Special session devoted to "The firm: Economics, Accounting and Law"

EAEPE, Istanbul 2006

RESEARCH AREA [E]: THEORY OF THE FIRM

Convened by

Y. Biondi (CNAM, Paris) and **M. Dietrich (University of Sheffield)**

First Panel : The firm… (I) - The Economics of the Firm: New Thinking
President and Moderator : Pascal Petit

1. M. Dietrich (University of Sheffield) – Book Presentation: Understanding the Economics of the Firm
2. *Book review* by O. Weinstein (University Paris XIII, France)
3. *Book review* by J.-L. Ravix (Nice University)
4. *Book review* by M. Morroni (Pisa University)

Round Table with Replies and Discussion with all the co-authors

Second Panel: The firm… (II) – Governance and Empirical Matters
President and Moderator: Olivier WEINSTEIN

1. Jackie KRAFFT and Jacques-Laurent RAVIX, "The Firm and its Governance over the Industry Life-Cycle"
2. Dr. Ciaran DRIVER & Paul TEMPLE, "What's wrong the textbook account of investment? Evidence from Hurdle Rates"
3. George MOLENKAMP (KPMG) and Yvette TAMINIAU (Vrije Universiteit, The Netherlands), Accounting Disclosure for Corporate Social Responsibility: an analytical survey of current practices
4. David S. ROSETTENSTEIN, "There is No Accounting for Divorce: Value, Cost and Control – Perspectives from the American Treatment of Options on the Impact of Marriage Dissolution on Incentive Compensation Schemes"

Third Panel: The firm… (III) – Governance Issues and the Law
President and Moderator: U. Mattei (Hastings College of the Law and University of Turin)

Presidential Address (Presentation of a new "Advanced School on Global Capitalism")

1. Azoulay and Weinstein: "Firms, Markets and property: understanding the *post-Chandlerian* Firm"
2. Stavros IOANNIDES, "Entrepreneurship and Corporate Ownership: An Austrian View"
3. Pavel LUKSHA, "Men influencing men: behavioural foundations for niche construction by the firm"
4. Moore and Rebérioux, "The corporate governance of the firm as an entity".

Fourth Panel: The firm… (IV) – The Firm as an Entity
President and Moderator: Pascal Petit

1. Y. Biondi (CNAM, Paris) – Book Presentation: The Firm as an Entity, an interdisciplinary Approach
2. *Book Review by* M. Dietrich (University of Sheffield)
3. *Book Review* by Ch. A. Grambovas (Manchester Business School, University of Manchester, Christos.Grambovas@mbs.ac.uk)
4. *Book Review* By U. Mattei (Hastings College of the Law and University of Turin, matteiu@uchastings.edu)

Round Table with Replies and Discussion with all the co-authors

FIRST AND LAST PANEL

Concerning the first and the last panel, all the co-authors of the collected books are kindly invited to join the meeting and the session to participate to the overall discussion.

For the first panel, the co-authors are:

- **Yuri BIONDI**, Conservatoire National des Arts et Métiers (CNAM), Paris, France
- **Sue BOWDEN**, University of York, UK
- **Michael DIETRICH**, University of Sheffield, UK
- **Elizabeth GARNSEY**, University of Cambridge, UK
- **Paul HEFFERNAN**, University of Cambridge, UK
- **David HIGGINS**, University of York, UK
- **Werner HÖLZL**, Austrian Institute of Economic Research (WIFO), Austria
- **Stavros IOANNIDES**, Panteion University, Athens, Greece
- **Jackie KRAFFT**, CNRS-GREDEG, University of Nice, France
- **Pavel LUKSHA**, Higher School of Economics Moscow; University of Hertfordshire, UK
- **Bart NOOTEBOOM**, Tilburg University, The Netherlands
- **Christopher PRICE**, University of York, UK
- **Erik STAM**, Erasmus University Rotterdam, The Netherlands; Utrecht University, The Netherlands; Max Planck Institute of Economics, Jena, Germany
- **Hassan YAZDIFAR**, University of Sheffield, UK

For the last panel, the co-authors are:

- **Reuven S. AVI-YONAH**, Irwin I. Cohn Professor of Law, and **Dganit SIVAN**, University of Michigan (USA).
- **Yuri BIONDI**, Conservatoire National des Arts et Métiers (CNAM), Paris, France
- **Arnaldo CANZIANI**, full professor of Economia Aziendale (business economics) at University of Brescia (Italy).
- **David GINDIS**, lecturer in economics at Institut National des Sciences Appliquées (INSA) de Lyon and PhD student at University of Lyon 2.
- **Thierry KIRAT**, CNRS Research Fellow on Law and Economics issues, attached to the IRISES, University Paris-Dauphine, France.
- **Giuseppe MARZO** (PhD, MBA), a lecturer in Business Strategy and Firm Valuation at the University of Ferrara and in Business Communication at the "Università Cattolica del Sacro Cuore" (Brescia, Italy).
- **Federico MANFRIN**, Researcher in Economics and Law at Brescia University (Italy).
- **Marc T. MOORE**, City Solicitors' Educational Trust Lecturer at the School of Law, University of Bristol, England.
- **Antoine REBÉRIOUX**, associate professor of economics at University of Paris X (Nanterre), France.
- **Olivier WEINSTEIN**, Professor in Economics at the University Paris 13, France.

SECOND PANEL

First paper:

Jackie KRAFFT and Jacques-Laurent RAVIX, “The Firm and its Governance over the Industry Life-Cycle”

Abstract: Since the original paper by Gort and Klepper (1982), it is now common knowledge among economists that key features of firms change as they age and progress over the life cycle. More recent contributions on the theme (Klepper, 1997) show that, in the early stages of the industry life cycle, firms are numerous product innovators, most of them are profitable and very few exit the industry. They operate on a small scale basis, each firm representing very small market shares. In the final stages of the cycle, on the contrary, firms tend to be big process innovators. They are very few in number and capture large market shares.

What is much less debated is whether the governance of these firms changes over the life cycle and how. Should firms be owned and managed the same way at the time they emerge, grow, age, and decline? Or should there be distinct types of corporate governance that follow the phases of the life cycle? This paper attempts to answer these questions by examining two trends of literature that are generally disconnected. On the one hand, the literature on start-ups and venture capital suggests that firms should be governed on the basis of a close cooperation between the founder entrepreneur (or professional manager) and the investor (business angel, venture capitalist). On the other hand, the literature on the governance of corporate firms generally supports the shareholder value vision in which the relationship between the manager and the investor are in terms of conflicting objectives, with a realignment of the manager’s incentives in the investor’s interests. The conclusion of these two trends of literature is thus that there should be distinct modes of governance, one dedicated to small, young and risky firms, and based on cooperation; the other dedicated to older and mature firms, and based on conflict.

In this paper, we argue that the distinction between the governance in the early stages of the life cycle and in the late stages of the life cycle is not yet satisfactory for the reason that age and size are not necessarily the key determinants of innovative behaviours of firms. In many industries, large firms are still important drivers of innovation, either via the development of R&D capacities or via the provision of complementary assets. In that perspective, imposing to these firms a conflicting mode of governance may not be the optimal solution, especially when this mode of governance favours short term choices that may be detrimental to the development of innovation. What is more important thus is to consider whether the innovative behaviours of firms exist, and occur in a phase of growth or decline of the industry. In this perspective, we advance the idea that new principles of governance should be proposed for big, innovative corporations.

In a first step, we review the literature on the governance in the early stages of the life cycle, by characterizing the relationship that may exist between the entrepreneur and the investor. In a second step, we document the nature of the interactions between the manager and the shareholder in the big corporation. In a final step, we derive new perspectives on the governance of innovative corporations, by defining the notion of

‘corporate entrepreneurship’ within which managers and investors are collectively involved in the coherence and development of the big innovative firm.

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Second Paper:

Dr. Ciaran Driver & Paul Temple, “What’s wrong the textbook account of investment? Evidence from Hurdle Rates”.

Ciaran Driver, Tanaka Business School, Imperial College, University of London (U.K.)
Paul Temple, Department of Economics, University of Surrey, UK

Abstract: The economics text-book story is that firms should invest only if the return exceeds the cost of capital. Behavioural theories, however, explain the use of investment hurdle rates that differ from discount rates. Hurdle rates lower than the cost of capital may be explained either by a desire for empire benefits, or alternatively by a dominance of strategic interests over financial ones in the managerial hierarchy. Hurdle rates higher than the cost of capital may be explained by an uncertainty premium.

If companies are polarised into shareholder oriented businesses (strong financial discipline) and those with managerial autonomy (lax financial discipline), we should expect to see this reflected in investment appraisal and specifically in the ‘wedge’ between discount rates and hurdle rates. There have, however, been surprisingly few direct studies of hurdle rates in capital budgeting. One possible reason for this inattention is that hurdle rates are generally unrecorded and have to be found by surveys of company managers, so that consistent observation is difficult. In this paper we present an analysis of hurdle rates using the PIMS dataset of large industrial firms, where both cost of capital and hurdle rates are recorded. We find that there is substantial evidence of heterogeneity in the manner in which companies appraise investment opportunities and that the differences across companies cannot fully be explained by established theories. We find that hurdle rates are frequently below and also frequently above the recorded cost of capital.

For the empirical analysis we use multinomial logit to discriminate between the cases where the wedge between the hurdle rate and the discount rate is positive or negative. We find evidence that cultural and institutional features affect investment behaviour. This is further narrowed down to influences affecting the opportunity for autonomous behaviour by managers and influences on the motivation of managers to adopt different investment stances.

The main message of this paper then is that firms often use hurdle rates that are different from the cost of capital. Capital investment theory should be broadened to include the motivational concerns of managers and the extent of their discretion, both of which in turn are influenced by the institutional environment.

Third paper:

George Molenkamp and Yvette Taminiau, Accounting Disclosure for Corporate Social Responsibility: an analytical survey of current practices

Yvette TAMINIAU is a Univesity Lecturer at the Department of Public Administration and Organization, Faculty of Social Sciences, Vrije Universiteit. Her research interests include: Strategizing for opportunities, initiatives, networks and community building. Her recent publications include: (2006 in press) Beyond known uncertainties, interventions at the fuel-engine interface, Research Policy; Koolen, S., Taminiau, Y., Faber, C. (2005), Monti and Market Dynamics, the Strategy of a National Car Importer, European Management Journal 23 (5); Taminiau, Y. (2001), Room for manoeuvre, 25 years of European emission regulations culminating in the Auto-Oil Programme analyzed from a technology and policy perspective (Menno van de Koppel, Amsterdam).

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Fourth Paper:

David S. Rosettenstein, “There is No Accounting for Divorce: Value, Cost and Control – Perspectives from the American Treatment of Options on the Impact of Marriage Dissolution on Incentive Compensation Schemes”

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Abstract: Traditional stakeholders in the firm tend to be identified as employees, management, shareholders and the “employer”. Virtually no attention is paid to the spouses of the individuals found within these stakeholder units. Because of this, there often is little acknowledgment within the “firm” of the consequences for the employer’s incentive compensation schemes of the divorce of an individual located in the stakeholder units. This is so even though the likelihood of divorce is very high and even though the operative legal regime may give the spouse an absolute or presumptive entitlement to a substantial portion of the rights of the beneficiary of the incentive scheme. The problem for the firm arises because the fact of the divorce creates a new market for the benefits of the incentive scheme. In this market, by virtue of the needs of the domestic economy and the underlying rules associated with divorce, tax and securities law, not to mention the individual grant and corporate protocols, the “value” attributable to the individual’s incentive related entitlements may in no way match the “value” assigned to them by the firm’s various stakeholders. This, in turn, can distort the character of the incentive scheme itself. Potentially these distortions may lead to grantor responses which might produce untoward consequences for the other stakeholders.

While the subtleties of the above concerns preclude comprehensive treatment in a single paper, the themes just outlined will be considered using examples from the American experience. The discussion will include some ramifications of the relatively recent changes in American law in response to concerns about corporate integrity, including the Sarbanes-Oxley law, SEC regulations covering insider trading, new standards for reflecting the cost of options in corporate accounts and newly "identified" ambiguities in the tax treatment of option exercise.

Research Program: For the last five or six years I have been engaged in analysing the treatment of stock options and other employer incentive compensation structures in the context of divorces. I am probably the leading academic in this field in the United States and have considerable international recognition in this regard.

Publications:

- *Stock Options Round Two: Towards Understanding the Money Trail* in FAMILY LAW UPDATE 2006, Ron Brown and Laura Morgan eds. 87 (Aspen Law & Business 2006).
- *Big Money" Divorces and Unequal Distributions: Value, Risk, Liquidity and Other Issues on the Road to Unfairness*, 19 Int. J. Law, Policy and the Family 206 (2005).
- *Speculating on Stock Options and Child Support: Long on Income and Short on Value (and Theory) – A Jurisprudential Attempt at a Butterfly Straddle?,* 82 Neb. L. Rev. 947 (2004).
- *Options on Divorce: Taxation, Compensation Accountability, and the Need to Look for Holistic Solutions*, 37 Fam. L. Q. 203 (2003).
- *The Distribution of Stock Options on Divorce and Proposed Changes in American Divorce Law* in FAMILY LAW: PROCESSES, PRACTICES, PRESSURES, John Dewar and Stephen Parker eds. (Hart, 2003).
- *D. v. D.: Equality, Fairness, Risk and the Distribution of Share Options on Divorce*, 14 Child and Fam. Q. 207 (2002).
- *The ALI Proposals and the Distribution of Stock Options and Restricted Stock on Divorce: The Risks of Theory Meet the Theory of Risk*, 8 Wm. & Mary J. Women & L. 243 (2002).
- *Exploring the Use of the Time Rule in the Distribution of Stock Options on Divorce*, 35 Fam. L. Q. 263 (2001).

THIRD PANEL

First Paper:

Nicole Azoulay and Olivier Weinstein (University Paris XIII), "Firms, Markets and property: understanding the *post-Chandlerian* Firm"

Abstract: Major transformations of the structure and behavior of large-scale corporations are at the core of the transformation of the world economy since approximately twenty-five years. These transformations lead to the decline of what can be called the "Chandlerian" firm, the large-scale, vertically-integrated, managerially directed enterprise, which has been dominant during the greatest part of the XXe century.

The analysis of this transformations, like the more general analysis of the transformation of capitalist economies, have been developed according to two axes which remain more often disconnected: on one side some works puts emphasize on the financial dimension -- which includes in particular all that concern the transformation of Corporate Governance -- and the other side, we find analyses centered on technological transformations, the speeding-up of innovation, and the new forms of organization of production in a "knowledge-based" economy. Our object will be to question the coherence of these changes, and in particular to try to better apprehend the relationships between financial and real dimensions, in the light of the fundamental questions concerning the theory of the firm. In that perspective we will proceed in two stages:

- In a first part we will try a synthesis of some literature which appears to us most important as regard the current transformations of firms, and the various factors likely to explain the evolutions observed since the beginning of the eighties.
- In a second part, we will question the capacity of different developments of the theory of the firm, to capture these changes. For that, we will first come back to the question of the "nature" of the *capitalist* firm as a specific *market-oriented* institution. In that perspective, we put emphasize on the modes of interrelations between the structures of firms and the definition and organization of markets, and on the conditions of definition and evaluation of firm's performances, and on the complex relations between "real" and financial performances. This theoretical background will be used to analyze the transformations of firms from the Fordist "Chandlerian" form – characterized by a strict separation between markets and firm's internal organization – and the new forms of organization and governance characterized in particular by a strong interpenetration between firms and markets relationships and the growing importance of market evaluations for firm's management.

We will return then to the questions raised by Berle and Means, on the transformations of firm's governance and financial markets and their connections with the transformations of the forms of property. It will lead us to try to identify the new forms of property on which rest the current transformations of the corporation, and the tensions around which they are built. What ultimately bring us to the question of the relationship between modes of property and forms of production (and markets forms).

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Research program oriented towards the study of *Institutions, Firms and Markets*.

- As regard the foundations of an economic, or socio-economic analysis of Institutions, the reflection, initiated with works about National and Sectoral Innovation systems, is going on, from three main references: (i) the new institutionalism, (ii) some aspects of the old American Institutionalism (Commons, Veblen, Bearl et Means), (iii) works on the comparison of Institutional Systems and the Diversity of Capitalism (The "Comparative institutional analysis" of Aoki; The "Varieties of Capitalism" School (Hall and Soskice) and the French Regulation School). This backgrounds is used on two main, interrelated, subjects:
- The theory of the Firm, as Organization and Institution: the confrontation (and integration?) between the contractual, the "competence based" and the Institutional views. The analysis of the transformation of the capitalist firm, as a key component of Institutional Systems.
- The study of Markets as Institutions and Social Structures. Our purpose is, after a confrontation of different economic and sociological approaches of Markets, to build a general theoretical framework for the analysis of the conditions of construction of Markets, and the effects of the institutional choices on the functioning and the economic and social outcomes of Markets. This framework will be applied to different domains, and currently, to the study of Knowledge Markets.

Nicole AZOULAY, GERME, University Paris 7 and CEPN (Centre d'Economie de l'université Paris Nord, CNRS UMR 7115)
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Her research program is concern with the economic nature of the firm:

- Its representations and theorizations: contractual and neo-institutional approaches, representations of the firm in terms of capabilities and individual and organizational learning.
- The analysis and of its historical transformations in the long term : evolution of the articulation between coordination by hierarchy and market coordination during the twentieth century; the transformation of the forms of corporate governance, and the relations between the conditions of productive efficiency and financial performances of the firm.

Publications or Papers related to the subject proposed:

♦ Azoulay N. and O. Weinstein, "Firms' Capabilities and Organizational Learning. A critical survey of some literature" Paper prepared for the DYNACOM research project, funded by Targeted Socio-Economic Research (TSER) Area 1.1, under the Fourth Framework Programme, European Commission (Contract n. SOE1 – CT97-1078. December 1999. (With). (Short version, in French : « Les compétences de la firme », Revue d'économie industrielle, n° 93, 4ème trimestre 2000, 117-154).

♦ Azoulay N. and O. Weinstein, « Nature et formes historiques de la firme capitaliste : Prolégomènes à une nouvelle représentation », papier présenté au Forum de la Régulation, Paris, septembre 2001.

♦ Coriat, B. and O. Weinstein, Les nouvelles théories de l'entreprise, Hachette - Livre de Poche, 1995

♦ Coriat, B. and O. Weinstein, "Organizations, firms and institutions in the generation of innovation", Research Policy, 31 (2002) 273-290.

♦ Weinstein, O., “The current state of the economic theory of the firm: contractual, competence-based and beyond”, in Y. Biondi, A. Canziani and T. Kirat (eds.), *The firm as an Entity: Implication for Economic, Accounting and Law*, London and New York: Routledge, 2006.

<u>Second Paper:</u>

Stavros **Ioannides**, “Entrepreneurship and Corporate Ownership: An Austrian View.”

Abstract: The application of Austrian ideas to the theory of economic organization is a rather recent development. Most contributors to this growing literature make the concept of entrepreneurship the starting point of their analyses. The open-ended approach of Austrian economics depicts the entrepreneur as a creative actor, in contrast to the static context of contractual theories that view agents as passive ‘contract takers’. On the other hand, the idea of the firm as a cognitive entity, the emphasis on tacit knowledge and the evolutionary account of the processes of business organizations –i.e. the major ideas of the capabilities perspective- are viewed as implying open-endedness and, thus, as more receptive of the Austrian notion of entrepreneurship.
We argue here that the Austrian concept of entrepreneurship offers a conceptual framework in which ideas from both perspectives may be combined in order to explore one central issue in the theory of economic organization: corporate ownership. We take our heed from Foss and Foss (2002: 103), who argue that the entrepreneurial approach to economic organization sees that ‘the productive opportunities that can be realized is a function of economic organization. Thus, one property rights arrangement may stimulate entrepreneurial discovery to a greater extent than another.’ On these grounds, we argue that Israel Kirzner’s theory of entrepreneurship can help us understand under what circumstances a bundle of cooperating resources will remain independent –e.g. in a joint venture- and under what circumstances they will be jointly owned by the legal person of the corporate firm. A by-product of our analysis is that it may lead to a reconsideration of the significance of Kirzner’s concept of entrepreneurship, by legitimizing its linking to ownership under the circumstances we will describe.

<u>Third Paper:</u>

Pavel Luksha, “Men influencing men: behavioural foundations for niche construction by the firm”

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Abstract: An issue of interaction between the firm and its environment is one of the important elements of the present evolutionary economic theory. As it is discussed in the earlier EAEPE paper (Luksha, 2004), much of the economic theory treats environment as given, an entity beyond the impact of the firm. Certain exceptions are presented by game

theory, sunk cost discussions in industrial organization, and few models of industrial evolution.

There are, however, many evidences that ability of the firm to influence its environment extends beyond the limits presently considered: the ‘Coca-Cola effect’ (Cheratony, McDonald, 1972), emotional brand-building (Harley-Davidson, Macintosh etc.), multi-level marketing (Amway, Herbalife etc.), or ‘ecogenesis’ (IKEA, IBM, Toyota etc. (Normann, 2001)) evidently do not fit into the traditional picture of autonomous agents and markets. Explanations provided so far (recognition of signals, mutual adaptation etc.) are not satisfactory, and merely do not match with findings of other sciences, e.g. psychoneurology (McClure, Li et al. 2004).

Recent studies in organizational coevolution, as well as recent publications in strategic management (esp. Weick and ‘cognitive school’), indicate that this point is started to be recognized in organizational studies and strategic management; however, the appropriate systematic treatment of the issue is still lacking.

In the evolutionary biology, from which many inspirations of the evolutionary economics were borrowed, the similar situation has occurred: in the first half of 20th century, biological science became dominated by ‘environmental determinists’ praising ‘adaptation’ and ‘selection’, yet disregarding the active role of organisms in the environment (Brandon, 1995). This was criticized by Lewontin (1983, 1985), who claimed that organisms select environments and aspects which are relevant, and organisms are able to transform their environment. Further, Lewontin’s views were elaborated in the publication of Odling-Smee et al. (2003), that coined the term of ‘niche construction’ as ‘the process whereby organisms, through their metabolism, their activities, and their choices, modify their own and each other’s niches’. Recent studies show that niche construction can play a role in biological evolution, that for certain species can be equally important as natural selection.

In (Luksha, 2004) the benefits of adopting niche construction concept within evolutionary economics were discussed. Niche construction by the firm is seen as a capability to influence long-term behavioral patterns [of other agents] in socio-economic life. It implies that organization is capable to alter ways in which agents perceive social reality and react to it. Construction thus occurs primarily in the socio-economic (and not only physical) space. Niche construction is an important organizational phenomenon that complements adaptation (whereby the firm changes itself to fit its environment) and niche utilization (whereby the firm adjust its positioning in the environment).

An important consideration that was mostly disregarded in the earlier presentation concerns aspects of human behaviour in which niche construction ability of the firm could be grounded. An ability to influence others’ behaviour may arise from the way decisions are made and activities are performed. The generalized agency model (which could be found in neoclassical, game theoretical, transaction cost, and evolutionary economics) assumes the three-stage process: (1) agent is presented with situation, (2) agent processes information about the situation, and (3) agent accomplishes an action, which further influences the ‘situation’.

The firm can influence its environment, that consists of its counterparts (individual and collective agents) by establishing communication, or inflicting change in the environment, that enters into the counterpart’s ‘agency cycle’. Three levels of this action could be identified:

On the first level, counterpart’s cognitive model remains steady, and no change of objectives / practices occurs. Counterpart’s behaviour could be altered by producing actions (seen as signals), by producing stimuli (incentives or threats), or by producing ‘neutral’ signalling which yet can influence counterpart’s behaviour (financial reporting is considered 'neutral', yet it can lead investors into specific action, and in certain cases – e.g. ENRON or Parmalat – there can be room for abuses). In this case, agent's response is adaptive and rational, in certain predictable way.

On the second level, counterpart's cognitive model is slightly altered, i.e. minor change of objectives / practices occurs, e.g. by inducing new preferences. This is typically achieved by 'surpassing' rational action reasoning that involves physiological & psychological mechanisms of attraction / distraction (a lot of examples concerning this can be brought from marketing practices). Despite claims of Becker (1996), many evidences support the statement that preference patterns can change.

On the third level, counterpart's cognitive model can be seriously altered, and some major change of objectives / practices can occur. This is typically achieved by creating new contexts of interactions, resulting in projection of new values, methods of thinking, beliefs etc. for the counterpart, the outcome being different perception of the world hence reaction to it. A clear example could be economic consequences of a religious conversion; there are also many examples from everyday industrial practices, e.g. ecogenesis in supplier chains (Normann, 2001), multi-level marketing, and so on.

The paper thus aims to demonstrate the generalized behavioural grounds for the ability of the firm to influence its environment. By recognizing the ability and identifying its 'foundations', it is possible to identify this important phenomenon in many economic processes. Analogously to evolutionary biology, niche construction has important implications for many industries, and will influence entry barriers and sustained competitive advantages within these industries.

<u>Fourth Paper:</u>

Moore and Rebérioux, "The corporate governance of the firm as an entity"

- Marc Moore, University of Bristol School of Law, M.T.Moore@bristol.ac.uk
- Antoine Rebérioux, EconomiX, University of Paris X – Nanterre, antoine.reberioux@u-paris10.fr

Abstract: Corporate governance debates are primarily concerned with the allocation of power within listed companies, from a positive and a normative point of view. On both aspects, these debates have been structured, throughout the 20th century, between managerialist and agency theories. The theory of 'managerialism', as set out in the seminal work of Berle and Means (1932), stresses the inherent divergence of interest that occurs within widely held firms between corporate 'owners' (shareholders) and 'controllers' (managers), and the resultant 'politicisation' of the corporation as an object of public concern. In response to the perceived need to minimise this separation, 'agency theory' suggests a range of market and institutional mechanisms aimed at bringing the incentives of managers into line with those of shareholders.

Over the last two decades, pro-shareholder mechanisms have become increasingly prevalent within corporate governance, in the United States and in the European Union. At first sight, this development would appear to signal the failure of managerialist theory, and the final victory of the agency perspective and its underpinning contractarian approach. In this article, we cast doubt on the above account. If traditional managerialist theory is somewhat misleading as a depiction of present day capitalism, this does not necessarily imply that shareholder primacy is 'right'. In fact, current evolutions show that the growing implementation of shareholder sovereignty has dramatic consequences,

which are hardly explicable within the confines of the agency paradigm: a decline in managerial accountability, as illustrated by the high profile corporate scandals of the Enron-era and the explosion of executive compensation. Yet the story becomes much more intelligible once we adopt a conception of the firm as an entity, rather than as a nexus of (complete or incomplete) contracts. The theory of the firm as an entity, focusing on the productive dynamics, is the core of a volume collected by Biondi, Cianziani and Kirat, to be published by Routledge. A session of the EAEPE conference is devoted to a presentation of this volume.

The idea that corporate governance discussions should be based on a theory of the firm is obvious: it is hard to figure out how a firm is governed and how it should be governed without any conception of what is, precisely, a 'firm'. Therefore, this article intends to show that considering the firm as an entity allows us: (i) to understand the failure of shareholder primacy as a way to foster managerial accountability; and (ii) to reject shareholder primacy in favour of a more inclusive model of corporate governance. From this point of view, the normative conclusion put forth by Berle and Means (1932) still represents a powerful insight: managerial accountability is best achieved through the promotion of common interest rather than through shareholder primacy.

The article is organized as follows. The first part offers an original account of corporate governance in the 1990s and the 2000s that runs against the predictive dimension of agency theory. In the second part, we highlight the limitations of this theory, and its underpinning contractarian logic, as a normative basis for corporate governance. Based on these findings, we set out in the third part a preliminary scheme for the implementation of Berle and Means' inclusive model of the firm within a market-based environment, taking insights from both the US and evolving European model of corporate governance.