time has now passed.[177]

[177] Michael Harris Bond & Miriam Muethel, "Doing Better Research on Organizational Behaviour in Chinese Cultural Settings: Suggestions from the Notebooks of Two Fellow-Travellers", 8 Mgmt. & Org. Rev. 455, 457–458 (2011).

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