ABSTRACT

This study examines the cultural dimension in the determination of the corporate capital structure, by exploring the hypotheses that firms owned by Overseas Chinese in Taiwan, Hong Kong, Malaysia, and Singapore, will have a capital structure reflecting the precepts of Confucianism, and that, in spite of a similarity of ownership, concentration of control, and the distribution of shares, it will differ from the capital structure of firms in geographic areas not influenced by Confucianism. The literature related to theoretical considerations, empirical evidence of cultural influence on capital structure and international experience of cultural influences on capital structure is reviewed. The related Confucian ethics and morals precepts are discussed and a landscape of characteristics of firms owned by Overseas Chinese in SEA is presented. A detailed plan for the empirical part of the study, including the potential sources of information, and a short report on the work in progress is added.

THE CULTURAL DIMENSION OF CAPITAL STRUCTURE DETERMINANTS: STUDY OF THE INFLUENCE OF CONFUCIAN WORLDVIEW ON THE CAPITAL STRUCTURE OF FIRMS OWNED BY OVERSEAS CHINESE
In HONG KONG, TAIWAN, MALAYSIA, AND SINGAPORE

by

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OVERVIEW

The intent of this study is to attract attention of the researchers to the role of the cultural dimension in the determination of the corporate capital structure. Such a role should be most visible at the intersection of the "Spirit of Capitalism", defined by Smith (2001) as the principle that acquisition is the ultimate purpose in life, with the value based on service oriented Confucian\(^1\) worldview, still ascribed to by the South East Asia Overseas Chinese economic actors not yet contaminated by the Western Communist ideology of Mainland China. This paper, therefore, will seek to demonstrate the influence of the Confucian worldview on the capital structure of the Overseas Chinese owned corporations on Taiwan, in Hong Kong, Singapore, and Malaysia. The selection of these four countries historically influenced by British or USA colonizers, provides also the opportunity to gauge the valence of the Confucian worldview when exposed to two different politico-economic pressures, British and USA.

The following are the basic premises of this study:

A. A similarity of capital structure of firms owned by Overseas Chinese on Taiwan, Singapore, Hong Kong and Malaysia would suggest the common influence of Confucian moral and ethical precepts.

B. If such similarity is demonstrated, the firms influenced by Confucianism will be compared with similar firms in non-Confucian areas, and the difference attributed to the influence of Confucian precepts.

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1. Throughout this paper I will use Kongsi’s latinized name of Confucius.
C. If, as expected the Confucian influence will be associated with 1. relatively small number of firms of similar characteristics in a single country, 2. family (or related group) ownership, 3. concentrated control (few investors owning 25% or more of shares), and 4. narrow distribution of shares, then the proper country for comparison will be Germany, and Germany will be used as proxy for non-Confucian areas. The additional advantage of Germany is that Germany had never exerted any significant political or economic influence on the area under Confucian influence.

The study is presented as follows: In Part One, section 1, I will address the question “Can cultural differences be reflected in capital structure?” on the basis of theoretical considerations and by reviewing the international experience suggesting cultural influences on capital structure. In section 2, I will discuss the salient features of Confucianism and the attempts to develop “Confucian Capitalism”. In section 3, I will present a landscape of characteristics of firms owned by Overseas Chinese in South East Asia countries with Confucian tradition. In section 4, I will conclude Part One by formulating appropriate hypotheses. Part Two, the empirical part of the study, will concern itself with the examination of these hypotheses.
PART ONE: DEVELOPMENT OF THE THESIS AND FORMULATION OF TESTABLE HYPOTHESES

INTRODUCTION

In 1948 Karl Marx in the Communist Manifesto, predicted that the expanded multiplication of the means of production in capitalism would bring about a unified global market through destruction of all existing divisions in social relations, and the disappearance of boundaries between East and West. Marx is being proven only half-correct. Indeed the worldwide net of almost immediate communications and information transfer are challenging the cultural, political and economic distinctions between nations and geographic areas. Yet the world population’s opposition to economic globalization, in spite of its financial and economic benefits, is growing, and the self-identity of people in various cultural regions of the world, with their distinct languages, customs, cultural norms and ethnic outlooks formed in the past hundreds or thousands of years, shows an unexpected resiliency to the challenge of cultural globalization. It thus seems likely that the future of the world’s financial and economic development can be glimpsed from an examination of the pragmatic answer to the challenge of globalization at the points of the greatest tension between the economic globalization and the cultural values of the land. Such an intersection point is undoubtedly the area of South East Asia, especially its parts belonging to the Confucian cultural sphere, such as Taiwan, Hong Kong, Singapore, and Malaysia.

Of immediate practical value, critical for the future of the economic globalization effort in general and for the capital structure of the globalizing firms in particular, is the endeavor to find an accommodation between Confucianism and Capitalism without encroachment upon the
precepts expressed in both *ren* and *li*\(^2\). If adjustment are not possible, the introduction of Capitalism and Westernization in the Confucian cultural\(^3\) sphere, will demand departure from Confucian precepts by the business segment of the population, an event, not unthinkable but promising to reduce significantly the speed and the economic effectiveness of the globalization. For that reason the precepts of Confucianism, and the attempts to develop the “Capitalist Confucianism” will be included in this study.

SECTION 1. “CAN CULTURAL DIFFERENCES BE REFLECTED IN CAPITAL STRUCTURE?”

1.1. Theoretical Considerations

Culture does matter because culture affects the management’s perception of the cost and risk related to debt financing and agency problem in all countries. Adler (1997) argues that culture influences our values, which in turn affect our attitudes, and then our behavior. Homer and Kahle (1988) have empirically demonstrated such hierarchy.

One of the more detailed studies addressing the question of the cultural determinant of the capital structure is that of Chum, Lloyd, and Kwok (2002). The authors study empirical hypotheses of possible cultural influences on capital structure of corporations drawn from financial models and cross-cultural psychology, and test the hypotheses against a sample of 5591 firms across 22 countries. The authors base their cultural dimensions on Schwartz’ (1994) classification of cultural dimensions, and relate these to capital structures of corporations under

\(^2\) *Ren* stands for benevolence, humanity; *li* stands for prescriptions of behavior, manners and general deportment that binds human beings in networks of interlocking roles within the family and within the society.

\(^3\) I define “culture” as a set of values developed through historical experiences, and their interpretations by a group, in this case the population of a country that shapes the perception of the world, and the behavior, of the significant part of the population of a country.
the influence of a particular cultural dimension. Thus cultural dimension of “conservatism” demands harmonious working relationships. Firms concerned about harmonious relationship will be more concerned with the liquidation costs to its stockholders and thus are expected to have lower debt ratio. In fact Titman (1984) suggests that the liquidation of a firm imposes a cost on workers, suppliers, and customers, disturbing that harmony. He shows that the more important these costs are to the firm, the lower is the firm’s debt ratio. In conservative societies members of the group tend to act according to the interest of the group, even against their personal interests, thus reducing the well-known agency problem. This represents an advantage in debt financing, and assuming that the debt, by reducing the free cash flow, acts, as restraining the management from pursuing own interests, is less important to the firm in conservative societies, one should expect firms to have higher cash flows and lower financial leverage. Public image is important in conservative societies also. To maintain the image of success, the managers will tend to avoid the risk associated with debt, as debt may worsen the firm’s financial position and increase the danger of bankruptcy. In such societies bankruptcy is regarded as a sign of a failure damaging the public image of the firm as well as of the manager. Thus, the firms in conservative societies are more likely to use less financial leverage. The cultural dimension of conservatism stresses conformity and tradition in capital structure. Conservatism fosters values emphasizing security and avoidance of uncertainty, preferring certainty and predictability. Thus the cost of uncertainty is reduced. The use of debt puts a firm in greater financial instability and is likely to be avoided. Thus lower leverage should be expected.

For countries with a culture emphasizing the belief of the managers that events are controlled through their own actions and their own decision-making, Schwartz coils the term of cultural dimension of “Mastery”, and defines it as a value that promotes active effort to modify
one’s surrounding through self-assertion. In countries with a high level of the “Mastery value”,
the firms should be more willing to use aggressive policies, as managers want to demonstrate
their abilities and might not want to be bound by restrictive covenants of debt. Yet, even in these
societies managers care about their own performance prefer safer projects that have a higher
probability of success. Thus, wise managers choose safer capital structure and have a lower level
of financial leverage.

Important also is the “Father figure” of the manager in authoritative (hierarchical) form
of firm governance. The “Father figure” is expected to take care of the employees, leading to a
stable workforce, which, in turn, strengthens the financial stability of the firm. As the result firms
with a "Father figure" will have a lower financial leverage in their capital structure. Chum et al
(2002) argue that the observed country effects are related to the culture of each country, and
present two hypotheses. 1. the corporate debt ratio of a country is negatively related to the
country’s level of conservatism, and 2. the corporate debt ratio of a country is negatively related
to the country’s level of "Mastery" type of corporate governance. Empirical findings of the study
support these two hypotheses at both the national and the firm levels. The effect of the cultural
dimensions are strong and remain significant even after accounting for differences in economic
performance, legal systems, financial institutions, and some other known determinants of debt
ratios. The results are robust across countries, legal systems, financial, institutions development,
and the "traditional" determinants of debt ratio such as assets tangibility, agency cost, firm size
and profitability. Thus knowing the name of the country is important for the determination of
capital structure.

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4 As will be shown in section 3, Confucianism stresses a hierarchical structure of interpersonal relationships,
conservatism, and the importance of control of the environment through self-cultivation.
1.2 Empirical Evidence Of Cultural Influence On Capital Structure

Capital structure determinants are receiving much attention in the financial research, yet only a few studies in the USA literature are looking beyond the USA boundaries. However as early as 1981, Aggarwal (1981) had analyzed 500 largest European firms and concluded that country factor is an important determinant of capital structure. Rajan and Zingales (1995) examined the leverage decisions of the firms belonging to G-7 countries over the period 1987-1991 and found that while national capital structures are fairly similar across the countries some differences remain and are not explainable by institutional factors. Recently Booth, Aivazian, Demirguc-Kunt, and Maksimovich (2001) found that although capital structure decisions in the developing countries are affected by the same variables as in developed countries, there are persistent differences in leverage across countries. The authors explain the difference by difference in the institutional features. Grinblatt and Keloharju (2000) document that investor stock trading decisions are affected by culture. Stonehill and Stitzel (1996) and Sekely and Collins (1988) present evidence that cultural variables can influence capital structure.

Bancel (2003) reviews the determinants of capital structure of European firms and concludes that other than the “classical” determinants of the capital structure are determining the debt ratio of European corporations. He finds that the legal system appeared to have little validity as explanation for differences in capital structure of European firms. He concludes that the lack of consistent patterns across different legal systems countries, suggest that the capital structure choice may be a consequence of complex interaction of many institutional features such as tax code, bankruptcy laws, and stock market developments that is not captured by the legal system of a country. While the authors do not mention the factor of culture, their evidence of a “missing factor”, is compelling. The notion of a “missing factor” among the determinants of capital
structure is supported from a rather unexpected direction, that from the examination of private benefits of control by Dyck and Zingales (2002). Private benefits of control are the benefits controlling shareholders can obtain that are not shared by other shareholders. By their very nature private benefits of control are difficult to observe and are not reliably quantifiable. Were it otherwise, other shareholders would try to obtain the same benefits. Bebchuk (1999) predicts that where private benefits of control are larger, entrepreneurs should be reluctant to go public and would be likely to retain control when they go public, and Dyck, (2001) showed that a revenue maximizing government is more likely to sell a firm through a private sale than through a share offering. Thus the problem of extracting private benefits assumes significance in capital finance and in the legal concerns focused on by LaPorta’s group (1997) and Johnson et al (2000). However, the legal concerns are not the only, or not even the most binding constraints controlling shareholders extracting private benefits. Reputation and moral considerations, or institutions not focused on shareholder rights, play a role in limiting the consumption of private benefits (Coffee, 2001) and (Dyck, 2000). In their study, Dyck and Zingales focused on three extralegal institutions prominent in the literature: the potential to limit private benefits through external product market competition, through internal pressures from organized labor, and through the internal policeman of moral norms. Coffee (2001) highlights the potential internal policeman of moral norms, and suggests that they account for the fact that the Scandinavian countries have a well functioning financial market in spite of a weak formal protection for the investors. Stulz and Williamson (2001) make a related argument about possibility that culture defined as “a system of beliefs that shape the actions of individuals in a society” may play a role in determining managerial actions. The authors conclude that the contention arising from the existing literature that legal reform is a necessary step for financial activity to flourish might be
premature. Extra legal mechanisms appear to be at least as important as the legal ones. The effectiveness of family ownership is the predominant form of ownership worldwide.

LaPorta et al, (1999) show that family control of firms appears to be common globally and that at least 69% of the time the family that controls the company also participates in its management. The recent experience of scandalous behavior of corporations controlled by legal means suggests that the extralegal control, by pressure of moral and cultural factors of family owned firms, may be stronger then that of the law.

1.3. International Experience Of Cultural Influences On Capital Structure

McClure et al. (1999) examined the differences in capital structures of G7 countries. The authors find that, contrary to the financial theory that suggests that in an efficient global capital market the capital structure of identical firms in different nations would be same, empirical studies have consistently identified differences in company capital structures by countries, differences that persist even after the obvious effects of reporting differences in company capital structures by country have been accounted for. Using data “from bottom up”, that is data based on individual firm performance, rather than on national averages, by comparing pair-wise country differences, and utilizing both the parametric W-D K-ratio test and the more parametric Turkey’s Studentized Range test, the authors find that capital structures are still significantly different by nationality for the G7 countries, and that the tax rate and accounting differences do not appear to be able to the explain the cross-sectional differences. The country differences in capital structures seem to be rather a global observation. Booth, et al (2001) addresses the differences in developing countries. They analyze the capital structures of firms in 10 developing countries and find that, while their choice of capital structures are affected by the same variables
as in developed countries, there are persistent differences across countries, indicating that specific country factors are at work. These findings suggest that although some of the insights from modern finance theory are portable across countries, much remains to be done to understand the impact of different institutional features of capital structures of choice. The country differences are deep, reaching to the basic values of business cooperation. Even in the unified, unity-enthusiastic, Europe. Broadbeck (2000) assembled 47 authors from European countries, including the post-Soviet areas, in exploring the basic question of any organizational behavior, that of the concept of leadership. Basing the study on prior cross-cultural research of cultural values by Ronen (1985) the authors provide evidence that the leadership prototypicality dimensions are highly correlated with cultural dimensions of diverse countries. Smith’s 1997 study confirmed that societal diversity in a united Europe remains unquestioned, even after 12 years of unification. A most interesting view on capital financing in Europe is presented by Berglof (1997) who states that the fundamental forces influencing the corporate governance are poorly understood, and that in harmonizing the business laws it is important to realize that the influence of legal systems on the corporate financing is important but limited. Other factors must be introduced into the explanatory model. These “other factors”, I believe, are to be found in the moral and cultural dimension as a determinant of the corporate capital structure.

1.4. A Short Look At German Corporate Structure

The continuing importance of families in control of large corporations is one of the central features distinguishing continental European countries from those of UK and US. The significance of family control does not seem to have markedly decreased over the last two decades. Holding companies are especially important in Germany. Attempts at hostile takeover
in Germany are rare and no truly hostile takeover has succeeded. Important difference among European countries is in terms of ownership concentration in individual firms, the identity of these owners, and in the capitalization of equity and debt market. Germany has an enterprise-based legal system, with less emphasis on the role of the market. A relatively small number of firms are listed and there are even a smaller number of firms with a majority of shares actively traded. Security market regulations and their enforcement are weak. There are no explicit takeover regulations. Two-tier board, Aufsichtsrat and Vorstand, with the strategic role assigned to the Aufsichtsrat that appoints the Vorstand, are the hallmark of corporate governance. Three banks have a potential voting control of most German firms. As Mayer (2001) notes, Germany is a good example of “insider system”. It has fewer than 800 quoted companies compared with nearly 3,000 in UK, and 85% of the largest quoted companies have a single shareholder owning more than 25% of voting rights. Corporate ownership is characterized by a strikingly high concentration of ownership, primary in the hands of families and other companies. Corporate holdings frequently take the form of a complex web of holdings and pyramids of intercorporate holding. Bank influence and control are extensive while shareholders are widely dispersed. There exists a significant private benefit of control related to dynamic evolution of ownership and control.

SECTION 2. REVIEW OF CONFUCIAN ETHICS AND MORALS, CONFUCIAN CAPITALISM: “GLOBALIZING THE HEART OF THE DRAGON”

2.1. “Confucian Cultural Identity”

An understanding of Confucian cultural tradition is crucial to a comprehensive understanding of the Chinese business and social behavior, and thus of the corporate and capital

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5 To my knowledge the expression Wang first used "Globalizing the heart of the Dragon" in 2002 (Wang, 2002).
structure of the corporations owned by Oversees Chinese in the area of Confucian influence. Hwang (2001) provides a basic understanding of the deep structure of Confucianism. The deep structure of Confucianism is composed of five interrelated parts: conception of destiny, a model of mind, ethics for ordinary people, practical methods of self-cultivation, and ethics for scholars. Confucian view of the destiny is that as a biological being humans our physical destiny is birth, aging, diseases and of death at the end of the physical life. However, as beings with a conscience and self-awareness, humans, in order to fulfill their heavenly ordained mission or responsibility, must actively put into practice the moral principles that exceed personal interests. Without recognition of the ordinance of heaven, a person would only consider immediate personal interests. The ordinance from heaven is expressed in the ren (benevolence), yi (righteousness), and li (propriety). Intellectual reflection is conceived as “when the mind selects from among emotions by which it is moved,” wrote Hsun Tze in his treatise “Concerning heaven”. The practice of benevolence, as expression of individual’s moral conscience must be proportional to the intimacy of the interpersonal relationship with others, the guangxi. The guidance for guangxi is provided by the Way of Humanity (which corresponds to the Way of Heaven) based on the ethical system of ren-yi-li, the benevolence (showing affection to closely related to us), righteousness (respecting the superior according to their rank, and loving others according to who they are), and propriety (forms and distinctions in social life). While interacting with others the relationship between oneself and others is assessed by the dimensions of intimacy/distance and of the superiority/inferiority. The basic relationship is that of dominance/subservience. A person is defined by his or her function within the social frame, and the superiority/inferiority dimension is based on observance of the Way of Humanity precepts. “He who outrages the benevolence proper to his nature is called a robber, he who outrages righteousness is called
ruffian. The robber and the ruffian we call mere fellow", that is denying them their superior status even if they had one. I believe that the later precept permits disobeying when justified by higher, moral and ethical reasons, a position that opens a door for accommodations. Wong (2001) supports this interpretation. The author, in describing the Confucius’ education of his pupils, notice that Confucius did recognized the validity of striving for the purpose to achieve recognition, albeit only for non-material gains. Somewhat ambiguously he included political and social gains into non-material gains, though both are, obviously associated with increasing wealth. However, Confucius himself resisted any compromise with the high moral standards, and his insistence on the high moral standards might have had a dampening effect, if not a negating effect, on his disciples’ ambitions. The recognition of the unavoidable presence of moral dilemma might suffice to moderate a departure from moral standards in a non-ideal world, and Confucius recognized that arriving at a correct moral solution is not always possible, but demanded that one exerts great effort to find a morally acceptable solution. Thus if the worldly community is corrupt the individual member of that community need not to be corrupt.

The distinction between private and public realms makes possible to preserve the idealism that is the core of Confucianism, and provides a connection for adjustments to Capitalism corrected by moral ideals. Chang (2000) appears to look in this direction. In his article on Confucian ethics Chang (2000), the author argues that the Confucian insistence of individual's self-cultivation implies the acceptance of incremental changes and permits an individual to reach a stand above the crystallized traditions and dogmas. Even the expression of *li*, the precepts of proper behavior, may be changed. Chang notes that Je, a direct disciple of Confucius, points out that “additions” and “abridgments”, of Confucius’ teachings have been made even at the time of Master’s life and some have been approved by the Master. While
tradition must remain the basic framework in which the change may take place, like yin and
yang, there should be no breaking of the continuity. The Master himself, as much as he
proclaimed loyalty to the past, had arrived at innovative interpretations of the past, which broke
new paths.

Thus emerges the need for an evolutionary rather than a revolutionary progress, but a
progress nonetheless. And there is much to accommodate to, as discussed by Wang (2002). The
author considers the impact of technology on Confucian ethical values by posing three
interrelated questions. 1. How does the technology challenge the traditional Confucian ethical
values? 2. does the technology create the need for confidentiality? and 3. must technology
inherently undermine the traditional Confucian value of sharing, in favor of the Western
the author argues that Confucian moral tradition, based on justification by an obvious social
benefit (minben) for China’s future, may also be able to provide an argument even in defense of
intellectual property rights, a concept absolutely foreign to Confucian worldview. Yet there are
obstacles to accommodation with the Western globalizing practices. Confucian ethical tradition
is primarily an ethic of virtue. “The moral person understands what is moral, the small (petty)
person understands what is profit”, and “If one is guided by profit in one’s actions one will incur
much ill will”, said the Master. In the Confucian ranking system merchants were placed at the
bottom. “It is shameful to make salary your sole object,” Yang Hu said: “If one’s aim is wealth
one cannot be benevolent, if one’s aim is benevolence one cannot be wealthy”.

There is no place for the sense of privacy or for private rights, and thus there is no need
for confidentiality in the Confucian value system. Human beings are intrinsically relational and
civilization is defined by a set of relationships. Personal and moral growth also depends on broad
access to the common heritage of the past and of the present. It is inconceivable to regard the fruits of intellectual endeavor as a private, simply because the common heritage is the property of the community. Sharing is the most important virtue in Confucian ethics, and there is nothing a person would wish to hide from community.

A rather impressive list of obstacles to overcome, I would add.

A comprehensive look at the problem is taken by my last Confucian reference (Young-Bae Song, 2002). The author begins by stating that no matter how fast the phenomenon of globalization takes place; the everyday self-identity of people in various cultural regions of the world cannot be separated from their traditional norms and ethical outlooks. Globalization brings on the inevitable conflict and tension between the diverse manifestations of the traditional cultural self-identity of various nations and the forces of globalization, which seeks to incorporate national cultures into the universal and globally enforced system of moral and ethics. The central academic concern of pre-capitalist traditional Confucian societies was the propagation of a firm moral sense among the ruling class of educated scholars-officials, who were expected, without fail, to promote public good and to suppress any concern for private interest. What the Confucian society sought to establish were not some institutional guarantees for the rights of individuals or for a pursuit of utilitarian ends, the main concerns advocated by the modern proponents of the materialistic consumerism, but rather the high ethical standard required of those who would be in charge of inducing different classes of the society to live in harmony. Thus, contrary to Western priorities, the main stress of moral attitudes was on responsibility, not on rights. Summarizing the difference between the liberal individualistic tradition, which aims to sustain a contractual society by giving primary consideration to the private interests of individuals, and its direct opposition of the Confucian virtue-ethic giving
primary consideration to the harmony and the welfare of the entire community, the author states that Confucian worldview insist that such harmony and welfare, is to be achieved by engaging in a rigorous regimen of learning and self-examination.

2.2. The Western View

The countries of the Confucian cultural sphere (Taiwan, Hong Kong, Singapore and Korea) have achieved an unparalleled economic growth from 1970s until the 1990s economic crisis, and have generated a positive attitude toward Asian values before the 1997 crisis. Since then the sign of attitude has changed, and has assumed a negative tone in the discourse of Asian values for the economists. The main “Asian” impediments to economic progress now are seen in patriarchal authoritarianism, cronyism, in lack of transparency of business operations, corruption, and injustice. Of these only the first two are associated with Confucianism. Ting-Toomey et al (2000) studied the differences in actual practice. In matter of the conflict resolution styles the Westerners, US Americans, used dominating style, the Asians preferred an obliging style, the first looked for a compromise finding an "in between" positions, the latter preferred an integration that would include both point of views. The Asian's concern with "saving the opponent's face" was foreign to Westerners, and as investors Westerners preferred short-term, while Asians preferred long-term investments.

2.3 The Search For "Confucian Capitalism"

Since 1970s a part of South East Asia’s intelligentsia began to look for a “Confucian style of Capitalism” that would offer an autonomous road to modernization, different from that of the West. Neo-Confucian ideals point beyond the dictates of this world, but found in this
world, reflecting the positive traits of Confucianism, such as diligence, honesty and thrift. The road is long, because the Neo-Confucianism is a moral system that rejects all utilitarian pursuits. Is there chance of an accommodation of Confucianism with the USA kind of Capitalism? If USA Capitalism is inflexible, is Confucianism flexible? The reader might have noticed, the year of the cited publications. They are quite recent. A search for an accommodation seems to be going on. It would be tragic for the world if the Western businessman’s arrogance would trample on the nascent sparks of an accommodation process.

SECTION 3. A LANDSCAPE OF CHARACTERISTICS OF FIRMS OWNED BY OVERSEAS CHINESE IN SOUTH EAST ASIAN COUNTRIES WITH CONFUCIAN TRADITION

A paternalistic communitarianism without social and institutional guarantees will always run the danger of being held hostage to a form of cronyism. Confucian insistence on the primary responsibility of an individual for the welfare of the members of the family, leads to open “cronyism” that is frowned upon by the Western partners. Johnson (2003) describes the problem in Malaysia. The author examined the role of “cronyism” during the SEA crisis of late 1997-1998, and found that political connections was an important determinant of Malaysian firms’ capital structure choices during the SEA’s 1997-1998 crisis. Government’s capital control affected the Malaysian firms by cutting off access to international capital market. Surprisingly, the authors found that the presence of political connections in East Asian economies does not mean that cronyism that the authors called euphemistically a “relationship-based capitalism”, was necessarily a suboptimal system for these countries. The results of their examination suggest that macroeconomics, depending on institutional structures as suggested by Blanchard (2000)
were more important, and that macroeconomics matter for long-term growth. The findings were confirmed by Acemoglu’s (2001) studies. The author felt that a great deal remains to be done before we understand precisely how institutions affect short-term and medium term outcomes. While the Malaysian political system, that legalizes a discrimination against business owned by non-Malayan citizens, gives cause to a call for caution before generalizing the Malayan business experience, it does not affect the internal structures of corporations owned by Overseas Chinese in Malaysia. The “cronyism” may be seen also in the use of family members in managerial positions in the corporations. The realization of this observation has practical significance when studying the apparent separation of ownership and control and noted by Claessen et al. (2000). The authors investigated the separation of ownership from control in 2,980 publicly traded companies in Hong Kong, Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand. In all East Asian countries control is enhanced by pyramidal structures and cross-holdings among firms, with more than two thirds of firms controlled by a single shareholder. While the separation of ownership and control is most pronounced among family-controlled firms and small firms, the managers of closely held firms tend to be relatives of the controlling shareholder’s family. Older firms are generally family-controlled, dispelling the notion that ownership becomes dispersed over time. Significant corporate wealth is concentrated among a few families. Moreover, the families are often interrelated, and polygamous marriages make the untangling of family connections to establish ownerships and controls are often difficult, as described by M. Backman and Ch. Butler (2002). The complexity of interfamily relationships is illustrated by LaPorta et al (1999): Hutchison Whampoa, the third most valuable company in Hong Kong is 43.9 controlled by Cheung Kong Holdings, which is the fifth largest publicly traded company in Hong Kong, Li Ka-Shing family owns 35% of Cheung Kong. Thus
Hutchison Whampoa and Cheung Kong are family controlled companies, the former is owned through a pyramid but the latter is owned directly. Li Ka-Shing family controls the three of the 20 largest companies in Hong Kong.

The Confucian precepts of personal responsibility for members of the family are reflected in the strong systems of governance of corporations owned by Overseas Chinese. The importance of a strong governance system is well illustrated by the study of the impact of corporate governance on the East Asian financial crisis of 1997-1997 (Mitton, 2003). The author examined a sample of 398 firms from Indonesia, Korea, Malaysia, Philippines, and Thailand showed that the firm-level variables related to corporate governance had a strong impact on firm performance during East Asian financial crisis of 1997-98. Better stock performance was associated with firms that had higher outside ownership concentration and with firms that were focused rather than diversified, and had the stronger corporate governance.

The agency problem in Singapore, minimized by the family control of the Overseas Chinese owned firms, is examined by Ding (2001). The author used investors’ reaction to the introduction of ESOP by the firms in Singapore to gauge the agency problem, because ESOP is assumed to reduce the discrepancy between the managers’ and the investors’ interests. The study is important because Singapore is currently a major hub as the location regional headquarters of multinational companies and is rapidly becoming a center for financial management in Asia. While the firms are not classified by ownership, it is interesting to note that the larger firms, presumably owned by the Overseas Chinese, use ESOP less than smaller firms, suggesting that indeed, the agency problem is less acute in the family run firms in Singapore.
SECTION 4. HYPOTHESES

Hypothesis 1. In spite of many years of exposure to different colonizers, and in spite of many years of different historical, geographic and political experience, similar firms owned by Overseas Chinese on Taiwan, in Hong Kong, Malaysia, and Singapore, will have a similar capital structure corresponding to the precepts of Confucianism.

Hypothesis 2. In spite of a similarity of corporate organization, the capital structure of firms owned by Overseas Chinese on Taiwan, in Hong Kong, Malaysia and Singapore, will differ from the capital structure of similar firms in areas not influenced by Confucianism.
PART TWO: DEVELOPMENT OF A PROOF OF THE THESIS

SECTION 1. GENERAL COMMENTS

Additional review of literature related to Malaysia showed that Bumiputera legislation makes the identification of the real owners in Malaysia very difficult and possibly unreliable. This is suggested by the requirement that more than 30% of all IPO shares must be reserved for Bumiputera (Paudyal et al. 1998), by institutional arrangements in the Malaysian stock market (Hameed, 2000), and the observation that not all companies file prospectus with the KLSE Library files (Salamudin et al. 1999), I have, therefore, decided to drop Malaysia from this study at least for the beginning.

Because I expect to find a predominance of family-owned firms in both the Confucian SEA and in Germany, and because I am aware of the potential, in such a case, of managerial entrenchment, I was impressed by an older paper (Zwiebel, 1996) describing a model in which managers' self-discipline they by voluntarily choosing a debt. A really Confucian solution to the entrenchment problem, that I might want to include in my study.

A review of ultimate ownership of Western European corporations by Faccio (Faccio and Lang, 2002) supported my choice of Germany for the country to be used in the study. The authors convincingly show the difference between the corporate ownership in Germany and the UK, Ireland and the Scandinavian countries.

SECTION 2. GENERAL SCHEME OF EMPIRICAL WORK

Stage One

Purpose: Construction of a sample of firms owned (controlled) by Overseas Chinese in HK, Taiwan, and Singapore (see below remark on Malaysia), and of family - owned firms in Germany.
Method:

1. Develop list of publicly owned firms listed on stock exchanges in HK, Taiwan, Singapore and Germany. As part of the pilot approach, I used the Worldscope data of June 2003, but the appropriate time or time period of observation will be suggested by the progress of the research.

2. Develop criteria of ownership:
   - The criteria will follow those of Rajan (1995), Franks and Mayer (2001) and Claessen (2000), with the exception that the ownership will be divided only in two groups: Family and Others (rather than by banks, state, institutions, as in the cited authors).
   - Corporate ownership will be measured by cash-flow rights, and corporate control by voting rights (Faccio, 2002) recording multiple classes of voting rights, pyramids (Franks and Mayer, 2001) and cross-holdings (Claessen, 2000), and the involvement of family members in the senior management of family owned firms (Anderson and Reeb, 2003). Where the available data will not permit this, I will base the control (and ownership if other means to identify this are not available) on the size of share holding, starting at 25%. I am aware of the importance of changes of ownership through sale of shares and will follow these.

3. Identify firms owned by Overseas Chinese on lists from HK, Taiwan and Singapore. Where nationality is not stated, I will make the identification by family name or by the origin of the owner family name in China.

Sources:
- For HK, Taiwan and Singapore: Worldscope and Global Vantage databases providing names of holdings of all owners with more than 5% of company's stock, Thompson

- For Germany: Datastream, Hoppenstedt Stockguide, "Wer gehoert wem" publication, and companies' reports and files.

Global Vantage is not available at UGA, and Worldscope was discontinued by UGA on July 1, 2003. Thompson Analyst includes Worldscope information. The UGA librarian (John Campbell) and I have discussed ways to collect Worldscope data from Thompson Analyst. John also showed me that one way to collect these data is using the Worldscope CD from the UGA library; the library has Worldscope CD from 1993 to 2002 (monthly).

Stage Two

**Purpose:** Form groups of HK, Taiwan, and Singapore Overseas Chinese owned firms to be compared to groups of similar characteristics, except ownership by Overseas Chinese, in Germany.

**Method:**

- Construction of subsamples based on industry, size, complexity, age (over-or under 50 years), management turnover rate, degree of involvement of family members in management, and firm performance.

- The last three criteria are especially important for two reasons: first because they suggest the presence (absence) of the Confucian influence, and second because stability of ownership, long-term horizons and reduced agency costs, enhance the firm's performance
(Anderson, 2003) that reduces the cost of debt which, in turn, influences the capital structure of the firm.

Sources:

- Firm's annual reports, proxy statements, financial ratios of the firms, and other firm's reports and files.
- Additional information such as banks and other financial institutions publications. Reports in financial media, and similar sources.

Stage Three

Purpose: Identify presence (absence) of a relationship between the Confucian world-view and the capital structure of firms owned by Overseas Chinese in Hong Kong, Taiwan, and Singapore.

Method:

- Identify the capital structure of each firm of the sub-sample.
- Construct sub-subamples based on similarity of the capital structure in each group constructed in stage two.
- Compare the sub-subsamples of firms from HK, Taiwan, and Singapore, with the sub-subsample of firms from Germany.

As the research progresses the methods of comparison and the statistical test selected will depend on the number and characteristics of the observed firms and on the objective of the test.
SECTION 3. WORK DONE

I have collected 1,646 firms listed on HK exchange in June of 2003 using Worldscope and Thompson Analyst, with information about name of the firm, identity of owner, international industrial code, date of IPO (age of the public form of the firm) and other general information including financial ratios.

- Prior to July 1, 2003, I have collected 812 firms listed on Taiwan exchange, of which I had time to identify the name, the owner, the international industrial code, the date of IPO and other general information, in 620 firms.

- I also have decided that to work out the "bugs" early, I will proceed, in each stage, with a "pilot study" using HK and Germany, before extending the study to Taiwan and Singapore.

SECTION 4. SUGGESTIONS FOR POTENTIAL EXTENSIONS

If differences between Asiatic countries with different history of colonial influences can be detected, then, including Indonesia and Malaysia, examination of the influence of the colonizers' effect on capital structure and on corporate governance may be warranted. Acemoglu (2001) has already demonstrated such an effect on the development of the financial institutions in the developing economies.

Note: This study was conceived as a part of my dissertation and projected to take about one to one-and-a-half year because the discovery and the construction of pyramids of ownership is difficult and time consuming.
REFERENCES


Blanchard, O. (2000). What do we know about macroeconomics that Fisher and Wicksell


