

The Impact of Confucian Culture on the Labor Income Share in Firms

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Abstract. Against the backdrop of China's national strategy to achieve common prosperity, optimizing the income distribution structure has become a critical policy issue. This study investigates the impact of Confucian culture on the labor income share in firms, using panel data from A-share listed companies in Shanghai and Shenzhen between 2008 and 2021. A novel Confucian culture index is constructed based on geographical distribution, and a fixed-effects panel regression model is employed for empirical analysis. The results show that Confucian culture significantly increases the labor income share within firms. Further mechanism analysis reveals that this effect operates through two main channels: alleviating financing constraints and enhancing employee compensation. Specifically, Confucian norms help lower financing costs by fostering trust-based mechanisms, thereby expanding firms' capacity to pay wages; at the same time, they promote greater attention to employees' welfare, improve compensation conditions, and facilitate a redistribution of corporate income in favor of labor. This study enriches the literature on the role of cultural factors in income distribution and provides theoretical insights for optimizing corporate income allocation and advancing the goal of common prosperity.

Keywords: Confucian culture; labor income share; financing constraints; common prosperity.

1. Introduction

Under the guiding objective of common prosperity, optimizing the income distribution system has become a vital component of China's modernization of national governance. As key market actors, enterprises participate directly in primary income distribution through wage payments, and contribute to secondary and tertiary distribution via taxation and philanthropic donations. Consequently, they play an essential role in reshaping the income structure. However, the current structure of corporate labor income allocation remains imbalanced: labor's share is disproportionately low, while returns to capital and executive compensation are relatively high (Luo & Chen, 2012), presenting a major obstacle to achieving distributive equity and common prosperity.

While existing studies have primarily focused on formal institutional factors—such as trade unions, tax policy, and corporate governance—the potential impact of culture as an informal institution on income distribution has received insufficient attention. In practice, under conditions of weak institutional enforcement, culture—functioning as a deeply embedded social norm—can significantly shape firms' governance logic and distributive preferences (North, 1991).

Institutional economics emphasizes the role of informal institutions like culture in structuring organizational behavior and institutional arrangements (North, 1991), while upper echelons theory suggests that managerial decisions are shaped by their surrounding sociocultural environment (Hambrick & Mason, 1984). Confucian culture, as China's dominant value system, is rooted in core principles such as *ren* (benevolence), *zhongxin* (loyalty and trustworthiness), and *liyi* (propriety and righteousness). Through the “differentiated order” of social hierarchy (Fei Xiaotong, 2011), Confucianism constructs trust-based networks and becomes deeply embedded in corporate governance structures, potentially exerting a subtle yet institutionalized influence on firms' income allocation behaviors.

This study investigates whether and how Confucian culture affects the labor income share within firms, focusing on two theoretical pathways: first, Confucian culture may alleviate financing constraints by strengthening trust mechanisms and thereby expanding wage-paying capacity; second,

it may enhance attention to employee compensation, encouraging firms to reallocate income toward labor (Pan et al., 2019). To test these mechanisms, this study uses panel data of A-share listed firms in Shanghai and Shenzhen from 2008 to 2021, constructs a Confucian culture index using geospatial techniques, and applies fixed-effects panel regressions and mediation analysis to systematically evaluate both the effects and heterogeneity of Confucian culture on labor income share.

This paper makes three key contributions: theoretically, it incorporates Confucian culture into the analytical framework of labor income distribution, extending the traditional perspective dominated by formal institutions; methodologically, it advances the application of cultural economics in the domain of corporate income allocation; and practically, it offers theoretical guidance and policy insights for optimizing corporate distribution structures and promoting common prosperity (Xu & Li, 2019).

2. Theoretical Framework and Research Hypotheses

From the perspectives of institutional economics and behavioral theory, a firm's income distribution structure is shaped not only by the resource allocation logic of the external market environment (Pan et al., 2019), but also by embedded cultural factors (Chen et al., 2020). Within China's unique socio-institutional context, Confucian culture—an enduring mainstream value system for thousands of years—has deeply permeated organizational arrangements and managerial behavior. It plays a structural role in internal governance, resource allocation, and financing behavior (Fei Xiaotong, 2011). Specifically, Confucian culture builds trust-based networks through the differentiated mode of association and promotes moral principles such as *zhongxin* (loyalty and trustworthiness) and *junping* (equity). These cultural norms not only shape firms' behavioral boundaries when facing external constraints, but also reshape internal incentive structures and distributional decision-making. Under conditions of institutional incompleteness, such culture-based institutional arrangements can serve as functional substitutes, reconfiguring the firm - finance interface and the internal power dynamics between labor and capital. In doing so, Confucian culture creates favorable conditions for increasing the labor income share (Pan et al., 2019).

This study investigates the influence of Confucian culture on the labor income share from two key angles: the alleviation of financing constraints and the improvement of employee compensation. First, Confucian culture may increase labor's share of income by easing financing constraints. Financing constraints have a pronounced suppressive effect on labor income share: (1) firms facing tight credit conditions often cut wage expenses to preserve cash flow (Luo & Chen, 2012); (2) restricted financing channels reduce firms' willingness to invest in human capital; and (3) high financing costs lower workers' bargaining power and reduce their share of surplus returns (Neumeyer & Perri, 2005). Rooted in localized social networks, implicit contracts, and moral obligations, Confucian culture helps reduce transaction costs and mitigate information asymmetries (Pan et al., 2019), thereby improving firms' access to credit. Trust-based mechanisms enhance financial stability under imperfect institutional conditions, allowing firms to better allocate resources and increase the income share allocated to labor.

Second, Confucian culture guides income allocation toward labor by emphasizing greater concern for employee compensation. Improving wage levels helps foster organizational identification, boost employee morale, and enhance productivity. At the same time, increasing the marginal return to labor enables workers to share more fully in corporate gains. Confucian principles promote distributional ethics centered on *junping* (equity) and *weigong* (public-mindedness), upholding the idea that “it is not poverty but inequality that is to be feared.” These values institutionalize managerial attention to fair compensation and equitable incentives (Jin & Liang, 2018). This orientation curbs excessive executive compensation (Chen et al., 2020), reinforces corporate concern for rank-and-file employees, and redirects profits toward improved employee remuneration, thereby reshaping the internal

distribution structure in favor of labor. Based on the above theoretical analysis, this study proposes two hypotheses to be empirically tested:

Hypothesis 1: Confucian culture increases the labor income share in firms.

Hypothesis 2: Confucian culture increases the labor income share in firms by alleviating financing constraints and enhancing employee compensation.

3. Research Design

3.1 Model Specification

To examine the relationship between Confucian culture and the labor income share, we construct the following fixed-effects regression model:

$$LS_{i,t} = \alpha_0 + \alpha_1 Confu_{i,t} + \alpha_2 Controls_{i,t} + Year + Industry + \varepsilon_{i,t} \quad (1)$$

The dependent variable, $LS_{i,t}$, denotes the labor income share, measured as the proportion of employee compensation in a firm's value added. The core explanatory variable, $Confu_{i,t}$, captures the intensity of Confucian cultural influence in the firm's location and is constructed based on region-level historical cultural metrics. $Controls_{i,t}$ represents a set of firm-level and region-level covariates, including firm size, capital structure, profitability, board size, among others. In addition, the model controls for year fixed effects (*Year*) to absorb macroeconomic and policy shocks, and industry fixed effects (*Industry*) to account for time-invariant sector-specific characteristics. $\varepsilon_{i,t}$ is the error term.

The analysis focuses on identifying the relationship between Confucian culture and the labor income share. Based on the theoretical framework, we anticipate a significantly positive relationship, suggesting that Confucian culture effectively increases the proportion of income allocated to labor revealing its inherent orientation toward equitable distribution.

3.2 Variable Definitions and Measurements

3.2.1 Dependent Variable: Labor Income Share (LS)

Following Shi et al. (2019) and Wang & Huang (2017), we define the labor income share as the ratio of total cash paid to employees in the current period to total operating revenue. This indicator reflects the proportion of firm income allocated to labor and serves as a proxy for firms' human capital deployment and distribution preferences.

3.2.2 Independent Variable: Confucian Culture (Confu)

There is currently no standardized metric for measuring the influence of Confucian culture. While some scholars have attempted to use survey-based methods to capture Confucian values such as ren (benevolence), yi (righteousness), and li (ritual propriety), such approaches often suffer from limited objectivity and small sample applicability. Others have used the number of Confucian schools at the provincial level as a proxy. However, this method assumes uniform cultural exposure within administrative units and neglects spatial heterogeneity, potentially introducing systematic bias.

To address these limitations, we adopt the spatial-cultural measurement approach proposed by Li & Zhu (2021), which captures the spatial distribution intensity of Confucian influence through geographic proximity to Confucian temples. Confucian temples, as key institutions in traditional Confucian dissemination, provide a credible proxy for local cultural atmosphere. Their spatial density is presumed to shape cognitive orientations and behavioral norms of corporate actors.

In operationalizing the variable, we collect names, addresses, and geographic coordinates (latitude and longitude) of Confucian temples across Chinese provinces and municipalities via online platforms such as Baidu and Google. We then match these with the registered addresses of listed firms. Using spatial measurement tools, we compute the number of Confucian temples located within a 200-kilometer radius of each firm's headquarters and apply a natural logarithmic transformation to construct the Confucian culture proxy, denoted as *Confu*.

3.2.3 Control Variables

The control variables selected in this study and their measurement definitions are as follows: firm size (*Size*: natural logarithm of total assets); firm age (*Age*: natural logarithm of the current year minus the founding year plus one); firm growth (*Growth*: ratio of revenue increase to total revenue in the previous year); capital structure (*Lev*: ratio of total liabilities to total assets); return on assets (ROA: net income divided by total assets); cash flow (*CF*: ratio of net cash flow from operating activities to total assets); capital-output ratio (*Ky*: natural logarithm of net fixed assets to main business income); board independence (*Bodindept*: ratio of independent directors to total number of board members); ownership concentration (*Top1*: shareholding ratio of the largest shareholder); board size (*BSize*: natural logarithm of total board members); and employee size (*LnEmp*: natural logarithm of total number of employees).

3.3 Sample Selection

This study selects A-share listed companies in China from 2008 to 2021 as the research sample. To enhance the reliability and representativeness of the data, the initial sample is processed as follows: (1) firms in financial industries such as banking, insurance, securities, and real estate are excluded; (2) firms designated as ST or delisted during the sample period are removed; (3) firms with incomplete or unidentifiable customer name disclosures are excluded; (4) observations with missing values for key variables are dropped. After these steps, a total of 18,540 firm-year observations are retained. Data on Confucian culture are obtained from the China Confucian Temple Network, while financial and firm-level data are sourced from the CSMAR and WIND databases. In addition, to mitigate the influence of outliers on the empirical results, all continuous variables are winsorized at the 1st and 99th percentiles.

4. Empirical Results and Analysis

4.1 Baseline Regression

To ensure the robustness of the empirical results, this study adopts a progressive regression strategy, whereby control variables and fixed effects are sequentially introduced into model (1) for estimation. In Column (1), which excludes any control variables, the estimated coefficient of the Confucian culture variable (*Confu*) is 0.0014 and is statistically significant at the 10% level. This preliminary result suggests that the Confucian cultural environment of a firm's location has a positive effect on the labor income share.

Recognizing that firm-specific characteristics may influence income distribution structures, Column (2) adds a set of control variables, including firm age, size, cash flow, capital structure, and corporate governance attributes. The estimation shows that the coefficient of *Confu* increases substantially to 0.0041 and becomes highly significant at the 1% level, indicating that the positive effect of Confucian culture on labor income share becomes more pronounced after accounting for firm-level heterogeneity.

Column (3) further incorporates industry and year fixed effects to control for potential confounding effects arising from sectoral institutional differences and macroeconomic trends. The coefficient of *Confu* remains positive, with a value of 0.0017, and is significant at the 1% level. This confirms that the positive relationship between Confucian culture and labor income share remains robust under multiple layers of control.

To interpret the economic significance of this result, we consider the standard deviation of the labor income share variable, which is 0.080. Based on this, a one-unit increase in the Confucian culture index is associated with an average increase of approximately 2.1% in the labor income share ($0.0017 / 0.080$), indicating substantial explanatory power and real-world relevance.

In summary, the baseline regression results demonstrate that Confucian culture significantly enhances the labor income share within firms, thereby providing empirical support for Hypothesis 1 proposed in this study.

Table 1. Baseline Regression Results

	<i>LS</i>	<i>LS</i>	<i>LS</i>
<i>Confu</i>	0.0014* (1.931)	0.0041*** (6.672)	0.0017*** (3.309)
<i>Control</i>	No	Yes	Yes
<i>Year</i>	No	No	Yes
<i>Industry</i>	No	No	Yes
<i>N</i>	18540	18540	18540
<i>r2_a</i>	0.0001	0.2587	0.5064

4.2 Mechanism Analysis

The preceding results demonstrate that Confucian culture significantly enhances the labor income share in firms. However, whether this effect is driven by underlying transmission mechanisms requires further empirical validation. As outlined in the theoretical analysis (Section 2), Confucian culture may influence labor income share indirectly through two primary channels: alleviating corporate financing constraints and improving employee compensation. Based on this framework, we examine these mechanisms along two dimensions: financial accessibility and compensation structure.

We first assess the role of Confucian culture in easing financing constraints. Drawing on the *KZ Index* developed by Kaplan and Zingales (1997), we construct the variable *Limit* to measure the degree of financing constraints, where higher values indicate more severe constraints. As shown in Column (1) of Table 2, the estimated coefficient of *Confu* is -0.0243 , which is significant at the 10% level. This suggests that Confucian culture significantly reduces the financing constraints faced by firms. The result indicates that Confucian norms strengthen trust-based mechanisms and relational networks, thereby enhancing corporate credit ratings and access to financing. As a result, firms can alleviate financial bottlenecks, allocate more resources to labor input, and ultimately improve their labor income share.

Next, we examine the role of Confucian culture in enhancing employee compensation. From a theoretical perspective, Confucian values such as “guide the people with timing, engage them with tasks, and ease them with ritual” reflect strong normative support for fair labor treatment and equitable income distribution. To empirically test this mechanism, we use average employee compensation (*EmPer*) as a representative indicator. As shown in Column (2) of Table 3, the estimated coefficient of *Confu* is 0.0304 and is significant at the 1% level, indicating that Confucian culture significantly increases the income level of ordinary employees. This finding suggests that Confucian values prompt firms to pay greater attention to employee welfare, encouraging management to prioritize labor motivation and security in income distribution decisions. In doing so, firms gradually shift from a model centered on “efficiency first” toward one that balances both efficiency and equity, thereby increasing the share of labor in overall corporate income.

In summary, the mechanism regression results provide strong evidence that Confucian culture positively affects the labor income share through two channels: “easing financing constraints—expanding wage-paying capacity” and “enhancing employee compensation.” These findings not only empirically support Hypothesis 2, but also highlight the institutional role of traditional culture in guiding corporate behavior under conditions of institutional incompleteness.

Table 2. Mechanism Analysis

	(1)	(2)
	<i>limit</i>	<i>EmPer</i>
<i>Confu</i>	-0.0243^*	0.0304^{***}

	(-1.762)	(7.408)
<i>Control</i>	Yes	Yes
<i>Year</i>	Yes	Yes
<i>Industry</i>	Yes	Yes
<i>N</i>	17962	17888
<i>r² a</i>	0.6286	0.5946

5. Conclusion and Policy Implications

Based on panel data of A-share listed companies in Shanghai and Shenzhen from 2008 to 2021, this study systematically examines the impact of Confucian culture on the labor income share in firms, as well as its underlying transmission mechanisms. The empirical findings indicate that Confucian culture significantly increases the labor income share, with the effect being particularly pronounced in private enterprises and small and medium-sized enterprises (SMEs). Mechanism identification further reveals that Confucian culture promotes labor-oriented income allocation by easing financing constraints, expanding firms' wage-paying capacity, and enhancing employee compensation, thereby increasing the share of income allocated to labor.

In light of these findings, firms are advised to proactively internalize and institutionalize Confucian values in the course of digital transformation. Special attention should be given to integrating core principles such as *ren' ai* (benevolence), *zhongxin* (loyalty and trustworthiness), and *liyi* (propriety and righteousness) into managerial training and incentive systems. This can help optimize resource allocation, raise employee compensation levels, and strengthen organizational identification. For private firms and SMEs with relatively limited resources and technological capabilities, Confucian culture can serve as an endogenous governance mechanism to enhance employee loyalty and labor income, thereby contributing to a more inclusive and sustainable income distribution structure.

Meanwhile, at the macro level, the government should establish a policy framework that gives equal emphasis to cultural guidance and institutional support. On one hand, Confucian values should be modernized and integrated into corporate practice through educational promotion and policy advocacy. On the other hand, differentiated support policies should be designed in accordance with cultural and developmental disparities. In particular, greater investment in digital infrastructure and enterprise-level digital capabilities is needed in economically underdeveloped regions. Additionally, the use of tax incentives, financial support, and related instruments can guide firms toward building fair and orderly income distribution systems. Such efforts will foster the deep integration of traditional cultural values with modern corporate institutions, thereby supporting both high-quality development and the broader goal of optimizing income distribution and achieving common prosperity.

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