

Corporate Governance, Legal Origin and Firm Performance

An Asian Perspective

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Jönköping, May 2, 2012
Andreas Högberg

Abstract

This dissertation deals with corporate governance, legal origin and firm performance with a focus mainly on Asia. The dissertation consists of four individual papers and an introductory chapter. All papers can be read individually but share a common theme in corporate governance and investments. The main region of interest is Asia due to its special characteristics of ownership structures and governance. However, comparative studies of Asia and Europe as well as global outlooks are included in the dissertation too. The papers contribute to research by studying effects on investment performance, firm performance, capital allocation and capital structure from legal traditions, institutional indicators and ownership type.

The first paper focuses on family ownership which is found to affect firm performance negatively when using measures of firm valuation and returns, but investment performance positively when measured by marginal q. This suggests that family owned firms may be better at avoiding bad investments but at the same time have lower market valuation and returns to capital compared to firms with other owners.

The second paper investigates investment performance and firm size in terms of number of employees in 58 countries around the world. It is found that initial increase of staff size tend to positively affect investment performance overall, but excessive employment has a negative impact on investment performance.

The third paper studies the capital allocation in India after their economic reforms in the 1990s. It is found that allocation of capital has been slow to respond to reforms and firms face significant costs in adjusting their capital stock, leading to inefficient capital allocation.

The fourth paper deals with firm capital structure in 24 Asian and European countries. Both financial market indicators of maturity and firm specific characteristics influence the leverage of firms. Financial market maturity measures have a negative effect on debt levels as do family ownership of firms.

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Introduction and summary of the thesis

I. Introduction

Interest for corporate governance, firm performance and the effects of legal protection of property rights is far from novel. Berle and Means (1932) usually acts at the starting point of numerous studies within the topic even though it has been 80 years since publishing “The Modern Corporation and Private Property”. While the study is written in a different time era, their research questions and results are still highly relevant for today’s research¹. Similarly, issues concerning management and principal agent problems discussed by Jensen and Meckling (1976) still form a theoretical foundation and explanation to potential conflicts between owners and managers. Building on this is the discussion of what happens if the owners are also the managers of the firm; additional personal interest by the owner may lead to bad investments and entrenched managers (A. Shleifer & Vishny, 1989; Oliver E. Williamson, 1963). As a consequence, the legal actions available for minority owners who find themselves expropriated by controlling owners will affect capital and its availability for firms. The series of studies published by La Porta et al. (1999; 2008; 2002; 1998) further spurred the interest in the field of studies and the number of journal articles. Now also La Porta et al. became just as important to refer to as Berle and Means when including aspects of legal origin.

Taken together, the field of corporate governance, firm performance and legal protection of property rights can appear as both extensive and broad in its directions. The aspect of family ownership for example is one of the directions which have been given much attention in the field of corporate governance. Why does it matter who owns a firm? In what way is a family different from any other type of owner? How do family ownership differ around the world and are observed differences connected to the formal judicial system of a country, or more so, its informal institutions? The question of causality of family ownership and legal protection of property rights have been less studied

¹ A simple search on Google scholar in 2012 for the key words corporate governance, firm performance legal tradition produce around 97 000 hits.

than the effects on firm performance from family ownership. The potential complexity of causality issues is enhanced in Williamson's (2000) discussion on institutional economics. This discussion on the structure of institutions, both formal and informal provides a fundamental understanding of corporate governance, firm performance and effects of legal protection of property rights research.

The remainder of this introductory chapter includes a presentation of institutional economics and its structure, thereafter a connection to legal traditions and property protection with a special focus on Asia. Principal agent theory is discussed briefly in connection to corporate governance, ownership structures and control enhancement in Asia. There after follow a brief introduction to each of the four papers included in the dissertation.

2. Institutions

The interest in institutional settings and its effects on countries' economies has been revitalized substantially during the last couple of decades. Nobel laureate 2009, Williamson (2000) stress this point and further argues that the new institutional economics still pose several unanswered questions. Williamson will be revisited shortly. However, an explanation of the term *new* institutional economics is necessary and also natural due to the *old* institutional economics, or basically a branch of the German Historical School which was active in the late 19th century. Relying solely on real world observations and case studies, the German Historical School disregarded abstract economic theories and universal axioms to a full extent. Yet, notions of what today is considered business cycles were introduced in the German Historical School based on these observations. Also, the ideas that detailed cultural contexts would be the main explanation behind economic development and differences between countries was very influential and important. While the German Historical School met positive reactions in Europe, it did not enjoy any real attention in North America at the time.

The influence in Europe from the German Historical School decreased substantially during the first part of the 20th century and instead the neoclassical school and theorization of economics became increasingly dominant. Yet, in 1986 R. C. O. Matthews, quite sensationally, claimed that 'the economics of institutions has become one of the liveliest areas in our discipline'. Later Matthews (1986) defended his claim and declared that 'institutions do matter' and 'the determinants of institutions are susceptible to analysis by the tools of

economic theory' (p. 903). Ever since Matthews' statements in 1986, the growth and influence of the new institutional economics literature and research has rapidly gained momentum. The ever changing nature of institutions and their actual influence on economic development pose interesting challenges to researchers. Furthermore, the different types of institutions tend to change at different rates of speed.

North (1990) separates institutions into 'informal constraints and formal rules and of their enforcement characteristics' (p. 384). While the formal rules and their enforcement characteristics are partially possible to quantify and measure, informal constraints, or informal institutions, pose a much larger problem in that sense for researchers. Furthermore, the relative importance of the formal and informal institutions seems to differ around the world. Roche (2005) for example stress the importance of informal networks and family traditions in corporate governance in Asia. On the other hand, the formalized rules and legal origin has also been shown to have a strong effect on corporate governance in Western countries, especially Anglo American countries (see La Porta et al. (2008) for an overview of the studies of legal origin and its importance made during the last decade). During the last decade, influences of the formalized Western institutions have become much more central and implemented in many Asian countries. One of the most prominent reasons for this is doubtless the economic crisis in Asia in 1997. Countries like South Korea, Indonesia and Thailand, which were most severely affected by the crisis, had to undergo substantial changes in legal systems, corporate governance systems and structural reforms to receive support and help from the IMF (see also OECD White Paper (2003)).

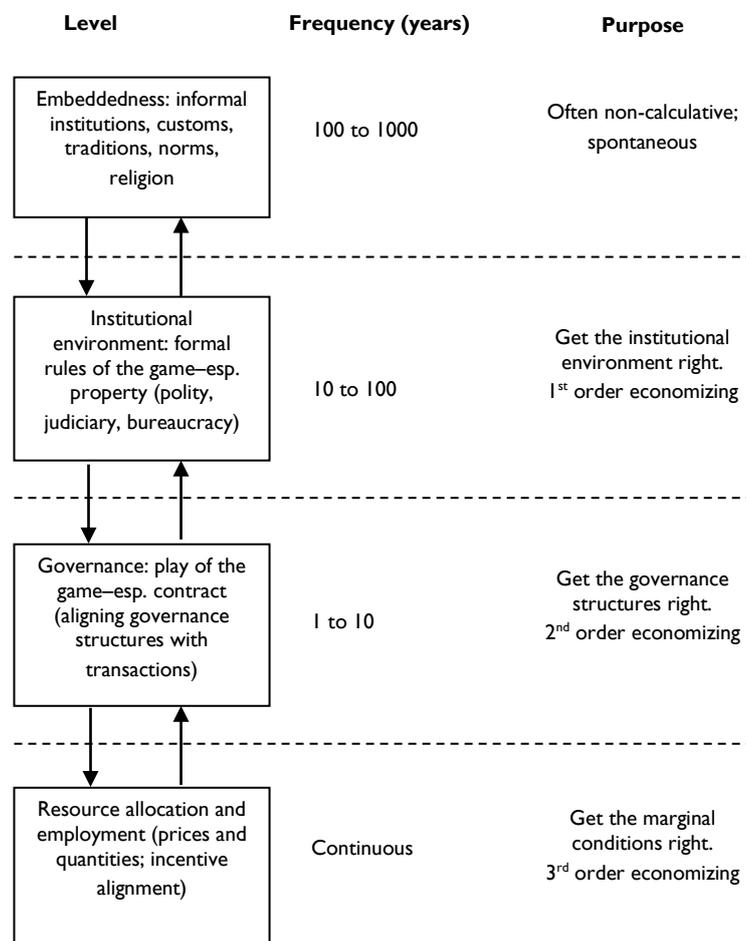
These circumstances make the institutional structures, the formal and informal, very interesting to study. The events taking place before, during and after the economic crisis of 1997 in Asia have been studied on both country level and between countries. The purpose of this paper is to synthesis these studies and their results for a comprehensive overview of the institutions of Asia.

2.1 The structure of institutions

Returning to Williamson (2000) and the structure of institutions, he adds one more dimension, or level, to the structure²; a continuous process for use of and

² The original framework discussed here was presented first in Williamson (1998), Figure 1 was however presented in Williamson (2000)

interpretation of institutional settings. This structure of the economics of the institutions leaves us with four levels of the institutional setting and also institutional change over time. The structure of the economics of institutions as it presented by Williamson (2000) is illustrated in the re-production presented in figure 1. While Williamson does not explicitly use the world cultural context as the German Historical School did in his structure of the economics of the institutions, the top level includes informal institutions, customs, traditions, norms and religion.



Source: re-production of institutional model presented in Williamson (2000)

Figure 1, Economics of Institutions structure

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Figure 1 shows each of the four levels of the economics of institutions in Williamson's structure of institutions. Level one, is made up by social theory. Here we find informal institutions, customs, traditions, norms and religion. All these aspects clearly have some parallels to the old institutional economics (the German Historical School) and its main focus on cultural context as an explanation for economic development and differences between countries. However, Williamson in his structure of institutions show that changes on this level occur over very long time periods, from centuries up to millennia. The change is partially caused by influences from the level below, the institutional environment, or "the formal rules of the game". The influence between each level of the institutional structure is however much stronger downwards than upwards. So, even though we observe some similarities between the *old* and *new* institutional economics, new institutional economics have a much more complex picture of institutions, how they change and at what speed. Furthermore, and clearly most important, new institutional economics does not dismiss all economic theory and axioms as the German Historical School did. Rather, economic theory founds the basis for new institutional economics.

The third level in the economics of institutions presented by Williamson is the how the formal rules in level two is interpreted and followed by legislators. Again, the influences on level three on level two is stronger than the influence upwards in the structure. The fourth level, as already mentioned, illustrates the everyday process of adapting to and allocates resources efficiently depending on the current institutional state and its interpretation. Again, the linkage and importance from the level above is much stronger than the effects upwards. There is a given hierarchy of how the different parts of the institutional structure affect each other down the structure. However, according to Williamson (2000) there is also this feedback process affecting the structure upwards.

Based on this structure, it is clear that the most influential factor is the informal institutions. Never the less, these are very hard to study and quantify, and they also change very slowly. Williamson calls this section social theory. The formal institutions and how they are interpreted and implemented is addressed the economics of property rights and transaction cost economist respectively. Neoclassical economics or agency theory represents the continuous, fourth level in the institutional structure.

Thanks to Williamson's structure of institutional economics it is possible to organize a comprehensive literature overview in the same manners on research made of each of the four levels. Focusing on the institutional structures of Asia,

the remainder of the paper is structured in the following way: next section holds a general discussion on corporate governance and agency theory in general and its links to institutional framework in a country. Thereafter, a summary of recent research on institutions and the effects on corporate governance in Asia is presented in the aspect of ownership structures, board compositions and dual vote systems and pyramidal ownership. The paper concludes with a discussion on the previous findings and what questions that may still need some attention.

3. Legal origin, ownership protection and informal institutions in Asia

In studying institutions and their effects on economic growth, firm performance and ownership of firms one need to address the early works of Berle and Means (1932). Even though we have seen a massive increase during the last decades in the literature on ownership and performance of listed firms around the world, much of this work builds on Berle and Means pioneering article from 1932. The article deals with agency cost and dispersed ownership using the US and the Anglo Saxon legal origin as an example. However, it was written after (or during) the period when a large share of the firms in the US changed from being held in business groups to being single firms with dispersed ownership. The transition was rapid and thorough mainly due to changes in double dividend taxation, the public utilities holding company act, investment company act and securities and exchange commission act (Morck and Yeung (2009)). The discussion on ownership referring to Berle and Means naturally focus on a dispersed ownership of publicly held firms for this reason. The relationship between shareholders and managers under both dispersed and concentrated ownership is later treated theoretically by Jensen and Meckling (1976). They show how the issues of separation of ownership and control and concentrated ownership affect the agency costs and manager's decisions for the firm. In firms where the supervision of managers, either by controlling owners or legal protection of shareholders, is low, managerial discretion is commonly a problem. Williamson (1963) discuss how managers may enrich themselves rather than the shareholders both in monetary and non-pecuniary terms. Much of this discussion is originally based on the situation described by Berle and Means with dispersed ownership and a strong legal protection of shareholders.

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The United Kingdom does show similarities with the US in the ownership structure of firms. The explanation behind this is however rather different from the one described for the US. In United Kingdom, family ownership and control of firms was fairly common and had even increased in the first half of the 20th century. By using dual class shares, families could maintain control of the firms with a disproportional relation between voting power and capital. This was possible even at a time when hostile takeovers and acquisitions increased and the pressure from institutional owners were common. However, with new regulations and changes on the London Stock Exchange, dual class shares were prohibited. Family controlled firms were rapidly being taken over and ownership became dispersed in the United Kingdom (Frank et al. (2004)).

As mentioned, the general view is that the Anglo Saxon legal traditions offers a generally strong legal protection of minority shareholders (see for example La Porta et al. (1997), Morck et al. (1987) and Holderness and Sheehan (1988)). This increased protection of minority shareholders decrease the risk for minority shareholders to be expropriated by managers and/or controlling shareholders. Supporting this, dispersed ownership has been shown to be fairly uncommon for a majority of countries with other legal origin than the Anglo Saxon, or common law tradition. Somewhat surprisingly, Shleifer and Vishny (1986) show that ownership even in the US may be concentrated, yet moderately so compared to other countries.

A multitude of both case studies and cross country studies has shown that concentrated ownership is indeed prevalent around the world and, furthermore, that the controlling owner often is defined as an individual or family (see for example Denis and McConnell (2003), La Porta et al (1999) and Shleifer and Vishny (1997)) just as case with the United Kingdom during the first half of the 20th century.

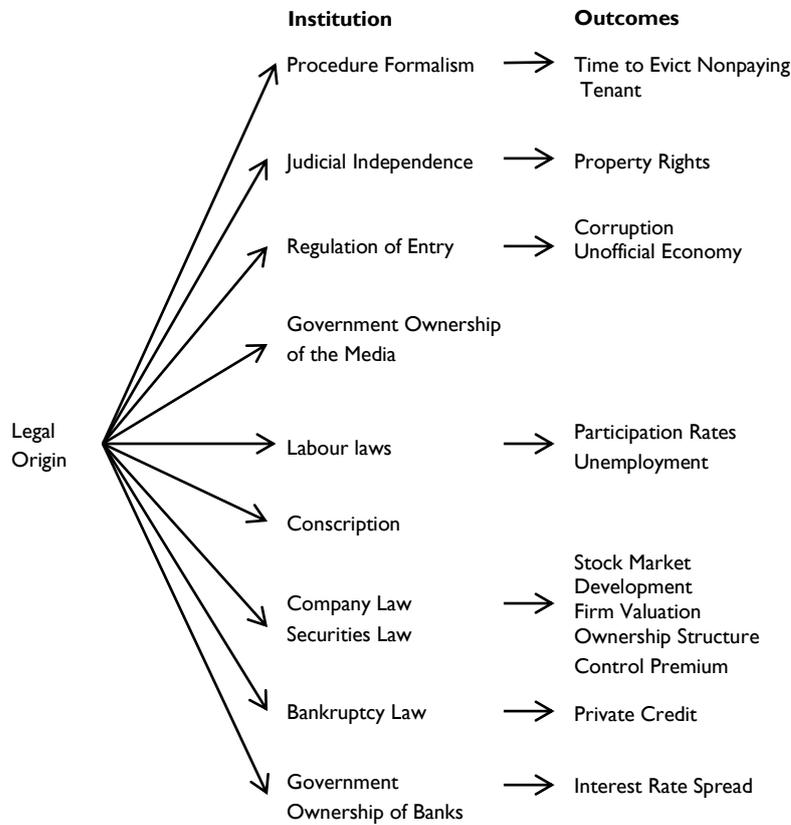
The consequence is that the original discussion on dispersed ownership and control is based on a fairly uncommon example. Yet, the effects on corporate governance systems, ownership structures and institutional settings for countries with different legal traditions have been thoroughly investigated, however, with some diverse results. The division made by La Porta et al. (1998) suggests in line with earlier studies that the *common law*, or Anglo Saxon legal tradition offers a better protection of minority shareholders than the *civil law* legal traditions. The authors divide the civil law legal traditions into Scandinavian, German and French legal traditions. Scandinavian legal traditions offer the highest minority protection and French the lowest. In practice the Scandinavian legal tradition use elements from both the civil and common law

traditions. Further supporting the division between different legal origins, La Porta et al. (1999) show in a cross country study that countries with higher degrees of protection of minority shareholders (*common law*) have a higher degree of dispersed ownership compared to countries with lower minority shareholder protection (*civil law*). The results are also supported by Faccio et al (2001) who study the relationship between dividend pay-outs and the legal protection of minority shareholders. They find that there is a strong correlation between the level of legal protection and the level of dividend pay-outs to shareholders.

The strong relationship between legal protection of minority shareholders, the relative concentration of ownership and dividend pay-outs has however been questioned. Mueller (2006) show that the average dividend pay-out indeed is higher in countries with an Anglo Saxon legal tradition than the average pay-out in countries with civil law. However, he also shows that the average dividend pay-out is higher in countries with French legal origin than the German. Furthermore, Mueller (2006) stress the fact that there are large differences within groups of countries with similar legal traditions with high diversity for civil law countries. For example, the Scandinavian legal traditions seems to offer better protection of minority shareholders than the German and French, much in line with the suggestion that this legal tradition is a mixture of common and civil law. Also, firms in countries with Asian-Germanic and the European-Germanic legal traditions differ substantially in dividend pay-outs according to Mueller (2006), illustrating the differences within the German legal traditions.

This is not the only case of disparity from the division of legal traditions made by La Porta et al. (1998). In fact, the response has been massive in terms of articles supporting or rejecting the importance and effects of legal origin. For example, Fagernas et al. (2008) show by compiling 60 different indicators of shareholder protection that Germany offers a higher level of protection than the US. Furthermore, they also show that the level of shareholder protection change over time. Some ten years after publishing their article, La Porta et al. (2008) address the issues and consequences of legal origin again, now in the light of research done after their previous series of papers. Just as Williamson, La Porta et al. (2008) illustrate the connection between institutions and effects on society with a figure. However, the figure is horizontal in its effects rather than vertical as in Williamsons' case. Also, the driving force behind institutions is the legal origin of a country. This illustration of legal origin, institutions and outcomes is reproduced in figure 2.

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Source: re-production from La Porta et al. (2008)

Figure 2, Legal Origin, Institutions, and Outcomes

If we compare this figure with the one representing the institutional structure presented by Williamson, legal origin may be considered similar to the second level of Williamson's structure. The institutional column in Figure 2 compares to the third level in Figure 3 and the Outcomes may very well match the continuous resource allocation level suggested by Williamson. In addition to these similarities, Figure 2 also presents some more detailed information concerning what institutions actually may be. Even more importantly, the outcomes suggested are something that may very well be measured and used for evaluation of the effects from certain institutional settings. The background for all of the institutional settings, the legal origin should still be discussed.

La Porta et al. (2008) note that the division between the common law (Anglo Saxon law) and civil law (French, German and Scandinavian law) holds differences within the groups for natural reasons. For example, the common

law legal traditions and its influence around the world is much the result of colonizing and the fact the countries may have been forced to adapt to its legal system. Other states have voluntarily chosen their legal systems in phases of modernizing of their countries, such as the Ottoman Empire and Russia during the 19th century adopting the French civil law. Whether the country was forced to adopt the legal system or chose it voluntarily may have had effects on the development of the legal system in that country over time. The Scandinavian legal origin is concentrated to one region, much due to the fact that colonizing was sparse, or non-existing. Even though the kinship to German legal traditions is strong, Scandinavian legal traditions are generally considered to be different enough to be distinguished as a separate legal tradition.

Over time, the legal systems of the countries have been influenced by international law, other legal systems, culture and political background. Yet, La Porta et al. (2008) claim that the general division of legal traditions still holds. Countries in each of the groups are more similar in their legal traditions still, than across the groups. According to La Porta et al. (2008) legal origin is not a proxy for culture, politics and history which has been raised as criticism against the studies claiming the importance and impact of legal origin. Instead, legal origin should be considered a variable with enough explanatory power to explain differences in economic growth for countries.

The importance of legal traditions for corporate governance, firm performance and economic growth in a country cannot be denied. However, it is clear that both differences and similarities between countries should be explained with additional factors than the legal traditions only. Asian countries are often given as an example of the complexity between formal and informal institutions and the effects on the corporate governance system. So far, the informal institutions has been mentioned by Williamson and given an important role affecting the whole institutional structure. However, the informal institutions are not implemented in the figure by La Porta et al. The effects from informal institutions on the formal institutional structure may very well be much more direct in Asian than Western countries, complicating the study of the impact of legal origin primarily on corporate governance, firm performance and economic growth in Asia (Roche, 2005).

When looking closer at the Asian countries we observe that there are many cases of high levels of concentrated ownership, control enhancement tools and the controlling owners are often individuals or families. These complexities have resulted in that corporate governance in Asia has received quite substantial attention during the past decades. Claessens and Fan (2002) provide us with a

Introduction and summary of the thesis

thorough overview of research on corporate governance in Asia up to 2002. According to the Claessens and Fan (2002), Asia poses as an interesting example also due to the Asian financial crisis in the late 1990's and the subsequent effects on the corporate governance systems. Compared to earlier studies the conclusion, that even though the protection of minority shareholders in Asia is overall low firms are not always badly run or exploited by controlling owners or board members, is rather remarkable. This contrasts to earlier literature (see for example Jensen and Meckling (1976) Fama (1980)) which suggests that low protection of minority shareholders will in turn make the management focus on enriching themselves or some other goal not increasing, or even safeguarding, the returns to the investors.

There are several other reasons why Asia pose as such an interesting example; the relation between management and minority shareholders, and their protection may not only depend on legal settings but also on trust and informal contracts between the agent and principals. Relatively large impact of informal institutions and the importance of family affiliations all affect the formal institutions and the legal. Furthermore, informal networks between firms from different types of industries are especially important in some countries in Asia. The so-called *guanxi* relationships and personal honour influence contacts between owners and management, contracts between firms and how the firm is run to a high degree (Hamilton, 1992). It is important to recognize these similarities and differences in the corporate governance system in the most influential economies in Asia and supply reasoning about both the traditional formal institutions and the informal institutions in the region.

4. Principal agent theory

Before presenting an in depth review of the studies made on Asia it is necessary to give brief discussion on principal agent theory and its development. Since the discussion of the interaction between investors and management was brought to attention by Berle and Means (1932) agency theory has been developed as describing the different incentives and goals for investors and management of the firm (See for example Eklund (2008) for a comprehensive background on the importance of Berle and Means' *The Modern Corporation and Private Property*). Jensen and Meckling (1976) discuss agency cost and the problem for investors to monitor the managers, and raises certain questions about the influence from minority shareholders versus both controlling shareholders and the management of a firm. While the fundamental purpose

for the management of a firm is to maximize the value of the firm to its investors, there are some self-interest issues in agency theory concerning the relation between shareholders and management. The investors' objective for the firm is to receive a positive return on their investment, while the managers of the firm may have other objectives for the firm such as improving the growth of the firm, its reputation, or even more privately objectives such as the security of their own employment or simply financially reward themselves in any way. Since managers hold both the information about the firm and the decision making power while the investors, especially the minority shareholders, mainly hold the financial risk of the firm the incentives for the shareholders to control the managers is high.

The investors face several problems when trying to control the management. While some activities are easier to observe and control, for example salaries, other activities including non-pecuniary payments are harder for the investors to gain information about. According to Williamson (1963) non-pecuniary payments introduced to the theory of the firm will cause some analytical problems. Yet, non-pecuniary payments exist and may take many different forms. For example expansion of the number of employees will likely offer positive rewards to the management due to increased possibilities of promotion compared to the fixed-size firm. It may not only increase salary due to promotions, but also improve other attributes such as increased security, power, status, prestige and professional achievement. The problem with non-pecuniary payments compared to salaries is that the receiver has more restrictions on how it is spent. On the other hand, due to tax reasons non-pecuniary payments may be more attractive as well as being less visible rewards to the management, making it less provocative to shareholders.

The agency problems between investor and manager has been offered some possible solutions such as monitoring of actions by independent boards and giving economic incentives such as stock options to managers. However, the possible influence investor may have on management clearly increase as the investors controlling abilities also increase. Whether it is by large direct ownership of the firm or enhancing functions such as pyramidal structures or vote differential shares, a controlling shareholder has much more impact on the management than the minority shareholder. Hence, problems arise not only between management and investors but also between minority and controlling shareholders. The importance of contracts between investors and the firm and the enforceability of rule of law becomes imperative for the minority shareholders to be able to protect their own interests.

In addition to the mentioned agency problems between the investors, management and the controlling owners is that control enhancing tools such as pyramids, cross-holdings and the use of vote differential shares often can be traced to single families controlling the firm (see for example La Porta et al. (1999), Morck et al. (2004) or Faccio and Lang (2002)). As controlling families are often appointing management positions to individuals who are in some way related to the family, either in blood or through informal networks, potential agency problems face the possibility to be enhanced.

4.1 Corporate governance in Asia

The agency problems in Asia, with high deviation between control and cash flow rights, are generally known and anticipated by investors and hence also reflected in relatively lower share prices. Yet, low transparency, the informal networks and the influence by an often protective government still poses important agency problems and uncertainty in many Asian economies. The lower price of shares does to some extent reflect the increased uncertainty of the investment (Roche, 2005).

When describing corporate governance in Asia Roche (2005) presses the issue of the heterogeneity of the region, both within countries and between them. The possible consequences and importance of historical factors forming the corporate governance should not be underestimated when studying the Asian countries, a statement that should be compared with that of La Porta et al. (2008). Roche does not ignore the influence from legal traditions, but he does recognize that other factors may have a much higher impact in Asia compared to other parts of the world. Corporate governance in Asia has very different starting points in terms of cultural differences, timing of events, political processes and international affiliations. The informal institutions forming the formal institutions in Williamson's structure of institutions look rather different at the top level when comparing Asia and Europe for example.

Many of the Asian countries embraces different legal and economic diversity, for example the legacy of European colonialism is very strong in countries like Hong Kong, India, Malaysia and Singapore with their Anglo-Saxon origin legal system. Yet, European colonialism has also affected the legal systems in Thailand and the Philippines with French origin legal systems. China, Taiwan, South Korea and Japan with German legal traditions have been influenced by other reasons, Japan for example adopted the German legal system as a step in the country's movement from a feudal agriculture country to an industrialized nation (R. Morck & Nakamura, 2004). In the case of Taiwan,

its legal system originally relied much on that of China which just like Japan looked to the German legal systems during its period of modernization ((R. La Porta, et al., 2008).

Furthermore, as pointed out by Roche (2005) there is also an array of culturally, linguistically and religiously differences in a region with more than two billion people. In many Asian countries it is common that the legislation is implemented in advance of the corporate practice. In some cases, adoption to new legislations may be very slow, for example the implementation of double board structures in China and its effects on firm performance and general recommendations for corporate practice (Dahya et al. (2003).

According to some (for example Roche (2005) and Solomon et al. (2002)), it may actually be the case that the introduction of legislations by the state rather than a reliance on self-regulation in fact accelerate the convergence and achievement of best practice. Formal international institutions such as the European Union and the OECD may introduce pre-emptive legislations for increasing convergence toward a best practice. However, in Asia the Association of South East Asian Nations (ASEAN) has historically not been working actively to implement and support cross country legislations. In recent years this has changed however, as the ASEAN countries are working on improving their dialog on corporate governance in the region (ASEAN, 2009).

The impact of legal origin is however notable also in the Asian countries. When we compare the legal origin as grouped by Muller (2006) with information about accounting standards, creditors' rights and contract enforceability provided by Gugler et al. (2003) we get a good overview of the complex effects there may be on the corporate governance systems depending on legal traditions (Table 1).

Table I Legal origin and corporate governance indicators in Asia

Country	Legal Origin ²	Accounting Standards ³	Creditor Rights ²	Contract Enforceability ²
Hong Kong	English Origin	69	4	n.a.
India	English Origin	57	4	1.94
Malaysia	English Origin	76	4	2.28
Singapore	English Origin	78	4	3.17
Thailand	English Origin	64	3	2.23
Japan	Asian-Germanic Origin	65	2	3.12
South Korea	Asian-Germanic Origin	62	3	2.20
Taiwan	Asian-Germanic Origin	65	2	2.53
Indonesia	French Origin	n.a.	4	1.73
The Philippines	French Origin	65	0	1.81
China	German / Socialist*	n.a.	n.a.	n.a.

Sources: ² Mueller (2006), ³ Gugler et al. (2003), * Socialist legal origin is discussed in La Porta et al (2008)

While the creditor rights index is higher in the common law origin countries (denoted English Origin by Mueller) than the countries with other legal traditions, indicators such as accounting standards and contract enforceability does not show the same consistency. This supports for example the arguments by Roche (2005) and Mueller (2006) that several other factors than legal origin has important effects on the country's corporate governance system and the development of the system. Depending on what informal institutions really constitute it is likely that historical background, informal networks and law enforcement in reality does affect the formal institutions in some informal way.

The awareness of the importance of corporate governance has increased massively in Asia during the last couple of decades according to Roche (2005). The concept of corporate governance was more or less unknown in China some decades ago. But due to the economic development and also some serious financial and market manipulations scandals the concept of corporate governance has received an increased amount of attention for improvement and regulations. This is not unique for China; most of the Asian countries have gone through improvements in the corporate governance system.

In many cases, the Asian financial crisis in 1997 caused governments and firms to evaluate their corporate governance system and seek improvements. The economic effects on firms and countries due to the crisis could to some extent be traced to the current state of the corporate governance system (Roche, 2005). Countries with more well-developed and well-defined systems tended to be less affected by the crisis. To dampen the effects from possible new economic downturns, countries with relatively less developed corporate governance systems were given incentives to develop their systems. The IMF

for example induced countries like South Korea to drastically change their corporate governance rules if they would be eligible for economic support from the IMF.

Table 2 illustrates the effects on currency and stock markets for a handful of the Asian countries during the economic crisis in 1997. The effects from the crisis struck some of the countries especially hard and much of the debate concerned the factors behind the crisis.

Table 2 Effects from the Asian financial crisis in 1997-1998*

	Currency change, %	Stock Index change, %	Market Fall
Indonesia	-83.2	-35.0	-\$96bn (-88%)
Thailand	-40.2	-48.0	-\$40bn (-66%)
Malaysia	-39.4	-56.0	-\$217bn (-76%)
The Philippines	-36.1	-33.8	-\$43bn (-58%)
South Korea	-34.1	-58.7	-\$111bn (-71%)
Singapore	-16.5	-43.5	-\$91bn (-53%)
Hong Kong	n.a.	-43.2	-\$223bn (-42%)

* (Fall in currency exchange rate for US\$ between 30 June 1997 and 3 July 1998. Percentage decline in stock market index between 30 June 1997 and 3 July 1998. Fall in stock market capitalization in US\$ billions, between 30 June 1997 and 3 July 1998) Source: Clarke (2000)

From table 2 it is clear that the financial crisis was truly severe. However, there is not any clear pattern between legal origin and the effects of the crisis. It seems that the effects on the common law countries (Thailand, Malaysia, Singapore and Hong Kong) are just as big as the civil law countries (Indonesia, The Philippines and South Korea) in the table. Letting legal origin explain economic growth and firm performance, it does not seem to affect country resistance to financial crises, at least not in this example.

The general trend since the financial crisis has been a movement towards western influenced corporate governance systems in most Asian countries. The degree of change has, however, varied greatly across the countries. According to Roche (2005), there have been improvements in most Asian countries and efforts have been made to improve the legal and regulatory systems underpinning corporate governance. However, in other areas such as discipline, transparency and accountability the improvements have varied substantially between the Asian countries.

Roche (2005) singles out Singapore and Hong Kong as the countries with the class leaders in corporate governance. India is also represented as a country which has had its corporate governance system improved substantially. All three countries being old British colonies in Asia clearly has had some influence from legal origin and the legacy of a colonial power on their corporate

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governance. Countries like Taiwan, South Korea and Malaysia have improved as well, but not to the same extent as the previous countries. Taiwan, South Korea and Malaysia with German and English legal origin respectively have not been under colonial rule at the same extent as Singapore, Hong Kong and India. Thailand and the Philippines are still in need of improvements, and Indonesia seems to be lagging behind considerably. These countries also have a mixture of legal origin and also colonial influence. Possible linkages between legal origin, colonial influence and corporate governance do not seem to be totally clear for the region. Japan has always been and will probably remain a special case in many ways in Asia, something that is also true for their corporate governance system. The Japanese system has seen very little improvements and has very low transparency. Table 3 illustrates the improvements of self-regulations imposed by firms in the Asian countries for improvement of the corporate governance system.

Table I Implementation of self-regulations 1997 / 2003

	Official code of best practice?	Mandatory independent directors?	Mandatory audit committees?
China	Yes/Yes	Yes/Yes	No/Yes
Hong Kong	No/Yes	No/Yes	No/No
India	No/Yes	No/Yes	No/Yes
Indonesia	No/Yes	No/Yes	No/Yes
Japan	No/Maybe	No/Optional	No/Optional
South Korea	No/Yes	No/Yes	No/Yes
Malaysia	No/Yes	Yes/Yes	Yes/Yes
The Philippines	No/Yes	No/Yes	No/Yes
Singapore	No/Yes	Yes/Yes	Yes/Yes
Taiwan	No/Yes	No/Yes	No/No
Thailand	No/Yes	No/Yes	No/Yes

Source: Asian Corporate Governance Association ACGA (2002)

Several studies of corporate governance and its development have been presented during the last decade. On self-implemented practice by the firms Chuanrommanee and Swierczek (2007) considers the corporate governance statements by financial corporations in three ASEAN countries; Thailand, Malaysia and Singapore. The authors find that the corporations' own description of their governance show a much more improved corporate governance structure than previously reported and in fact in line with international best practices. However, they suggest that the statements do not fully reflect the real practices carried out and that the corporate governance of

the financial corporation's does not live up to the international best practices. Information and openness is possibly affected by these differences.

Singh and Zammit (2006) considers the Asian "way of doing business" and a possible on-going shift to an US way of doing business. As mentioned, the Asian financial crisis in 1997-1998 is by many claimed to have been caused by the Asian corporate governance system. However, the authors reject this hypothesis and instead claim that in general the Asian corporate governance model has been well-functioning and that the market competition is high, not low as suggested earlier. Furthermore, Singh and Zammit (2006) claims that the US business model would not benefit Asia as a whole since the area consists of industrialized countries and developing countries at different stages in their development. The US corporate governance has severe limitations for developing countries due to imperfect share prices and imperfect market for corporate control, according to the authors.

Solomon et al. (2002) studies the reforms of the South Korean corporate governance system after the Asian economic crisis in 1997-1998. The effects from the crisis hit South Korea especially hard since the large conglomerates where to large extent financed via debt and also a general low accountability for investors in the corporate governance system itself since the crisis. The reforming of the South Korean corporate governance system has been heavily inspired by western standards and is moving towards globally harmonized corporate governance. It is mainly investor relations, the accountability of *Chaebols* and an increased encouragement of shareholder initiatives that should strengthen the South Korean corporate governance system.

Lee and Yeh (2004) study the relationship between ownership, corporate governance and sensitivity for economic distress in Taiwan. By using proxies for corporate governance systems such as level of controlling owners and board positions, the loan ratio for shareholders and the dispersion of ownership and cash-flow rights, they test the economic sensitivity from corporate governance factors. Lee and Yeh (2004) finds that firms with weak corporate governance are more vulnerable to economic distress and also that the risk that the firm will fall into financial problems increase with a weaker corporate governance system.

Kao et al. (2004) find indications of a negative relationship between collateralized shares and firm performance in Taiwan. Further, they show that the negative relationship exists only for conglomerates. Kao et al. (2004) suggest that these findings point towards a larger principal-agent problem in conglomerates than regular, non-conglomerate firms. The principal-agent

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problems may be limited by increasing the monitoring by institutional investors and creditors. Furthermore, dividend policy may affect the principal-agent problem positively and have positive effect on the firm performance according to the authors.

According to Buchanan (2007) the Japanese corporate governance and ownership structure is foremost characterized by “internalism”. The general idea about the management of Japanese firms is that the directors should be internally appointed or recruited and integrated into the firm. The “internalism” is based on informal institutions affected by specific historical and economic circumstances with stronger foundations than the modern view on corporate governance and the appointing of the management. These informal institutions may be affected by external elements according to Buchanan (2007) but are not likely to do so in a near future.

Corporate governance and the adoption of new business models originating from outside Japan is discussed by Seki (2005). While changes in corporate governance has received an increased attention in Japan by both scholars and practitioners the results has, according to the author, been marginal. However, prominent changes in the composition of shareholders and changes in the legislation will lead to greater awareness of the effects from a changing corporate governance system. Seki (2005) predicts an increased shareholder activity in Japan in the future.

Arikawa and Miyajima (2005) study the influence on raising of firm capital by the level of interaction between banks and firms in Japan. By examining between 969 and 1,341 firms each year from 1986 to 2000 they find strong links between bank relationship and composition of debt. It seems that successful firms with strong ties to banks are more prone to issue public bonds than borrow from banks.

Liew (2007) studies the development of the corporate governance system in Malaysia after the financial crisis in 1997-1998. It gives clear indications of the problems of implementing an Anglo Saxon corporate governance tradition into a traditionally more socially focused governance model. Personal networks, typical for the Asian firms, remain important for the managers, contrary to the Anglo Saxon corporate governance system which focus mainly on the shareholders’ accountability on management. Pik Kun (2007) states that the reforms towards a Anglo Saxon inspired corporate governance system has in fact not been achieved and may hurt the Malaysian economy in face of future economic crises.

The Chinese corporate governance system has been studied by Zhang (2007) who finds some disturbing elements in the legal protection of shareholders. The Chinese movement to a market oriented creation of a corporate governance system lacks a basic legal foundation according to Zhang (2007) since disciplining measures are not implemented. Misbehaving managers are not punished in the legal system and the possible risk of punishment by legal system does not work as a repellent.

With a case study Dahya et al. (2003) gives an interesting illustration of corporate governance in China. The adoption of a two tier board structure, one board of directors and one supervisory board, and two separate annual reports by all Chinese listed firms show how the market reacts to irregularities in the general corporate governance system. The case study show that a firm not reporting the supervisory board report (either by mistake or negligence) suffers from more distrust from investors and a lower market value. The authors suggest that the Chinese corporate governance need to safe guard the supervisory board report and strengthen its function.

4.2 Ownership structures in Asia and consequences

Ownership structures of Asian firms has been studied extensively during the last couple of decades, they show a concentrated ownership with commonly family, or state, ownership as the predominantly type of owner. La Porta et al. (1999) summaries the ownership of the 20 largest firms in terms of market capitalization of common equity for 27 countries. Of the 27 countries however only Hong Kong, Japan, Singapore and South Korea represent Asia in the dataset. Using a cut-off of 20 per cent of the voting rights to determine control, 90 per cent of the large³ traded firms in Hong Kong has concentrated ownership. The corresponding figures for Japan, Singapore and South Korea are 10, 85 and 45 per cent. Using a lower cut-off for controlling ownership at 10 per cent, the amount of concentrated ownership remain at 90 per cent for firms in Hong Kong, but increase to 40, 95 and 60 per cent for Japan, Singapore and South Korea respectively. The share of firms with one controlling owner stand in sharp contrast to the dispersed ownership observed in for example the US.

³ La Porta et. al. (1999) also study medium-sized firms and find that the medium-sized firms show a higher level of concentrated ownership in all the Asian countries. Family ownership is also more common in the medium sized firms than in the large firms for all the Asian countries.

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La Porta et al. (1999) also consider the type of ownership defining a family ownership as whether the controlling shareholder is an individual or not. State ownership is treated in a similar way with controlling shareholders being defined as government ownership. Using the 20 per cent cut-off for determining ownership control, Hong Kong has relatively high level of family ownership at 70 per cent of the firms with concentrated ownership. Japan, Singapore and South Korea have only 5, 30 and 20 per cent family ownership of the firms with ultimate owners respectively. The figures are fairly stable for the lower cut-off at 10 per cent of the voting rights for all four countries. With the exception of Singapore with about 45 per cent state ownership, state ownership is low at around 5 to 15 per cent. This is rather surprising for South Korea since the influence of the often family controlled *Chaebols* is considered to be large.

Claessens et al. (2000) use a further developed version of the methodology from by La Porta et al (1999) and use a dataset with 2,980 firms in nine East Asian countries (Hong Kong, Indonesia, Japan, South Korea, Malaysia, The Philippines, Singapore, Taiwan and Thailand). Finding, and addressing, both a high level of control enhancing mechanisms such as dual voting shares and family ownership (according to the authors more than half of the East Asian firms are family controlled) make the paper interesting from a comparative perspective for the Asian countries. Claessens et al. (2000) find that firms in Japan are most often widely held, while firms in Indonesia and Thailand in most cases have concentrated ownership often held by families. Furthermore, state control of firms is common in Indonesia, South Korea, Malaysia, Singapore and Thailand. It is also found that size and age of the firms affects ownership in East Asia. For example, the relatively small firm and/or older corporation are more commonly controlled by a family. As the level of economic development increase, the concentration of control generally decreases. Except from Japan, family ownership of firms is common in East Asia. In Indonesia, the Philippines and Thailand about half of the firms in the sample are controlled by ten families. In Hong Kong and South Korea about a third of the firms in the sample are controlled by families. Overall, Claessens et al. (2000) gives a picture of concentrated ownership, high family ownership and high levels of control enhancing mechanisms.

Joh (2003) study 5,829 South Korean firms and the effects from ownership concentration and investor interests prior to the Asian economic crisis in 1997. Joh find that firms with dispersed ownership typically show a lower profitability than firms with high ownership concentration. Firms with high separation

between ownership and control i.e. via control enhancing mechanisms such as pyramid ownership show a lower profitability. Furthermore it is found that controlling shareholders expropriate firm resources even when their ownership concentration is relatively low.

Yeh et al. (2001) study the ownership structure of 208 publicly traded family firms in Taiwan. According to Yeh, family control and concentrated ownership is higher in Taiwan than many other Asian countries. They find signs of a non-linear relationship between the level of family control and the performance of the firms. In general, a family firm with low levels of control performs worse than firms with high levels of family control. They also find a negative relation between firm performance and the number of board members being part of the ownership family. These results point to positive effects for the firms from high family ownership but relatively low involvement in the management of the firm.

Sheu and Yang (2005) study the performance of 333 listed Taiwanese electronics firms using total factor productivity measurements and the effects of inside ownership. They find a non-linear relationship between the level of executive-to-insider ownership and performance of the firm. The highest and lowest level of executive-to-insider ownership has a positive effect on productivity. The board-to-insider ownership and the total insider ownership are not found to have any effects on the performance.

Wiwattanakantang (2001) studies a sample of 270 Thai firms. While concentrated ownership in the form of a controlling owner improves the performance of the firm (higher ROA and sales-asset ratio), Wiwattanakantang (2001) does not find evidence for expropriation of firm resources by controlling shareholders. One possible explanation is that control enhancing mechanisms are rarely used to separate control and cash-flow rights. Furthermore, this may explain the higher profitability for firms with high ownership concentration as controlling shareholders might be self-constrained not to expropriate extra benefits. However, a higher involvement of the controlling owner in the management and board affects the firm's profitability negatively. Last, it is shown that family firms, firms with foreign control and firms with more than one controlling shareholder (>25% of the voting rights) perform better than widely held firms.

Tam and Tan (2007) study ownership impact on performance in the largest 150 firms in Malaysia. Ownership is divided into individual (family), state, foreign and trust fund ownership where individual ownership constitute for 65% of the firms. They find that the type of ownership affect performance of

the firm in different ways, foreign owned firms having the best performance, and then followed by family firms and state owned firms. The level of concentration of ownership is also found to have a negative effect on the performance of the firm and is explained by low levels of minority shareholder protection.

Family ownership of firms in Asia tends to affect the board composition for firms. If the family owners have some certain interest that does not match the interest of the shareholders, the effects on board composition and managements may be very important. The family ties and informal networks for the controlling owner may affect board composition in a way that is not in accordance with other shareholders.

4.3 Board composition and transparency

Fan and Wong (2002) focus on ownership structures and also the effects on transparency of management decisions in seven East Asian economies; Hong Kong, Indonesia, Malaysia, Singapore, South Korea, Taiwan and Thailand. Fan and Wong use the same data as Claessens et al. (2000) but exclude Japan resulting in a dataset with 1,740 firms. The reason for excluding Japan from the dataset is for Asian conditions unique ownership structure. Furthermore, firms with ultimate owners having less than 20 per cent of the voting rights are excluded from the dataset. By studying the level of ownership and transparency of firm actions as well as reported earnings, they are able to find a negative connection between ownership concentration and informativeness of the management. They explain the relationship as an entrenchment of the controlling owners which both gives the ability and incentive to manipulate earnings and concealment of rent-seeking and proprietary information is done to eliminate potential competitors.

Chau and Gray (2002) study the relation between ownership structures and voluntary disclosure of firm information for 122 firms in Hong Kong and Singapore. They find that higher levels of outside ownership, defined as proportion of equity not belonging to directors or controlling shareholders, increase the level of voluntary information disclosure to the public. Firms with high level of insider ownership, defined as a strong connection between ownership and management, and family held firms tend to provide the public with less voluntary information. Since a large portion of the firms in Hong Kong and Singapore are closely held or owned by families the level of insight in firm activities are highly restricted according to Chau and Gray (2002).

Kim (2005) study the relation between board network characteristics and firm performance for 199 large, listed South Korean firms between 1990 and 1999. The board's network is identified as both its density and its external social capital. Density is defined as the contact intensity between the board members and external social capital is defined as the board members degree of external contacts. The results show that a moderate level of board density enhances the firm performance, but as the density increase more it has a negative effect on performance. Also, board members having external social capital affects the firm performance positively according to Kim (2005).

Chiang and Lin (2007) find similar, non-linear, results for Taiwan using also using total factor productivity to measure the impact on firm performance for 232 listed firms by ownership structure and the composition of the board. They also find that conglomerates are more productive than non-conglomerates, that high-tech firms are more productive than low-tech firms and contrary to other studies that family firms are less productive than non-family firms.

In their study of Japanese firms, their board composition and ownership structure, Yoshikawa and Phan (2005) finds that the board structure affects the product diversification of the firm. In general, the number of corporate nominee directors in the board is correlated with lower levels of product diversification in the firm. Yoshikawa and Phan (2005) concludes that Japanese corporate nominee directors see themselves as representatives of certain production interests. Hence, the board composition should be taken into consideration by investors for assessing the level of protection of certain interests. However, in this case, there remains a potential possibility of a principal-principal problem rather than the classical principal-agent problem.

Ong et al. (2003) examines the factors affecting board interlocking for 295 listed firms in Singapore using ten independent variables such as firm size, financial contacts and firm performance. The authors find that for Singapore, an increase in interlocking of boards can mainly be explained by increased firm size, a higher firm performance, the size of the board and if the firm is a financial institution.

Wan and Ong (2005) test the relation between board structure, board process and performance of 212 listed firms in Singapore. They find that the structure of the board does not affect the process of the board, but that the board process affects the performance of the firm. Furthermore, the board process is negatively affected by decreased board transparency and conflicts within the board. These characteristics can be related to the individual board

members. Yet, Wan and Ong (2005) could not find that board process works as a mediating role between board composition and performance.

Wen et al. (2002) study the relationship between board characteristics and the capital structure for 60 listed Chinese firms during 1996 to 1998. They find that the capital structure is affected by the structure of the board and the tenure of the CEO. However, they do not find any effects on the capital structure from the board size or the compensation to the CEO. According to Wen et al. (2002) this suggests that the Chinese corporate governance system is not functioning as well, or in the manner, of western theoretical finance literature.

The composition of the board is important, not only for the specific firm but also firms and shareholders of firms that are owned by other firms. In firm with a board focusing on its own enrichment and which enjoys control over other firms with relatively small shares of capital, control enhancing tools such as dual vote shares become even more important.

4.4 Control enhancement and pyramidal ownership

Lim and Kim (2005) study the ownership structure of 30 major South Korean conglomerates (*Chaebols*) from a direct ownership perspective and also the indirect effects from the degree of family stake in the firms. They find that conglomerates with high levels of leverage and a large share of nonmanufacturing businesses usually have a direct ownership. Pyramidal ownership is more common in the large conglomerates and conglomerates with high degrees of nonvoting shares. Lim and Kim (2005) also find that South Korean conglomerates with a focused business line have a higher level of family stake, while conglomerates owning more listed firms and conglomerates using nonvoting shares have lower levels of family stake.

Yeh (2005) studies 251 Taiwanese firms to find a possible relationship between control enhancing mechanisms, negative entrenchment effects and firm valuation. He finds that corporate valuation is higher for firms with a controlling shareholder with higher degrees of cash-flow rights. A lower than median cash-flow right has a negative effect on the valuation of the firm. Negative entrenchment effects are avoided by positive incentives for controlling shareholders which increase the valuation of the firm when increasing cash-flow rights. For family firms, it is found that the valuation of the firm decrease as the controlling shareholder increase their influence over the firm with increased voting power through cross-holdings, deep and regular influence on the management and appointing of the board members.

Chen et al. (2007) implement and test an index for evaluation of corporate governance efficiency in 3,233 firm year observations in Taiwan. The index consists of four different aspects of the governance of the firm; the duality of the CEO: s, the size of the board of directors, the size of the management's holdings and the size of the block shareholders' holdings. The index shows a strong link between corporate governance efficiency and the performance of the firms. Firms scoring high on the corporate governance efficiency index show higher performance than firms with low efficiency.

In general, control enhancing tools, dual voting shares and pyramidal ownership is very common in Asia. However, the control enhancement may look very different in the countries. In South Korea for example, the ownership structure with one firm on top is fairly common. In this case, one firm control many other firms through relatively small shares of capital. In Japan on the other hand, firms tend to be held through cross ownership. In this case there is a cross dependence between the firms.

5. Outline, summary results and contributions of the thesis

The papers included in this dissertation fundamentally builds on the institutional settings and their effects on economic activity especially in Asia. Williamson (2000) stresses the importance and influence of informal institutions, however, the actual effects of informal institutions are often hard to measure and evaluate. As informal institutions are assumed to affect formal institutions such as legal traditions, legislations and consequently the governance following the laws, most studies need to settle with observing effects from formal institutions rather than the possibly more influential informal institutions. This makes Asia more complex to study as it is commonly assumed (Roche, 2005) that the informal institutions are especially important in most Asian countries. Family ties, personal contacts, "guanxi" and honour tend to have much higher value in Chinese culture than in most Western countries, and, hence, even more influential informal institutions. Yet, we are still stuck with the formal indicators when studying the effects of for example family ownership on firm performance. This is a limitation to this study, but also something that should be discussed and given more attention in the future.

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The four papers included each deal with different aspects of corporate governance, legal origin and firm performance, mainly with an Asian perspective. All papers use measures of formal institutions as explanatory variables for firm performance, investor performance or capital allocation. Formal institutions can be seen as proxy variables for the effects of informal institutions, though, not all of the information can be captured by formal institutions.

5.1 *Family Ownership and Firm Performance: Empirical Evidence from Asia*

The first paper “Family Ownership and Firm Performance: Empirical Evidence from Asia” builds on an European study by Maury (2006). The main results show that family ownership affect firm performance negatively when using traditional firm performance measures such as return on assets or Tobin’s q. These results are in line with previous studies even though a relatively strict definition of the family firm is used in the study. Family ownership, and especially family control, has been shown to be much more common in Asia than displayed in this paper. What is interesting to note is family ownership effects on investment performance, marginal q. Family owned firms tend to have better investment performance than non-family owned firms in Asia. This suggests that while the family firms may be performing worse in terms of valuation or returns measures, they are actually better at investments or at least avoiding bad investments to a greater extent. The main contribution of the paper is the study of family ownership effects on firm performance in Asia. In addition, the study shows that using relatively few measures of performance will not capture the whole effect of family ownership.

5.2 *Legal Origin and Firm Size Effects Around the World*

The second paper “Legal Origin and Firm Size Effects Around the World“ investigates investment performance and firm size (in terms of number of employees) in 58 countries around the world. The size of the dataset and number of firms included makes it possible to draw parallels between legal origin studies and literature on limits to firm size. In terms of impact of legal origin on investor performance we find more similar results Fagernas et al. (2008) than Mueller (2006), however, we note the same variance within each group of legal traditions, mainly the German legal origin. This is extra evident

when estimating the investment performance on a country level. We also find that increase of the staff initially has a positive effect on the investment performance, but that this effect is non-linear and has a local maximum. There seems to be a pattern between limits to firm size and the legal traditions of a country, however, this effect is not obvious and needs to be given more attention in the future.

5.3 *Pro-Market Reforms and Allocation of Capital in India*

The third paper “Pro-Market Reforms and Allocation of Capital in India” studies the capital allocation in India after its pro-market economic reforms in the 1990s. We measure the investment efficiency by using the accelerator principle and examine the effect of ownership type on the allocation of capital. We find no significant improvement in the allocation of capital during the period that we study; rather our findings suggest that the firms face large costs in adjusting their capital stock during the reforms. The data we use is unique as it allows us to estimate the elasticity of capital with respect to firm output in a setting which also let us control for different types of owners. This paper has been published in *Journal of Financial Economic Policy*, 2011.

5.4 *Pieces of the Capital Structure Puzzle: Financial Markets and Ownership*

The fourth paper “Pieces of the Capital Structure Puzzle: Financial Markets and Ownership” deals with firm capital structure in 24 Asian and European countries. The paper brings together both firm specific factors and country specific factors to explain the capital structure of firms. The topic has been given much attention, especially since Myers (1984) article, which describes how little is actually known about how managers choose firm capital. Yet, given the attention to the topic, surprisingly little has been written on the combination of country specific factors and firm specific factors in terms of ownership. Here it is found that both indicators of financial market maturity and firm specific ownership characteristics influence the leverage of firms. Financial market maturity measures have a negative effect on debt levels as firms may have better access to equity financing in well-functioning financial markets. Family ownership of firms also has a negative effect on firm leverage as it is hypothesised that family owners have longer time horizons in their investments and rely more on equity financing. It is also found that domestic

owners tend to positively affect the leverage level as these are likely to have better access to debt capital and also better understanding of the risk and cost of financial distress in case of default.

5.5 Concluding Remarks

These four papers contribute to the corporate governance, legal origin and firm performance literature by providing a broader understanding of the effects of ownership type and legal origin on firm performance and allocation of capital mainly in Asia. While the papers answer the questions they were set out to answer, several unanswered questions remain, and Asia will provide for more interesting studies within the corporate governance field.

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