Chapter 14
Bank vs. Bond Finance:
A Cultural View of Corporate Debt Financing

Wolfgang Breuer
RWTH Aachen University, Germany

Benjamin Quinten
RWTH Aachen University, Germany

Astrid J. Salzmann
RWTH Aachen University, Germany

ABSTRACT

This chapter enhances the growing research field of Cultural Finance by analyzing the relationship between cultural value types—in particular, Autonomy and Embeddedness—and the corporate debt choice of either bank or bond financing. The authors derive their hypotheses from a slight modification and re-interpretation of the Chemmanur and Fulghieri (1994) approach of "relationship lending." Referring to the importance of specific human capital investments and individuals' future orientation, they show that firms in autonomy cultures tend toward bank finance, whereas firms in embeddedness cultures show a preference for financing by issuing bonds. In a cross-country analysis with 71 countries, the authors find empirical evidence for their established hypotheses.

1. INTRODUCTION

International capital markets have been outriders of globalization during the last decades, as many financial outcomes still differ considerably among countries. In recent years, the field of Cultural Finance has emerged as a multidisciplinary research stream and has incorporated national culture to explain cross-country differences in various financial studies. According to Hofstede (1980), culture is defined as "the collective programming of the mind". Culture is composed of certain values which shape behavior as well as one's perception of the world. Following this reasoning, one may conclude that corporate decisions may not only be determined by an objective assessment of the underlying problem, but also by a subjective perception toward the problem which

DOI: 10.4018/978-1-4666-6551-4.ch014

depends on national culture. This rationale is the main intuition behind cultural driven analysis of corporate financial decision making.

Scholars have already demonstrated the important influence of national culture on capital structures (Chui et al., 2002), dividend policy decisions (Shao et al., 2010, Fidrmuc & Jacob, 2010), cash holdings (Ramirez & Tadesse, 2009), and debt maturity choice (Zheng et al., 2012). We contribute to this literature by analyzing a further important corporate financing decision; namely, the decision between bank and bond finance. De Fiore and Uhlig (2005) found that the ratio of bank to bond finance was 0.75 for the USA, whereas in contrast it was 7.3 in the Eurozone. Despite this considerable cross-country variation of debt financing in corporate finance worldwide, research on the issue of the determinants has yet been inconclusive. Our chapter extends Antonczyk et al. (2014) who evidence that the degree of long-term orientation in a country is positively related to the use of bank relationship lending.

When examining the relevance of cultural aspects for corporate financing decisions, one may directly draw relationships between cultural variables and certain financing activities including dividend payments or the bank versus bond decision. This approach is the most straightforward; however, it is typically based on ad-hoc arguments without formal background and the precise mechanism that links culture and corporate financing decision remains more or less obscure. In our investigation, we therefore start by referring to a formal model background. Instead of directly relating cultural variables to financing features, we suggest a relationship between certain input parameters of the model under consideration and cultural influences. As the input parameters in turn determine financial decision making, we are thus able to establish an indirect link between culture and finance. One major advantage of this approach is that it becomes clearer by which mechanism culture may affect financial decision making.

To be more precise, we refer to the well-established model by Chemmanur and Fulghieri (1994) in order to derive time preferences and the extent of human capital investments as the main drivers of the decision between bank and bond finance. In a second step, we then link these two determinants with cultural features. From this line of action, it is then possible to draw conclusions for the relationship between culture and the decision between bank and bond financing. We operationalize culture with data on the Schwartz cultural dimensions of Autonomy and Embeddedness for 71 countries and generate testable hypotheses. Autonomy describes the extent to which personal interests and desires are pursued in a community, while Embeddedness refers to the preservation of existing orders and traditions. In an empirical analysis, we show that firms in Autonomy cultures tend toward more future orientation and more specific human capital and thus bank finance, whereas firms in Embeddedness cultures tend toward a higher presence orientation and less specific human capital and thus bond finance.

Summarizing, we complement extant literature in several important ways. First, based on a detailed cross-country analysis, we document that national culture has a systematic influence on the corporate choice of debt financing. Second, we derive our hypotheses theoretically by incorporating cultural values directly into the well-established model by Chemmanur and Fulghieri (1994), which provides a sound basis for the proposed relationships. Third, we elaborate on the channel through which national culture affects the bank versus bond finance decision, namely through time preferences and human capital investments.

Our analysis provides an important extension to Antonczyk et al. (2014), as we focus on the Schwartz framework to incorporate cultural values instead of the Hofstede model. We draw on the cultural dimension of Autonomy and Embeddedness that transcends time preferences and exceeds long-term orientation distinctly. Additionally, we specify the influence of the cultural dimension