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Legal Determinants of External Finance Revisited: The Inverse Relationship between Investor Protection and Societal Well-being

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Draft Paper

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Legal Determinants of External Finance Revisited: The Inverse Relationship between Investor Protection and Societal Well-being

Abstract

This paper investigates relationships between corporate governance traditions and quality of life as measured by a number of widely reported indicators. It provides an empirical analysis of indicators of societal health in developed economies using a classification based on legal traditions. Arguably the most widely cited work in the corporate governance literature has been the collection of papers by La Porta et al. which has shown, inter alia, statistically significant relationships between legal traditions and various proxies for investor protection. We show statistically significant relationships between legal traditions and various proxies for societal health. Our comparative evidence suggests that the interests of investors may not be congruent with the interests of wider society, and that the criteria for judging the effectiveness of approaches to corporate governance should not be restricted to financial metrics.

Introduction

The most influential (Solomon, 2007) contribution to the literature on corporate governance is that made in a series of papers by La Porta, Lopez-De-Silanes, Shleifer, and Vishny (see, for example, La Porta et al., 1996, 1997a, 1998, 2000, 2002, 2006 and 2008; Shleifer and Vishny, 1997). The extent of their contribution to the field of finance, in particular, is exceptional. According to “in-cites” (an editorial component of Essential Science Indicators published by Thomson Scientific) the four most influential authors in the world in the area of economics and banking in 2007 were Shleifer (with 3,765 citations), Lopez-De-Silanes (with 2,396 citations), La Porta (with 2,394 citations) and Vishny (with 1,531 citations). Each of these authors has an ISI Web of Knowledge rating of “highly cited”, and in a recent classification of the most cited articles in finance from 2000-2006, three of the top five papers are contributions by this group (Keloharju, 2008). Their key papers have influenced research across disciplinary boundaries being “some of the most-cited pieces in economics, finance, and law” (Siems, 2005).

They investigated, in particular, relationships between legal traditions and corporate governance systems, especially with regard to differing levels of investor protection and their consequences. Their early papers (La Porta et al., 1997a and 1978) were based on the proposition that financial development was promoted by a legal system which protected outside investors against appropriation by insiders; and they viewed

this argument, following Jensen and Meckling (1976), as a natural consequence of a “contractual view of the firm” (La Porta et al., 2008).

It is arguable that their work has contributed to a marginalization of the stakeholder approach to corporate governance; instead, discussion of the topic tends to be dominated by an agency theory perspective. Furthermore, their work has played a significant part in the development of a conventional wisdom that the “Anglo-American” shareholder-value oriented form of corporate governance is the model to which other jurisdictions should conform (see, for example, La Porta et al., 2008; Aguilera and Jackson, 2003; Collison, 2003; Hansmann and Kraakman, 2001). Their statistical analysis has shown that the origin of a country’s legal system, in particular whether it is based on a civil or common law tradition, is significantly associated with levels of investor protection, and the degree to which its capital markets are developed. They show that countries sharing a common law legal tradition (such as the UK, the US and the other developed English-speaking economies) have greater levels of investor protection, larger capital markets with more dispersed ownership, and a greater propensity for funds to be committed to new enterprises by external investors. In La Porta et al. (1998) they also draw on other literature to show that such phenomena are associated with greater economic growth. In more recent work however La Porta et al. (2008) noted, citing Glaeser et al. (2004), that “the evidence on the relationship between institutions and aggregate growth more generally, which seemed substantial a few years ago, has been crumbling” (p.302). Notwithstanding this observation, the main edifice of the La Porta et al. work is regarded as robust by the authors: “our framework suggests that the common law approach to social control of economic life performs better than the civil law approach” (La Porta et al., 2008, p.327).

In this paper we revisit some of the key statistical findings reported by La Porta et al. and reveal that the civil and common-law traditions also show statistically significant associations with various measures of societal well-being. We call into question the criteria used by La Porta et al. for assessing “poor” laws, by taking a broader perspective on a country’s performance than the one based on financial and economic metrics. We also consider the differences between common and civil law to suggest a rationale for the results that we find, and for those reported by La Porta et al.; in

particular we draw on arguments developed by Berle and Means regarding the provenance and implications of civil and common-law traditions. Our main focus in this paper is on two of the earlier La Porta et al. papers, especially La Porta et al. (1997a) and also La Porta et al. (1998). Not only are these two of their most cited pieces of work, but the structure of the 1997 paper serves as a convenient basis for the statistical comparison that is at the heart of this paper. While our main focus is on the 1997 paper we will also adduce perspectives and more recent findings from their later work¹ especially La Porta et al. (2008).

The paper is structured as follows. In the next section of the paper we outline relevant parts of the La Porta et al. work and consider evidence of their influence in the corporate governance literature. The subsequent section considers the relevance of social indicators as a method of assessing countries' well-being, and reports our analysis of certain indicators using the same method of country classification (i.e. one based on legal origin) as that used, in particular, by La Porta et al. (1996, 1997a and 1998). In that section we reproduce material contained in La Porta et al. (1997a). The penultimate section considers possible explanations for our findings based on the nature of the common and civil law legal traditions. The final section concludes.

Common and civil law legal traditions and the work of La Porta et al.

In the introduction to this paper, we suggested that the work of La Porta et al. lends itself to normative arguments in support of an approach to corporate governance based on a narrow agency theory perspective. This is consistent with the Anglo-American, shareholder value-based model of capitalism as opposed to a stakeholder or social market-based approach. The “varieties of capitalism” literature (see, for example, Hall and Soskice, 2001; Dore, 2000, 2006, Hutton, 1995; 2003) is extensive and a substantive review of it would go beyond the scope of this paper. But it seems

¹ As pointed out in the La Porta et al. body of work, especially La Porta et al. (2008), some refinements have been made by the authors to the variables which they used in the 1997a and 1998 analysis. We think that it may be helpful if the figures which we quote from La Porta et al. (1997) are identifiable from that classic paper. Therefore in this paper we have reproduced some of the 1997 data as originally published; i.e. without adjustment for the subsequent refinements. We do not believe that updating La Porta et al.'s earlier data would have any bearing on the evidence and the arguments that we put forward in the current study.

apposite to note that, in their much cited work, Hall and Soskice (2001) take a “firm-centered” approach and regard “companies as the crucial actors in a capitalist economy” (p. 6). They apply micro level concepts to help understand the macro economy. Hall and Soskice draw a distinction between the two types of political economies, which they term respectively: liberal market economies and coordinated market economies. While they describe these ideal types as “poles of a spectrum” they broadly correspond to the classification used in this paper between Anglo American and social market forms of capitalism. La Porta et al. (2008, p.303) cite the observation from Pistor (2006) that “all the liberal market economies in the OECD are common law countries, and all the coordinated ones are civil law ones.” They then add “The literature on the variety of capitalisms has long looked for an objective measure of different types; perhaps it should have looked no further than legal origins.”

We should emphasise that La Porta et al. do not themselves adversely compare the generic “stakeholder model” of capitalism with the “shareholder model”; at least they do not do so explicitly. It is a question on which they appear to be silent: certainly the term “stakeholder” does not appear in any of their papers which are cited above. Shleifer and Vishny (1997) do note "several important topics closely related to corporate governance that [their] article does not deal with" (p.740). These are "the foundations of contract theory", the "basic elements of the theory of the firm", “noncapitalist ownership patterns” (although they state that “we pay some attention to cooperatives”) and certain functions of “financial intermediaries”. Given this careful exclusion of “important topics” related to corporate governance their silence on stakeholders in conventionally owned firms is a rather deafening one.

In their widely cited survey of corporate governance, Shleifer and Vishny (1997) were very clear regarding their criteria for judging corporate governance:

“Our perspective on corporate governance is a straightforward agency perspective, sometimes referred to as separation of ownership and control. We want to know how investors get managers to give them back their money.” (p.738).

They go on to make clear that they regard the principal question in relation to corporate governance systems as being not whether particular governance systems should be copied, but rather how external providers of finance can be provided with legal protection such that large-scale financing of entities can develop. They emphasise that this is not the case in many developing countries, nor in some “rich European countries” (p.738). Elsewhere in their paper they assert that “*The fundamental question of corporate governance* is how to assure financiers that they get a return on their financial investment.” (p.773, emphasis added)

Shleifer and Vishny emphasised the absence of a basis on which to judge corporate governance models. For example, in relation to the United States, Germany and Japan, they state that “all these economies have the essential elements of a good corporate governance system”, and that “the available evidence does not tell us which one of *their* governance systems is the best” (Shleifer and Vishny, 1997, p.739, emphasis in original). The ensuing body of work from La Porta et al. does go on to develop a view of which system, based on levels of investor protection, is best, and that, as indicated above, turns out to be a common-law system (corresponding to the Anglo American version of capitalism).

La Porta et al. (1996/1998 – hereafter 1998²) investigated the legal rules offering protection to shareholders and creditors in 49 countries. They examined the origin of these countries’ different legal systems, and the extent to which shareholders’ and creditors’ rights were enforced. Their basic classification of legal systems was twofold – those comprising common law with English origins and those based on civil law deriving from Roman law. They further classified the civil tradition countries (drawing on Reynolds and Flores, 1989), into the “three major families”: French, German and Scandinavian legal traditions. They noted that English common law and the French and German varieties of civil law had spread to many other countries through a variety of mechanisms including colonialism and “more subtle imitation”. The number of countries in each group was, respectively: 18 in the

² La Porta et al. (1998) is the later (published) version of a working paper which appeared in 1996. The 1996 version is referred to in the 1997a paper, the latter being to an extent a development of it. The sequence of the La Porta et al. work may not be apparent unless this is made clear. As indicated in the text our main focus in the current paper is La Porta et al. (1997a).

English origin group; 21 in the French origin group; six in the German origin group; and four in the Scandinavian group.

Their investigation of legal regimes showed that common law countries generally offer stronger legal protection for investors than their civil law counterparts. Amongst the civil law groupings the weakest legal protection for investors was found in the French civil law countries, with the German and Scandinavian civil law countries in between the French civil law and common law groups. Another key finding reported by La Porta et al. (1998) was that weaker investor protection is associated with more concentrated share ownership. Consequently, they hypothesized that stronger legal protection is likely to mean that a larger proportion of shares will be held in the form of minority holdings by diversified shareholders.

The latter hypothesis is supported by the findings reported in La Porta et al. (1997a) which show that countries with weaker investor protection have "smaller and narrower" capital markets for both equity and debt. They highlight the French civil law countries as having "both the weakest investor protections and the least developed capital markets" (p. 1131) especially as compared with common law countries.

La Porta et al. acknowledge (1997a) that they have refrained from asking "deeper questions" about why differences exist between common and civil law countries in relation to investor protection. (Although La Porta et al (2008) does include a searching exploration of the historical antecedents of the common and civil law traditions.) They pose the question: "what is it about the civil law family, and particularly about the French civil law sub family, that accounts for the relative unfriendliness of laws to investors?" (p. 1149). Their speculations include the possibility of pure coincidence, or active legal design aimed at keeping "investors relatively weak, and to assure family firms and the state a larger role in economic development?" They also speculate about whether "poor laws are just a proxy for an environment that is hostile to institutional development" and, drawing on evidence in La Porta et al. (1997b), suggest that countries which have low levels of trust among their citizens have less effective institutions. In particular they wonder whether "some

broad underlying factor, related to trust" may influence all institutions in a country including legal systems and capital markets³.

In La Porta et al. (1998) the authors also seek to place their findings in a wider context and pose "the ultimate question" of "whether countries with poor investor protections ... actually do suffer (p. 1152). This question is partially answered by reference to work cited by King and Levine (1993) and Levine and Zervos (1998) who found that "developed debt and equity markets contribute to economic growth". They also cited evidence from Levine (1998) who confirmed the King and Levine as well as the Levine and Zervos' findings when the analysis was extended to incorporate a La Porta et al. "legal origin variable". They also cited Rajan and Zingales (1998) who found that growth in capital intensive industries was related to the level of development of financial systems. Thus, La Porta et al. (1998) identified a link from the legal system of a country to its level of economic development, while acknowledging that the obstacles to growth created by poor investor protection had not prevented certain countries (they mention, in particular, France and Belgium) from becoming rich. The evidence regarding the link between legal tradition and economic growth has been reassessed by La Porta et al. (2008) but, ten years later, their perspective on the significance of legal regimes was summed up as follows:

In sum, there is by now a great deal of evidence that legal origins influence legal rules and regulations, which in turn have substantial impact on important economic outcomes—from financial development, to unemployment, to investment and entry, to the size of unofficial economy, to international trade. Much of this evidence suggests that common law is associated with better economic outcomes than French civil law. The evidence also shows that legal origins influence patterns of growth within industries, but it is less clear that legal origins predict aggregate growth. The last finding resonates with the obvious observation made by LLSV (1998) that countries like France and Belgium achieved high living standards despite their legal origin. (La Porta et al., 2008, p.302).

In this paper we take issue with the criterion, namely economic growth, used by La Porta et al., at least in their earlier work, to address the "ultimate question" of whether countries with poor investor protection "do suffer". The fact that subsequent evidence

³ In his examination of happiness, Layard (2005), drawing on Putnam (2000) reported that in continental Europe "levels of trust have improved (or not fallen) in every country since 1980" whereas, over a broadly comparable period, levels of trust had steadily declined in the UK and the US.

on that specific issue is unclear is beside the point. We take a broader social perspective in which economic growth is regarded as a means to an end, not an end in itself. Answer to our “ultimate question” relies on the criterion of societal well-being rather than the “better economic outcomes” referred to by La Porta et al. Of course there may not be a clear consensus on how societal well-being should be measured, although the same argument could be advanced about economic growth. There are, however, increasingly widely reported and authoritative social indicators which do inform such judgments (see, for example, the United Nations’ annual *Human Development Reports* and UNICEF’s annual *State of the World's Children Reports*). In the next section we shall briefly discuss the development and use of social indicators and argue that they reveal a very different perspective on the relative performance of common and civil law countries from that put forward by La Porta et al.

Social indicators and an extension of the La Porta et al (1997) analysis

This section draws on the literature of social indicators and also on the insights of Gray (2002) who suggested that social accounting may be “usefully thought of as the universe of all possible accountings”. From that perspective, economic and financial indicators, whether micro or macro, may be characterized as very constrained subsets of a potentially much broader and informative social accounting.

In the 1960s and early 1970s, a ‘social indicators movement’ arose as a result of the perceived inadequacy of the information available to policy makers (Carley, 1981; see also Glatzer, 1981). The suitability of macroeconomic metrics as indicators of societal welfare was increasingly questioned based on a growing body of research (see, for example, Christian, 1974; Galnoor, 1974; Goeke, 1974; Liu, 1974; Seashore, 1974). The field of enquiry into social indicators burgeoned and the early 1970s saw the inception of the specialist journal, *Social Indicators Research*. Indeed, only a few years later, Glatzer (1981) stated that its “breadth and diversity” meant that “no one social scientist can hope to provide an adequate survey of the relevant literature.” By 1976 the OECD had reported that:

“growth is not an end in itself, but rather an instrument for creating better conditions of life [and] increased attention must be given to the qualitative aspects of growth, and to the formulation of policies with

respect to the broad economic and social choices involved in the allocation of growing resources” (OECD, 1976, p.7)

Examples of “macro” applications of social accounting are not numerous in the accounting literature but a small set of studies which explicitly considered macro social indicators appeared in a special section of *Accounting Organizations and Society* in 1981. The special section, which was introduced by Dierkes (1981) was “devoted to the memory” of a particular scholar, Raymond Bauer, who, anticipating Gray’s perceptions on social accounting, was a pioneer in the development of both social indicators and “corporate social accounting”. In the special issue, Parke and Petersen (1981) addressed the potential of macro social indicators while Heard and Bolce (1981) and Preston (1981) considered corporate social reporting. In Bauer (1966, cited in Glatzer, 1981) the concept of social indicators was “elaborated for the first time” (Glatzer, 1981) although Glatzer points out that the same fundamental concepts had also received attention from the United Nations in the 1950s. In the current paper we report on a subset of the indicators published annually by the United Nations and, like La Porta et al., we consider the entity of interest to be the nation state.

Arguably the interest in social indicators, certainly as regards the developed economies, reached a high water mark in the 1970s, mirroring, to some extent, progressive developments in the field of accounting at that time (see for example, ASSC 1975; Burchell et al., 1985). Soon afterwards, there were fundamental changes in the political climate (see, for example, Gray et al. (1995) and since then, at least within the “common law” countries, economic metrics have been “regnant” (Diener and Suh, 1997) as reflected, we would argue, in the criteria used by La Porta et al.

La Porta’s 1997 analysis revisited with the legal and economic variables juxtaposed with social indicators

In this paper we have followed a similar pattern for the presentation of data to that used in La Porta et al. (1997). In Table II of that paper (p. 1138), they listed 49 countries, grouped by legal origin, and reported empirical measures of financial and legal variables with means calculated for each legal origin. Our equivalent to Table II in La Porta et al. (1997a) is Table 2 below; it differs from the La Porta et al. Table II

in three ways. Firstly we have added a number of social indicator variables. The social indicators comprise: the under five child mortality rate (U5MR 01-04); two separate measures of income inequality (R10/P10 and the Gini Index); the log of the prison population (Log Pr Pop); and the proportion of women in the lower, or a single, house of legislators (% Women MPs). These variables are defined in more detail in Table 1 Panel A.

Secondly we have restricted the number of countries investigated. The 49 countries considered by La Porta et al. span a very wide range of social and economic development. Had we used the same list of countries, any associations that may exist between social indicators and legal origins may well have been masked by the very large differences attributable to other factors. Such masking would be especially relevant to health indicators which show gross discrepancies between rich and poor countries lying on opposite sides of the “epidemiological transition”⁴. Our choice of countries is, therefore, a subset of the 49 investigated by La Porta et al. and is based on the method adopted by Collison et al. (2007) which investigated child mortality in wealthy nations.

Thirdly we have reported in Table 2 only a subset of the indicators from La Porta et al. (1997a). The indicators reported are those from the first four columns of the La Porta et al. Table II and they measure various proxies for the vitality of equity markets and shareholder protection. This has been done to aid clarity of the exposition. The definitions of these variables are reproduced, in summary form, in Table 1 Panel B. The rest of the financial/legal variables considered by La Porta et al. (1997a) are reproduced in an Annex to this paper (in “Supplement to Table 1B” and “Supplement to Table 2”) and they are also included in statistical investigations which appear later in the paper.

It is worth highlighting that La Porta et al. themselves investigated certain social indicators in one of their papers (La Porta et al., 1999) which assessed the “quality of government”. They argued that the provision of high quality “public good provisions”

⁴ The epidemiological transition is a significant stage in the relationship between health and economic development; it occurs where increased prosperity allows the eradication of many infectious diseases and other readily preventable causes of illness and death.

which included infant mortality (referring to deaths under 12 months of age), “is a sign of a well functioning government” (La Porta et al., 1999, p.226) In the discussion of their results they state:

Compared to common law countries, French origin countries are sharply more interventionist (have higher top rates, less secure property rights, and worse regulation). ... French origin countries fall behind common law countries in public good provision: *they have higher infant mortality*, lower school attainment, higher illiteracy rates and lower infrastructure quality. (emphasis added) (La Porta et al.,1999, p. 261)

La Porta et al. based their analysis of infant mortality on 196 observations meaning that they covered countries on both sides of the epidemiological transition, with a huge range of development levels, and extremes of per capita average incomes. Indeed, the sizable and highly skewed range among infant mortality statistics was reflected in La Porta et al. using the log of that particular variable in their analysis. Given the child mortality analysis in Collison et al. (2007) it appears that the La Porta et al. analysis was (i) seriously flawed in not adequately acknowledging important confounding factors, i.e. in not comparing like with like, and (ii) misleading in relation to their flattering assessment of the common law tradition.

By contrast, Collison et al. (2007) considered data from the 24 richest OECD countries. Of those 24, only 22 are included in the current analysis since two, Iceland and Luxembourg, were not included in the La Porta et al. study⁵. The principal findings of the Collison et al. study were: firstly, a very strong association (at the 0.1% significance level) between income inequality and under-five child mortality (for the years 2001-4); secondly, the discovery that “Anglo-American” countries (Australia, Canada, Ireland, New Zealand, UK and US) had higher levels of child mortality than any of the other 18 countries; and thirdly, the marked deterioration in the relative ranking of the “Anglo-American” countries among the 24 since 1960 when they had occupied upper and middle positions when the countries were ranked in order of increasing child mortality⁶.

⁵ The other OECD countries that were excluded from the Collison et al. study were the Czech Republic, Hungary, Mexico, Poland, Slovakia and Turkey. They were omitted since their per capita income levels were considerably lower than those of the other countries. While the cut-off point was to some extent arbitrary, it did allow a more ‘like with like’ comparison.

⁶ It should be noted that all countries’ figures had improved in absolute terms over that period.

These findings are entirely consistent with a growing epidemiological literature (see, for example, Wilkinson 2005; Wilkinson and Pickett, 2006, 2009) which has shown that, for the richest countries of the world, higher levels of wealth are not associated with improvements in population health; instead, income inequality is significantly associated with poor performance across a wide range of social and health indicators. Both income inequality, and child mortality featured in La Porta et al., (1999), but no reference was made to the relationship between them. Thus, in setting out the terms of their analysis they stated that:

“As a first step, it is important to agree on what constitutes "good government." We use the term "good" in this article to stand for good-for-economic-development. One can alternatively consider good government performance to manifest itself in lower inequality, but here we keep the narrow view.” (p.223)

Given their laudable choice of child mortality as an indicator of good government the limitation of their “narrow view”, which lies at the heart of our criticism, is ironically apparent.

The basis of the choice of the social indicators listed in Table 1 Panel A, merits some explanation. The results reported in Collison et al. (2007) highlighting the poor performance of the Anglo-American countries suggested the possibility of an underlying systemic relationship involving poor societal well-being which could be linked to income inequality. The epidemiological literature provides additional evidence to support such a proposition (see, for example, Wilkinson and Pickett, 2008). Two measures of income inequality were chosen and are explained in more detail in Table 1. They are the widely used Gini coefficient which takes into account income levels across an entire population, and a second, more extreme, measure which is a ratio based only on the income received by the top and bottom deciles. The child mortality and prison population variables were chosen as examples of indicators which previous research had shown to be related to income inequality. The percentage of women MPs was selected since it seemed to be a potential discriminator between common and civil law traditions; the former being identified with the preservation of established interests. It seemed plausible that such values could be manifested in various ways:

If the mechanics of a particular electoral system exclude to a large degree members of a particular ascriptive group (women or otherwise), then more often than not that is damning evidence that the system is excluding the *interests* of that particular group from the structures of decision-making power. ...Indeed, the degree to which a system successfully includes women can indicate a propensity for the system to include other disenfranchised minorities. (Reynolds, 1999, p. 549)

Table 1 Panel A
Description of the social indicators

U5MR 01-04	Mean under five child mortality rate for the years 2001-2004 Source UNICEF's State of the World's Children Reports 2003 - 2006
R10/P10	The ratio of the income or expenditure share of the richest 10% of a population to that of the poorest 10%. Source UN Human Development Report (HDR) 2007-08
Gini Index	Gini coefficient of income inequality Source UN HDR 2007-08. This measure, unlike the R10/P10 ratio is based on income levels for an entire population.
Log Pr Pop	Log of prison population as at January 2007 Source HDR 2007-08
% Women MPs	Percentage of Women in lower or single house of legislators as at 31 May 2007 Source HDR 2007-08

Table 1 Panel B

Summarised description of the variables reported in Table 1 of La Porta et al. (1997a)

Origin	Identifies the legal origin of the company law or commercial code of each country source.
Ext cap/GNP	The ratio of the stock market capitalisation held by minorities to gross national product in 1994.
Domestic firms/pop	Ratio of the number of domestic firms listed in a given country to its population (in millions) in 1994 source: emerging market fact book and world development report 1996
IPOs/pop	Ratio of the number of initial public offerings of equity in a given country to its population (in millions) for the period July 1995 to June 1996.
AntiDir Rights	An index aggregating shareholder rights.

Note that the data reported in this table are not all from the same year as each other or as the data reported in the La Porta et al. (1997) study. The figures on child mortality have been taken from the Collison et al. (2007) paper for consistency with that set of data. (It should be noted that more recent

child mortality figures based on the years 2005- 2007 have also been confirmed as showing comparable statistically significant correlations with income inequality (Collison et al., 2009). The differences in base year relative to the La Porta et al. (1997) study are arguably appropriate in principal since one could regard social indicators as being a lagging variable relative to economic indicators. However the broad structural differences in socio-economic variables between countries are arguably such that the ideal time differences for an examination such as this are moot. Furthermore we would not expect the figures and relationships under consideration to be very sensitive to such timing issues.

Table 2 External Capital Markets and Social Indicators

Definitions for each of the variables are given in Table 1

<i>Legal Origin</i>	<i>ExtCap /GNP</i>	<i>Domestic Firms/Pop</i>	<i>IPOs/ Pop</i>	<i>AntiDir Rights</i>	<i>U5MR 01-04</i>	<i>R10/P 10</i>	<i>Gini Index</i>	<i>Log Pr Pop</i>	<i>% Women MPs</i>
Australia	0.49	63.55		4	6	12.5	35.2	2.10	24.7
Canada	0.39	40.86	4.93	4	6.5	9.4	32.6	2.03	20.8
Ireland	0.27	20	0.75	3	6	9.4	34.3	1.86	13.3
New Zealand	0.28	69	0.66	4	6	12.5	36.2	2.27	32.2
UK	0.49	35.68	2.01	4	6.5	13.8	36.0	2.09	19.7
USA	0.39	30.11	3.11	5	8	15.9	40.8	2.87	16.3
English origin avg	0.50	43.2	2.29	4	6.5	12.3	35.9	2.20	21.2
* La Porta et al. avg	0.60	35.45	2.23	3.39					
Belgium	0.17	15.5	0.3	0	5.5	8.2	33.0	1.96	34.7
France	0.23	8.05	0.17	2	5.5	9.1	32.7	1.93	12.2
Greece	0.07	21.6	0.3	1	5	10.2	34.3	1.95	13
Italy	0.08	3.91	0.31	0	5.25	11.6	36.0	2.02	17.3
Netherlands	0.52	21.13	0.66	2	5.5	9.2	30.9	2.11	36.7
Portugal	0.08	19.5	0.5	2	5.5	15.0	38.5	2.08	21.3
Spain	0.17	9.71	0.07	2	5.25	10.3	34.7	2.16	36
French origin avg	0.19	14.2	0.33	1.29	5.36	10.5	34.3	2.03	24.5
*La Porta et al. avg	0.21	10.00	0.19	1.76					
Austria	0.06	13.87	0.25	2	5	6.9	29.1	2.02	32.2
Germany	0.13	5.14	0.08	1	5	6.9	28.3	1.98	31.6
Japan	0.62	17.78	0.26	3	4.5	4.5	24.9	1.79	9.4
Korea, Rep of	0.44	15.88	0.02	2	5.25	7.8	31.6	1.99	13.4
Switzerland	0.62	33.85		1	5.5	9.0	33.7	1.92	25
German origin avg	0.37	17.304	0.1525	1.8	5.05	7.0	29.5	1.94	22.3
*La Porta et al. avg	0.46	16.79	0.12	2.00					
Denmark	0.21	50.4	1.8	3	4.25	8.1	24.7	1.89	36.9
Finland	0.25	13	0.6	2	4.75	5.6	26.9	1.88	42
Norway	0.22	33	4.5	3	4	6.1	25.8	1.82	37.9
Sweden	0.51	12.66	1.66	2	3.25	6.2	25.0	1.91	47.3
Scandinavian avg	0.30	27.26	2.14	2.5	4.06	6.5	25.6	1.87	41.0
*La Porta et al. avg	0.30	27.26	2.14	2.5					

*Means reported for the original, and larger, groups of countries reported in La Porta et al., (1997a)

The statistical significance of the relationships between social indicators and legal origin and between social indicators and some of the specific measures related to investor protection used by La Porta et al. are examined in some detail below. But a

number of striking patterns emerge from a visual inspection of the mean statistics for the social indicators chosen. It is not surprising in the light of the results from Collison et al. (2007) that the common law (i.e. English origin) countries have the worst child mortality figures since the common law countries within the OECD constitute the group more usually referred to as the Anglo-American countries. Similarly the position of the common law countries with respect to inequality is consistent with the Collison et al. results. The common law countries also have the largest mean prison population in the OECD and this result too is consistent with findings reported by Wilkinson and Pickett (2009) that “more unequal countries have higher rates of imprisonment than more equal countries” (p.148).

The association of income inequality with a range of social ills is reflected in the consistent ranking of the legal origin groups across the income inequality, child mortality and prison population indicators. In each case the Scandinavian countries perform best, followed by the German group. The French group is consistently ranked third while the common law countries are consistently ranked at the bottom.

The final social indicator, percentage of women MPs, is of a different type to the others but, as discussed above may be considered as a proxy for the progression of the democratic impulse and so could be construed as having features in common with the other measures. This indicator again shows, we would argue, the worst performance being found amongst the common law countries (in aggregate) although admittedly, there appears to be little difference between the three non-Scandinavian groups. Close inspection reveals that the results are influenced by a few outliers. In the German group, the Asian nations have low figures which may be accounted for by differing cultural traditions. Were these to be removed, a rather different gradation of means would be apparent. However the figures for France, Greece and Ireland are all also relatively low. A cultural/historical examination of possible explanations for these figures goes beyond the scope of this paper, but we would venture that, *prima facie*, the common law countries, in aggregate, seem to have progressed less far on the journey towards representative democracy and pluralism than their civil law counterparts.

The next part of this section presents a more rigorous statistical examination of the data in Table 2 (and the rest of the La Porta et al data which appears in the Annex to this paper) but it already appears that, compared to the civil law countries, the common-law tradition is associated with greater inequality and a relatively conservative approach to social development.

Statistical analysis

The empirical analysis in this section of the paper has a number of parts. Initially, the social indicator variables (U5 01-04, R10/P10, Gini Index, Log PR Pop and % Women MPs) are examined for each of the legal-tradition categories which La Porta et al. derive. Specifically, the mean (median) of each of the social indicators is calculated for all four legal tradition groupings of countries and a test of the null hypothesis that the mean (medians) were equal is conducted. The second empirical component of the current article examines the relationships that exist between the various proxies for investor protection which La Porta et al. employ when grouping countries and the social indicators examined in the current investigation. In particular, correlation analysis is used to study the sign and size of any relationships that may be present. The third empirical part of the analysis distils the information in the 10 investor protection proxy variables, used by La Porta et al., into a number of principle components and regresses these components on the social indicators for the developed countries considered in the current study. In this way, a comprehensive investigation is undertaken to determine whether certain investor protection proxy variables and some legal tradition groupings of countries are associated with better indicators of social health and development such as under 5 mortality, measures of income inequality, the size of the prison population or the representation of women among elected members of a country's parliament.

The initial investigation focused on whether the five social indicator variables being considered varied across the four groupings of countries from La Porta et al. based on legal traditions. The results from this analysis are shown in Table 3. The top half of this table reports the findings from an analysis of means while the bottom half documents the results for an investigation of the median values for each of the social indicator variables; the median analysis is reported because some of the descriptive statistics in Table 2 suggested that the variables might not be normally distributed. In

the top half of the table, the mean value of each social indicator together with its standard deviation is provided for all four legal traditions. An F-statistic and its p-value are then reported for a test of the null hypothesis that these means were equal. In the bottom half of the paper, median values and their associated Z-statistics are provided for each of the four groupings of countries and an H-statistic together with its p-value is shown for the null hypothesis that these median values were equal.

[Table 3 about here]

An analysis of Table 3 reveals that sizeable differences exist in the measures of social health across the four groupings of countries based on La Porta et al.'s classification scheme. In particular, the mean level of under five child mortality in countries where the legal tradition has an English common law origin (mean = 6.500) is 60 per cent higher than in Scandinavian countries (mean = 4.063). A similar picture emerges from the other four social indicator variables considered. Specifically, countries where the legal system is based on an English common law tend to have the greatest income inequality (according to both the R10/P10 and Gini Index variables), the highest average prison populations and smallest percentage of Women MPs. The Scandinavian countries perform best. In between, the countries where the legal tradition is based on German Law are ranked second while those where the legal origin is French in character are ranked third⁷.

A more detailed inspection of Table 3 reveals that there is some variability within the country groupings for the social indicator variables being studied. In particular, some of the standard deviation figures were large. This seems to be especially the case for English common law countries (Legal Origin 1) where the standard deviation values were highest for three of the five social indicator variables being examined. For example, the standard deviation value of the Log PR Pop variable for Legal Origin 1 countries of 0.352 is nearly 4 times as large as the next highest standard deviation number. By contrast, Scandinavian countries (Legal Origin 4) tend to be much more

⁷ Strictly speaking, the ranking for the final social indicator variable (% Women MPs) is the opposite to that for the other four where a high number is better than a low number; for the other four variables, a larger number indicates a higher level of child mortality, a greater level of income inequality and a greater prison population.

homogenous in terms of the social indicator variables since the standard deviation values are smallest for four of the five measures being examined.

Despite this variability within groupings, the picture that emerges from Table 3 is that a consistent pattern exists in terms of the rankings of the country groupings according to their social indicator variables. The F-statistics confirm that the mean values for each social indicator are not equal across the four country groupings. All of the F-statistics were large and statistically significant at the 10 per cent levels; indeed, four of the p-values are less than the critical value of 0.05. This finding is confirmed by an analysis of the median values and their corresponding H-statistics. For all five social indicator variables the rankings of country groupings based on median values are identical to those based on their mean counterparts. Further, the null hypothesis that the medians are equal across the four country groupings can be rejected for four of the five social indicator variables; the exception to this general finding related to the Log PR Pop where the H-statistic is only 9.32 and its p-value is 0.25.

The Spearman correlations⁸ (a) among the investor protection and legal origin variables and (b) between the investor protection as well as legal origin variables and the social indicator measures are displayed in Table 4. Based on the results from Table 2, one would expect the correlation findings to confirm that a relationship exists between the legal origin of a country and its social indicators. However, this table goes further by examining whether a relationship exists between (i) the investor protection measures on which the legal origin grouping is based and (ii) the social indicator variables. Further, the table highlights whether there are correlations among the different investor protection measures which La Porta et al. employ or whether each one is capturing a different aspect of the legal origin grouping used by La Porta et al.

[Table 4 about here]

A visual inspection of Table 4 reveals that there is a strong negative association between: under-5 child mortality; income inequality; as well as the size of prison

⁸ The non-parametric Spearman rank correlation analysis was selected because there was some evidence that the variables being examined were not normally distributed. In fact, descriptive statistics revealed that data for one of the social indicators and six of the investor protection variables were positively skewed. In addition, there was some evidence of kurtosis in the data series. However, an analysis of the parametric Pearson correlation coefficients revealed very little difference in the values calculated.

population; and whether the legal origin of the countries being studied is based on English common law (Legal Origin 1). In addition, the association between the % of Women MPs and legal origin is positive, consistent with the figures showing that Scandinavian countries have a much larger representation of female elected representatives in their Parliament relative to their common law counterparts. When the investor protection variables were examined, however, relatively few of the correlations were statistically significant; in fact only six correlation values have p-values of less than 0.05: Anti Dir and U5 01-04, FirmsPop and U5 01-04, GDP Growth and % Women MPs, Log GNP and % Women MPs, 1s1vote and % Women MPs, Rule of Law and % Women MPs. The remaining 44 correlations in the bottom panel of Table 5 are not statistically different from zero at the 5 per cent level.

In the top half of Table 4, there is some evidence that the investor protection variables are correlated with one another. Of the 45 correlation values calculated, 12 were statistically significant: ExCapGNP and AntiDir, ExCapGNP and FirmsPop, ExCapGNP and IPOsPop, ExCapGNP and Debt/GNP, AntiDir and FirmsPop, AntiDir and IPOsPop, FirmsPop and IPOsPop, 1s1Vote and IPOsPop, Debt/GNP and Log GNP, GDP Growth and 1s1vote, GDP Growth and Rule of Law, 1s1vote and Rule of Law. Such a result is hardly surprising since many of the variables were constructed from a common component (e.g. GNP) while all were presumably selected by La Porta et al. because they helped to paint a picture about one issue (namely the protection of investor rights) within a country. All of these significant correlations had the expected signs. For example, it is not surprising that the correlation between ExCapGNP and Anti Dir is positive at 0.522 since one would expect the index value aggregating shareholders rights in a country to be high where the ratio of the capitalisation held by minorities to GNP to be high.

Since there is some evidence of a relationship among the investor protection variables from La Porta et al. studies, it was decided to use a statistical approach to take account of this correlation before examining the association between social indicators and the investor protection variables using regression analysis⁹.

⁹ In fact, a regression of the social indicator variables on all of the investor protection measures and the legal origin dummy variables indicated that multicollinearity was present in the data. For example, when U5 01-04 was the dependant variable, five of the independent variables had variance inflation factors (VIFs) that were greater than 10. Thus, PCA was employed to overcome this problem.

To examine the possible relationship between indicators of social performance and the various investor protection variables in the La Porta et al. studies, PCA was employed to identify relevant factors from the pool of data under consideration. PCA is a method which significantly reduces the number of variables from p to a much smaller set of k derived orthogonal variables that retain most of the information in the original p variables. The k derived variables which maximise the variance accounted for in the original variables are called principal components (PCs). After applying this analysis to the data series of each of the developed countries being studied, the dominant PCs are then extracted and used as inputs into a regression analysis to seek to explain the social indicators included in the study. The use of PCA is appealing for a number of reasons. First, it allows a large number of theoretically important factors that may affect the social indicators to be considered and second, it can be used effectively in conjunction with multiple regression analysis by addressing the problems of multicollinearity; specifically, because the k derived variables are orthogonal to each other multicollinearity should not be present.¹⁰

Table 5 summarises the results from applying PCA to the investor protection variables considered in the La Porta et al. papers. In particular, the bottom part of Table 5 details the eigenvalues and proportions of variance explained by the PCs, while the top part of Table 5 summarises the factor loadings for the dominant PCs. The data in Table 5 clearly shows that across all 20 countries examined, the bulk of the variability in the original 10 investor protection variables can be explained by 4 PCs. For example, the variance, or eigenvalue, of the first PC is 3.027. It explains 30.3 per cent of the total variance of the 10 investor protection variables. The second PC has an eigenvalue of 2.291 and accounts for 22.9 per cent of total variance of the 10 variables. The third and fourth PCs also have eigenvalues greater than 1.000 and explain 17.0 and 11.3 per cent and account for 17.0 and 11.3 per cent of the variability in the investor protection measures across the different countries. The proportion of

¹⁰ Factor analysis (FA) is a very similar technique to PCA and it could have been employed to identify the fundamental investor protection variables that are important in explaining the social indicator measures. The defining characteristic that distinguishes between the two techniques is that, with PCA, all the variability in an item is used in the analysis, while in FA, only the variability in an item that is common with other items is used. PCA was used to identify the important factors in this paper as it is the preferred method for data reduction, while FA is preferred when the objective of the analysis is to detect structure. In most cases, however, the two methods yield very similar results (Hill and Lewicki, 2006).

variance explained by the remaining 6 PCs is relatively low and their eigenvalues are all small.

[Table 5 about here]

The Kaiser criterion was used to select the PCs which should be used as inputs for the regression analysis. The criterion recommends that only those PCs with eigenvalues greater than or equal to 1, should be retained (Kaiser 1960). Jolliffe (1972) has suggested a cut-off point of 0.7. However, in this instance, Jolliffe's criterion results in the same number of components being retained as Kaiser's criterion of the eigenvalue being greater than or equal to 1 (Dunteman 1994). Therefore, the adoption of these criteria led to the retention of 4 PCs. Together, these four PCs account for 81.5 per cent of the variance in the investor protection variables. Therefore, the dimensionality of the dataset can be reduced from 10 to 4.

The values in top half of Table 5 indicate the factor loadings of the PCs that are identified from the data. In particular, the top half of the table therefore highlights the variables that have large coefficients of either sign in each PC vector¹¹. The first PC, which is shown in column 2, has high positive correlations with AntiDir, Rule of Law and IPOsPop and negative correlations with GDP Growth as well as 1s1Vote. This PC primarily reflects strong shareholder rights and a vibrant new issue market; it is labelled "Outsider Capitalism" in the current analysis. The second PC shows large negative co-efficients for ExCapGNP, GDPGrowth and 1s1Vote and can be interpreted as small stock market/ low growth variable. We label this PC "Insider Capitalism" in the remainder of the paper. The largest co-efficients for the third PC are positive for FirmsPop and negative for GDP Growth as well as Debt/GNP. This can be interpreted as a large stock market/ low growth/low debt variable; as a result, we label this PC as the "Small Economy" variable. The fourth PC is mainly associated with strong "Creditor Rights".

¹¹ PCA is subject to a number of limitations. One limitation of the method is that it can often be difficult to interpret the principal components. This situation typically arises when several variables in the PC vectors have large coefficients of either sign (Dunteman, 1994). However, this limitation was not a concern in the current analysis as, in each market, the identity of the high loading variables in each PC vector was very clear. A second limitation of the technique is that the choice of how many PCs to extract for further analysis is subjective, although the PCs will explain most of the variation in the original factors; they may not be useful in explaining the dependant variable (Brooks 2002). That is, and in terms of the current analysis, although the PCs will explain most of the variation in the original economic and fundamental factors, they may not be the most useful as explanations of emerging market share returns.

In the final part of the empirical analysis, the dominant PCs together with Legal Origin variables are used as inputs to a regression analysis in order to explain the social indicator variables of the 22 developed countries included in this study¹². Five regression models are considered. First, the under 5 child mortality figures of the sample countries are regressed on each of the four PCs as well as three dummy variables representing legal origin (Legal Origin 2 (French), Legal Origin 3 (German) and Legal Origin 4 (Scandinavian)); a variable was not added for Legal Origin 1 (English) as the regression equation would have been over-specified. Instead, the impact of Legal Origin 1 is accounted for in the constant term: all of the other coefficients need to be interpreted relative to the level of U5 01-04 in English common law countries¹³. Four similar regression equations were estimated for the other social indicator variables. These regression models took the form:

$$SI_{si} = \beta_0 + \beta_1 PC_{1i} + \beta_2 PC_{2i} + \beta_3 PC_{3i} + \beta_4 PC_{4i} + \beta_5 LO2 + \beta_6 LO3 + \beta_7 LO4 + \epsilon_i \quad (1)$$

where SI_{si} is the social indicator s for country i ($s =$ U5 Child Mortality 01-04, R10/P10, Gini index, Log PR Pop and % Women MPs), PC_i is principal component for country i , LO is the Legal Origin dummy variable for French (LO2), German (LO3) and Scandinavian (LO4) legal traditions. Finally, ϵ_i is a random error term.

Table 6 reports the results from estimating equation (1)¹⁴. In particular, the table details the co-efficient of each PC and Legal Origin variable, with their corresponding p-values. The adjusted R^2 s for the 5 regressions are also shown. An inspection of Table 6 suggests that a significant relationship exists between some of the social indicator measures and the PC as well as legal origin variables. The strongest and most significant associations are between under 5 child mortality as well as income inequality and legal origin variables. For example, the co-efficients for the legal origin

¹² In fact, the regression results reported in this paper relate to data for 20 of the 22 countries since IPOsPop information was missing for Australia and Switzerland. However, imputing values for these two missing observations and thereby increasing the sample up to 22 countries does not alter either the PCA results or the regression findings.

¹³ A regression was also run where one dummy variable was added depending on whether the country had an English common law tradition (value = 1), or not (value = 0). In this instance, the dummy variable had the following co-efficients: 2.237 (p=0.000) for U5 01-04; 5.124 (p=0.038) for R10/P10; 10.498 (p=0.003) for the Gini Index; 0.256 (p=0.142) for Log PR Pop; and -16.143 (p=0.013) for % Women MPs.

¹⁴ Although not shown in Table 6, the VIFs for all of the variables were less than 5.0 suggesting that multicollinearity was not problematic in these regression equations.

variables are negative for the U5 01-04 equation suggesting that under 5 child mortality is lower in countries which don't have an English common law tradition; for those countries with a German or Scandinavian legal tradition, the co-efficients are statistically significant at the 5 per cent level. A similar picture emerges for the Gini index equation where Legal Origin 3 and Legal Origin 4 dummy variables have co-efficients of -9.068 and -10.810 with p-values of 0.020 and 0.000 respectively. For the R10/P10 (% Women MPs) variable, only the co-efficient for the Legal Origin 4 countries is statistically negative (positive) at the 5 per cent level.

[Table 6 about here]

An inspection of the co-efficients on the PC variables indicates that only one significant value is observed. The Creditor Rights variable (PC4) is positively associated the percentage of Women MPs in a country (co-efficient = 4.244, p-value = 0.025). However, this may simply reflect the fact that in Scandinavian countries, creditor rights are protected to a greater extent and a larger percentage of MPs are women. None of the other PC measures constructed from the investor protection variables employed in La Porta et al. can significantly explain the social indicators of the countries being studied.

Finally, it is worth pointing out that three of the regression equations have relatively high explanatory power. Specifically, for the U5 01-04, Gini index and % Women MPs, the R^2 values are 0.71, 0.65 and 0.63 respectively. The only equation with a very low level of explanatory power is where Log PR Pop is the dependant variable; in this instance, the R^2 is only 0.05 and none of the co-efficient values are statistically different from zero.

Common and Civil Law Traditions and Corporate Law

Reference to the work of Berle and Means is a recurring theme in a number of the La Porta et al papers (see, especially, La Porta et al. 1999). That theme is the need to reappraise a common image of corporate structures, stemming from Berle and Means classic analysis, which focuses on the agency conflict between ownership and control. They state that "Our results present a different picture of the ownership structure of a modern corporation than that suggested by Berle and Means and widely accepted in

the finance literature.” (La Porta et al., 1999, p. 502). And La Porta et al (2008) state that:

“The last decade has witnessed an explosion of research on corporate governance that uses the investor protection framework. This research has successfully replaced the traditional Berle–Means conception of a public corporation with a much more realistic for most of the world model of family-run firms, pyramidal and group structures, and tremendous conflicts between outside investors and controlling shareholders. (p. 287).

However there is another, more fundamental, insight of Berle and Means on which La Porta et al appear to be silent, and which is an explicit critique of the common law tradition and its implications for corporate governance. That analysis, we will argue, is consistent with an expectation that societal well being will be better in civil law rather than common law countries.

In their discussion of “The traditional logic of property”, Berle and Means (1932, Book Four, Chapter 1), refer to legal, economic and social issues “which must now be squarely faced”. The most important issue that they identify is “who should receive the profits of industry”, in other words, should large companies be run in the interests of the “owners” or others? Berle and Means place quotation marks around the word “owners” to indicate the problematic issue of identifying the meaning of, and the rights attaching to, ownership of large and publicly important enterprises. They assert that under common law, the traditional logic of property requires that the entire profit be awarded to the shareholders. They discuss the historical development of the law pertaining to property when power to manage assets was delegated to others. The dominant tradition is that those with delegated rights to control assets owned by others do so as fiduciaries. They follow their examination of such developments by stating

“Underlying all this is the ancient preoccupation of the common law with the rights of property. Primarily, the common law did not undertake to set up ideal schemes of government. It aimed to protect men in their own.” (Berle and Means, 1932, p.296).

This legal tradition is subjected to a critical reappraisal by Berle and Means. In this exercise they address fundamental questions arising from the separation of ownership and control. However their interest in this question was not confined to the classic

agency problem with which they are closely associated - they were much more concerned with the significance for wider society of the operation of large corporations.

They reason that the nature of the modern corporation “calls for analysis, not in terms of business enterprise but in terms of social organization” because the corporation has become a site of highly centralized power in which many interests are at stake. Their discussion then centres on the historical process by which power is challenged – as happened in relation to the absolute religious power once wielded by the church, and the slow process by which constitutional law developed in the political context. Berle and Means do not predict how this essentially political question, of how the diverse groups which have an interest in the operation of the corporation will resolve their interests; but they do take a normative, as well as an analytic perspective in considering future possibilities.

They consider that the owners of passive property, having given up the role of managing their resources, have also given up the right to have the entity operated in their interest¹⁵. But they are also emphatic that the elimination of the “sole interest of the passive owner” does not mean that the controlling group should take over the same right: they conclude that neither “the claims of ownership nor those of control can stand against the paramount interests of the community”. They recognize that institutional and political accommodations will need to be fashioned, but hold that:

“When a convincing system of community obligations is worked out and is generally accepted, in that moment the passive property right of today must yield before the larger interests of society.” (p.312).

They envisage courts having to moderate their traditional position on property rights by whichever “legal theories they might choose” to recognize what Berle and Means see as a social imperative. They base this imperative on a continuing historical process whereby concentrated power is forced to accede to the wider interests of the polity. (see also Engelen, 2002 and Gomez and Korine, 2005). They argue that:

¹⁵ In the General Theory, Keynes (1936) famously went somewhat further than Berle and Means in his disdain for rewarding the passive investor. He advocated (metaphorically) “the euthanasia of the rentier, of the functionless investor” (p.235) and the consequent “euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity value of capital”.

“It is conceivable, - indeed it seems almost essential if the corporate system is to survive, - that the “control” of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity”. (p.313).¹⁶

They go on to reiterate the point about the historical imperative whereby power is and should be challenged whenever it becomes too concentrated – and with great prescience they foresee the potential for corporations to become so powerful that they can dominate the state. This reinforces their central point that the control of such organisations should become a matter of constitutional reform in the wider democratic and public interest, rather than a vehicle for promoting the interest of powerful groups.

Their views of the differing characteristics of a legal framework which aims to balance the interests of all members of society, and the common law which merely seeks to defend “men in their own” are, we submit, of great salience given the evidence adduced in this paper of the wider societal impacts which are associated with legal traditions.

Conclusion

Our conclusion to this paper can be stated succinctly. Following the thrust of the Berle and Means analysis we contend that the common law tradition leads to the spurious depoliticisation of issues that are central to political mediation. And we have adduced evidence that it leads to social outcomes, relative to those found in countries with a civil law tradition, which should give profound cause for concern and prompt the question of how such outcomes could be ameliorated. And in this context, we believe that the wide influence of the work of La Porta et al. is a matter for concern. Shleifer (2002) asserts that:

“The evidence identifies no benefits of the more interventionist institutions [of civil law countries] for economic or social outcomes. To the contrary, French legal origin typically is associated with worse public sector outcomes” (p.3).

¹⁶ For a vigorous and well known challenge to such a governance philosophy, see Jensen (2001).

And, perhaps even more worryingly that

“In the years ahead, institutional reform may become one of the key strategies for improving human welfare.” (p.5)

We also note that much of the analysis and evidence, produced by La Porta et al., on the relationship between varieties of capitalism, including legal traditions and related forms of corporate governance, is of great significance and potential importance. Unfortunately their “narrow view”, which may have appeal to some investors, has obscured the really important implications of their work for wider society.

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Table 3 An Analysis of the Social Indicator Variables According to a Country's Legal Origin

Legal Origin	U5 01-04		R10/P10		Gini Index		Log PR POP		% Women MPs	
	Mean	StDev	Mean	StDev	Mean	StDev	Mean	StDev	Mean	StDev
1	6.500	0.775	12.250	2.534	35.850	2.758	2.203	0.352	21.167	6.664
2	5.357	0.197	10.514	2.256	34.300	2.466	2.030	0.089	24.457	11.036
3	5.050	0.371	7.020	1.651	29.520	3.347	1.939	0.090	22.320	10.457
4	4.063	0.625	6.500	1.098	25.600	0.983	1.874	0.040	41.025	4.730
F statistic	18.18		9.28		15.73		2.72		4.64	
p-value	0.00		0.01		0.00		0.08		0.01	
Legal Origin	U5 01-04		R10/P10		Gini Index		Log PR POP		% Women MPs	
	Median	Z statistic	Median	Z statistic	Median	Z statistic	Median	Z statistic	Median	Z statistic
1	6.250	3.540	12.500	2.730	35.600	2.430	2.097	1.990	20.250	-1.220
2	5.500	0.180	10.200	1.450	34.300	1.450	2.017	1.020	21.300	-0.530
3	5.000	-1.210	6.900	-2.230	29.100	-1.610	1.978	-0.980	25.000	-0.940
4	4.125	-2.980	6.150	-2.470	25.400	-2.810	1.881	-2.470	39.950	3.060
H statistic	17.86		15.70		14.19		9.32		9.64	
p-value	0.00		0.00		0.00		0.25		0.02	

Table 4 Correlation Analysis

	Legal Origin	ExCapGNP	AntiDir	FirmsPop	IPOsPop	CredR	Debt/GNP	GDP Growth	Log GNP	1s1vote	Rule of Law
Legal origin	1.000										
ExCapGNP	-0.1.86	1.000									
AntiDir	-0.423*	0.522*	1.000								
FirmsPop	-0.364*	0.425*	0.671*	1.000							
IPOsPop	-0.222	0.413*	0.656*	0.688*	1.000						
CredR	0.238	-0.030	0.016	0.004	-0.126	1.000					
Debt/GNP	-0.168	0.481*	0.311	-0.032	-0.186	0.226	1.000				
GDP Growth	-0.148	-0.129	0.162	-0.164	-0.214	-0.139	-0.011	1.000			
Log GNP	-0.125	0.336	0.040	-0.307	0.181	0.050	0.557*	0.186	1.000		
1s1vote	0.162	0.063	-0.119	-0.031	-0.413*	0.066	-0.023	0.313	0.073	1.000	
Rule of Law	0.096	0.260	0.208	0.273	0.441*	-0.096	0.216	-0.382*	-0.056	-0.503*	1.000
U5 Mortality 01/04	-0.912*	0.349	0.418*	0.416*	0.219	-0.266	0.248	0.056	0.179	-0.285	0.065
R10/P10	-0.838*	0.036	0.293	0.350	0.206	-0.204	-0.003	0.009	0.035	-0.240	-0.207
Gini Index	-0.801*	-0.007	0.146	0.199	-0.029	-0.243	0.037	0.044	0.006	-0.188	-0.200
LOG PR Pop	-0.649*	0.049	0.248	0.199	0.019	0.130	0.336	-0.027	0.214	-0.261	0.088
% Women MPs	0.484*	-0.112	-0.093	0.012	0.285	0.300	-0.172	-0.417*	-0.368*	-0.533*	0.553*

Note: This table shows the Spearman correlation coefficients for the variables included in the analysis. The top half of the table displays the correlation coefficients among the investor protection and legal origin variables while the bottom half of the table shows the correlation between the social indicators and the La Porta et al. variables. An explanation of the variables is provided in Table 1 and an * indicates significance at the 1 per cent level for a one-tail test.

Table 5 A Principal Component Analysis of the La Porta et al. Investor Protection Variables

Variable	PC1	PC2	PC3	PC4	PC5	PC6	PC7	PC8	PC9	PC10
ExCapGNP	0.326	-0.438	0.002	-0.012	-0.034	0.272	0.715	0.228	-0.112	-0.225
AntiDir	0.454	-0.184	0.283	-0.187	-0.223	-0.230	0.044	-0.339	-0.122	0.641
FirmsPop	0.369	0.051	0.489	0.217	-0.284	0.045	-0.320	-0.166	-0.164	-0.579
IPOsPop	0.401	0.065	0.246	-0.402	0.525	0.147	-0.194	0.247	0.466	-0.023
CredR	0.104	-0.229	0.077	0.792	0.440	0.148	-0.123	-0.005	0.007	0.271
Debt/GNP	0.233	-0.391	-0.401	0.152	-0.282	-0.451	-0.189	0.127	0.504	-0.140
GDP Growth	-0.257	-0.409	0.274	-0.158	0.389	-0.593	-0.040	0.119	-0.342	-0.179
Log GNP	0.118	-0.377	-0.469	-0.265	0.194	0.339	-0.361	-0.412	-0.294	-0.121
1s1vote	-0.288	-0.409	0.249	-0.104	-0.362	0.372	-0.362	0.474	-0.016	0.227
Rule of Law	0.403	0.292	-0.311	0.032	-0.002	-0.136	-0.180	0.566	-0.521	0.107
Eigenvalue	3.027	2.291	1.696	1.132	0.546	0.447	0.359	0.283	0.130	0.090
Proportion	0.303	0.229	0.170	0.113	0.055	0.045	0.036	0.028	0.013	0.009
Cumulative	0.303	0.532	0.701	0.815	0.869	0.914	0.950	0.978	0.991	1.000

Note: This table shows the output from applying a principal component analysis to the investor protection variables in the La Porta et al. study. The top part of the table shows the weightings for the 10 investor protection variables of each PC. The bottom part of the table highlights the importance of each PC in explaining the investor protection variables.

Table 6 Regression Results

	U5 01-04		R10/P10		Gini Index		Log PR POP		% Women MPs	
Predictor	β	p-value	β	p-value	β	p-value	β	p-value	β	p-value
Constant	6.468	0.000	11.608	0.000	36.869	0.000	2.134	0.000	19.319	0.002
PC1	0.069	0.606	0.235	0.683	-0.494	0.470	0.0489	0.375	1.964	0.268
PC2	-0.027	0.818	-0.256	0.611	-0.115	0.846	-0.009	0.845	2.508	0.114
PC3	-0.049	0.710	0.209	0.715	-0.024	0.971	-0.010	0.858	-1.713	0.498
PC4	-0.154	0.252	0.277	0.623	-0.008	0.991	-0.020	0.704	4.244	0.025
LO2	-1.065	0.092	-0.533	0.835	-3.083	0.317	-0.051	0.835	6.015	0.440
LO3	-1.452	0.049	-5.335	0.087	-9.068	0.020	-0.152	0.585	5.670	0.522
LO4	-2.397	0.000	-5.100	0.016	-10.81	0.000	-0.278	0.134	18.261	0.006
R^2	0.71		0.43		0.65		0.05		0.63	

Note: This table displays the coefficients (β s) and their p-values for the five regressions undertaken. PC1 to PC4 represent the PCs extracted from the investor protection variables while LO2, LO3 and LO4 are dummy variables representing the French, German and Scandinavian legal origins respectively. LO1 was not included in order to avoid over-specifying the equation. R^2 refers to the adjusted R^2 of the regression equation.