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The merits of Anglo Saxon capitalism [1]

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As we all know one of the differences between the Anglo-Saxon variant of capitalism and others such as Rhineland such is the way in which economic activity is financed. They tend to use banks to finance both the debt and equity portions of a business, we tend to use markets to do so. For us large companies tend to issue shares, bonds, commerial paper, and even small companies don't get their equity from banks, only their debt financing.

As an aside it has hugely amused me the way in which recent events have had everyone spitting at the banks, insisting that they be cut down to size. And then the very same people (yes Mr. Hutton, we're lookin' at you) insist in the next breath that we must have Rhineland capitalism, the one in which the banks loom even larger in the financing of industry.

But that is an aside. What we really want to know is which is the best method of financing industry [3]?

> The nature of the firm and its financing are closely interlinked. To produce significant net present value, an entrepreneur has to transform her enterprise into one that is differentiated from the ordinary. To achieve the control that will allow her to execute this strategy, she needs to have substantial ownership, and thus financing. But it is hard to raise finance against differentiated assets. So an entrepreneur has to commit to undertake a second transformation, standardization, that will make the human capital in the firm, including her own, replaceable, so that outside financiers obtain rights over going-concern surplus. I argue that the availability of a vibrant stock market helps the entrepreneur commit to these two transformations in a way that a debt market would not. This helps explain why the nature of firms and the extent of innovation differ so much in different financing environments.

It would seem that the draw of being able to float a company increases the incentives to make it truly independent of the original guiding force, the entrepreneur. And as is mentioned, we very much want companies to both outgrow and outlive their founders. So it would appear that it is the Angoo Saxon variant that wins this little part of the battle then.

So rah rah for The City then, eh?

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