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CORPORATE GOVERNANCE AND SOCIAL RESPONSIBILITY

Firm, Property and Governance: From Berle and Means to the Agency Theory, and Beyond

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Firm, Property and Governance: From Berle and Means to the Agency Theory, and Beyond

Olivier Weinstein

Abstract

Over the last thirty years, the shareholder conception of corporate governance has established itself as the foundation of the power structure and management principles of the corporation. It is based on a specific theorization of the firm: agency theory. Our aim is to explain the full significance of this theorization, by considering the context in which it was developed and the project – of a fundamentally political nature – that it conveys. For that purpose, we return to the questions raised during the first half of the twentieth century, in the seminal book of Berle and Means and in subsequent works by Berle; questions of a much broader scope that the relationship between shareholders and managers. We will show that agency theory can be considered a response to the most important ideas advanced by Berle and Means, and then by Berle (and others), after the New Deal and the Second World War. Comparison of these two themes of reflection leads us to identify two theorizations, and two radically different conceptions of the firm and the corporation. To address these issues, we start by considering the questions raised in the early twentieth century about the nature of the corporation and the status of managers; and how, in response to these questions, Berle constructed a certain conceptualization of the corporation and of managerial capitalism; we shall then revisit the contract-based approach of Jensen and Meckling, to assess the theoretical and ideological content and show how it was actually strongly opposed to Berle's vision. Lastly, by way of conclusion, we shall endeavor to show how the opposition between these two theorizations should be seen, above all, as an opposition between two theories that are both “performative” rather than positive, and that the apparent success of agency theory and the dominance of shareholder primacy in corporate governance can only be understood in an institutional and political perspective.

KEYWORDS: Berle, theory of the firm, corporate governance, corporate social responsibility, agency theory, corporate governance, corporation, theory of the firm, contractual theories, agency theory, law and economics, ownership and control, property rights, shareholder primacy, power, real entity, institutional economics

JEL Classification Codes: L20, D21, D23, B25, B52, D23, G34, K22, L21, P12

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Introduction

The shareholder primacy doctrine has become established over the last thirty years as the inescapable foundation of corporate governance. The key article by Hansmann and Kraakman (2000), announcing “The End of History for Corporate Law”, sums up this doctrine: “The point is simply that now [...] there is convergence on a consensus that the best means to this end – the pursuit of aggregate social welfare – is to make corporate managers strongly accountable to shareholder interests, and (at least in direct terms) only to those interests.” The central features of the doctrine are quite clear: (1) managers should only concern themselves with the interests of the shareholders, and (2) this is the best way to pursue “aggregate social welfare”.

We believe that this vision of corporate governance marks a profound break in the underlying conception of the “nature” of the enterprise, and more precisely the large enterprise legally structured around one or more corporations, leading to a view of the enterprise opposed to the managerial view that dominated until the end of the 1960s. This new conception of the firm was one of the main ingredients in the financialization of capitalism and in the neoliberalism that gradually became established from the 1980s on.¹ It was partly founded on a specific theorization of the enterprise, linked to the rise of contract-based theories: agency theory, first presented in the seminal article of Jensen and Meckling (1976). It would be hard to overestimate the huge practical and theoretical influence of this theory.² Today, the contractualist conception of the firm expressed in this theorization remains the fundamental point of reference which, incorporated into a more general representation of economic relations in a free market economy, shapes the analyses and views of the firm.³ In many ways, agency theory constitutes the intellectual framework within which the question of corporate governance has been addressed since the 1980s, *as a problem of (agency) relations between shareholders and managers*, and of determining what the objective of managers should be (shareholder value). The meaning and justification of the principle of shareholder primacy, in the form advanced today as the inescapable foundation of corporate governance, can only be understood with reference to this actually very particular representation of the firm. It is therefore essential to identify the precise content of this theorization, and the

¹ See, for example, Aglietta and Reberlioux (2005).

² A study by Kim, Morse and Zingales (2006) of the articles most often cited in economic journals between 1970 and 2006 ranks the article by Jensen and Meckling (1976) in third place.

³ Although other contract-based theorizations differ on certain points, notably those that focus on incomplete contracts, they do not fundamentally question the dominant view of the capitalist firm as a nexus of contracts, with everything that this implies, as we shall see below. On this point, see the works of Grossman, Hart and Moore, and especially Hart (1995).

context in which it was developed, so as to grasp its meaning, and thereby the full significance of the principle of shareholder primacy, which, as we hope to show, cannot be reduced simply to a return of effective power to the shareholders.

For that purpose, we must return to the questions raised during the first half of the twentieth century, particularly in the founding work by Berle and Means and subsequent texts by Berle, as well as earlier and later writings such as those by Veblen or Galbraith, which accompanied the development of managerial capitalism up to the 1970s. These questions are much broader and more fundamental than the simple question of “corporate governance” as formulated during the 1980s.⁴ They touch on the meaning and implications of the emergence of the large modern firm, legally structured under the dominant form of the listed corporation, and then the group of companies, as the central institution of capitalist economies. These questions concern:

- 1) The “nature” of the corporation, as a radically new institutional form, and the determination of its aims (how and for whom should this institution be managed?).
- 2) The problems raised by the increasing power of the large firm, and consequently of those who direct and control it. For Berle, these problems are primarily of a social and political nature, before being problems of economic efficiency. Whence the key question: how can these new private powers be contained and controlled (made accountable to society as a whole)? And in such a way as to satisfy social welfare and the “public good”.

These questions involve fundamental points concerning the “nature” of the *corporation* (rather than the nature of the *firm* in general) and the development of principles of ownership on which the enterprise, and more especially its system of governance, are based, and the fundamental principles that tend to guide or should guide its action.

In many respects, and particularly in the writings of Jensen and Meckling, agency theory can be seen as a response to the most important ideas advanced by Berle and Means, and then by Berle (and others), after the New Deal and the Second World War. These theories were – to a certain extent - in keeping with the developments of the large managerial firm up until the 1960s, because of changes in its structure and management methods, and because of legal and regulatory developments and the broader social and political transformations that marked the major capitalist countries – in various forms – after the Second World War. It can also be considered a reply to those who have presented the firm, and more

⁴ On this point, see notably Cioffi (2011).

particularly the large modern firm (as analyzed by Chandler) as establishing the predominance of a method of economic coordination based on organization and planning, completely different or even contrary to the market.⁵ The contractualist view of the firm opposed this approach, reaffirming the primacy of the market, drawing on conceptions which, following Coase (1960), take private property, contractual freedom and the free market as the founding principles of a new social order. It is within this context that the fundamentally political project contained in the article by Jensen and Meckling should be analyzed.⁶

Comparison of these two lines of reflection leads us to identify two theorizations and two different views of the firm and the corporation,⁷ leading to profoundly different approaches to the implications of the development of the modern corporation and the foundations of its governance.

To address these issues, we start by considering the questions raised in the early twentieth century about the nature of the corporation and the status of managers, and how, in response to these questions, Berle constructed a certain conceptualization of the corporation and of managerial capitalism. We shall then return to the contractualist conception of Jensen and Meckling, seeking to clearly identify the theoretical and ideological content and then show how it is actually radically opposed to the viewpoint of Berle (and Means). By way of conclusion, we hope to show how the opposition between these two theorizations should be understood above all as the opposition of two theories that are both “performative” rather than positive, and how the apparent success of agency theory and the dominance of shareholder value can only be fully understood in an institutional and political perspective.

1. Corporation, property and managers: Berle (and Means) and the modern corporation as a new public institution

From the second half of the nineteenth century, the large firm organized as a corporation,⁸ what Chandler calls the “modern business enterprise” and Berle and Means the “modern corporation”, became established as the dominant form of

⁵ Coase (1937) presented an analysis of the firm based precisely on the opposition between market and organization as alternative forms of coordination. Galbraith (1967) offered a complete presentation of what American capitalism had become: “*The New Industrial State*” dominated by large corporations and the “planning system”.

⁶ Following the famous article by Milton Friedman (1970).

⁷ It is important to distinguish between firm and corporation, especially in terms of principles of ownership. On this point, see Robé (1999, 2011). Below, we will see how Berle addressed this question.

⁸ Then, from the beginning of the twentieth century, into groups of companies, from the moment that companies acquired the right to possess shares in other companies. See Strasser and Blumberg (2011) on this aspect.

organization of the firm and as the central institution of modern capitalism. This really did mark a radical break both in the nature of the firm (a “metamorphosis”, as Penrose put it⁹) and in the structures of capitalism, affecting at the same time production methods, finance structures, modes of ownership and control and systems of power. This comprehensive transformation of the heart of the capitalist system had profound consequences that were not only economic in nature, but also social and political. As early as the beginning of the twentieth century, it was provoking discussion about the nature of the firm and what we now call its ‘governance’: the status, functions and obligations of a new class of players –the ‘managers’ – and the obligations – already referred to as the ‘social responsibility’ – of the firm.

It is in this context that we must set the theories advanced in the book by Berle and Means, and then in the subsequent works of Berle. To appreciate them, it is useful to start by recalling the main features of this new form of enterprise.

1. 1. The new attributes of the corporation

The features of the corporation, underlying its capacity to serve as a support to the accumulation of capital and to an unprecedented concentration of material, human and financial resources, can be divided into three dimensions:

- The separation between investors and the enterprise: the status of the corporation helped to make the enterprise an autonomous entity (“incorporation gave the enterprise ‘entity’ status under the law”, Blair, 2004). This means that it is the corporation which owns the assets on which its activity is based, and which contract with the various stakeholders involved in its activity. Incorporation of the enterprise allows for strict separation between the assets of the enterprise and the assets of the investors. This is expressed in the principle of limited liability of investors (and of everyone participating in the activity of the enterprise) and in the fact that the assets used by the enterprise are protected from any claim by the shareholders. Moreover, the pseudo “owners” of the enterprise (the shareholders) cannot, on their own, decide to wind-up the corporation or sell its assets. To borrow the term used by Hansmann and Kraakman (2000), there is “asset partitioning”. This is how incorporation makes possible the long-term accumulation of assets *by the enterprise itself*. Added to which, the right of the commercial company to buy and own shares issued by other commercial

⁹ “A major turning point in the long history of the firm in the industrial world was the emergence and rapid spread of the joint stock company in the 19th century. This had enormous consequences for management and control, for finance, and for the legal position of the firm; in a sense this made possible the first real metamorphosis in the nature of the firm as it crawled out of its family chrysalis” (Penrose, 1994).

companies, which was acquired later, was to become an essential instrument for the expansion of the enterprise, and a central attribute of the large modern firm.

- The second dimension is well-known, because it concerns the principles of corporate governance: “incorporation required governance rules that legally separated business decision-making from contributions of financial capital” (Blair, *op. cit.*). In the corporation, shareholders lose control over the assets and activities of the enterprise. This control is transferred to the management, which is accountable to independent supervisory bodies, like the board of directors. This is what allowed the expansion of the modern firm – based on the centralization of considerable financial, material and human resources under unified control – and the establishment of stable long-term relations between the different parties involved in the firm’s activity. In this respect, legislative developments were essential: in the case of the United States, changes in corporate law from the beginning of the twentieth century very clearly gave ever greater discretionary powers to directors and officers and recognized their “managerial rights to allocate corporate resources” (O’Sullivan, 2000).¹⁰

- The third key feature specific to the public corporation is the fact that the shareholders can sell their stock. Modern capitalism really emerged with the growing numbers of shareholders and the development of capital markets. The possibility given to the “owners” of the firm to freely sell their shares (possibility that became effective with the emergence of liquid capital markets) signified *a radical change in the nature of the relationship between the investors and the enterprise*.

These fundamental transformations in the nature of the firm accompanied the formation of large enterprises possessing unprecedented power. From the early twentieth century this raised many questions about the nature and implications of this newly emerging capitalism, and these questions came from the most varied quarters. In particular, they can be found in the United States, starting with the numerous texts by Veblen, then in all the writings by Berle from the 1930s to the 1960s, and in the post-war work by Galbraith; in Germany with Hilferding and Rathenau, in England with Marshall, followed by Robertson, Sraffa and Keynes,¹¹ to name but a few.

Although viewpoints differ concerning the nature and implications of these changes, there is agreement on a number of essential points.

¹⁰ Berle and Means themselves showed very precisely how the development of the corporation’s characteristics throughout the nineteenth century gradually reduced individual shareholders’ power of control over managers, particularly in Chapter I of Book Two of their work. This led them to observe that “corporate management is at least an institution created by the law itself” (*op. cit.*, p. 207).

¹¹ On this point, see Arena (2010).

- Firstly on their scale: this was indeed a radical transformation of the enterprise, inseparable from the radical transformations of capitalist economies and societies. In this respect, many authors consider the microeconomic implications, as regards the characteristics and behavior of the enterprise, the relations between economic agents and the changes in industrial organization, as much as their implications in terms of macroeconomic dynamics and stability (Keynes and Galbraith, for example).

- Then on the importance of the *separation between ownership and management*¹². Of course, one could say that there is nothing new about this separation, insofar as the delegation, by an owner, of the management of an enterprise or property to a manager, or the centralization of capital of various origins by merchants who manage them with considerable freedom of action, are very long-established practices (Hessen, 1983). But this separation assumes an entirely new character when it is combined with limited liability and asset partitioning, the formation of very large enterprises and the growing autonomy and power of managers.¹³ This justifies mention of the separation between ownership and *control*, as Berle and Means do, or of “power without property”, as Berle later wrote (1959), and lastly, with the development of market finance and the *public* corporation, which transformed the nature of the relations between the holders of securities and the enterprise. Thus, there is a change in the very nature of the enterprise, between on the one hand, the individual enterprise (creation and property of one individual) or the “classic” corporation and traditional forms of partnership, where the partners (creators of the enterprise) remain closely tied to it, and on the other hand, the modern enterprise legally structured around one or more corporations, marked by the dispersion and mobility of the shareholders.

- A third aspect concerns the potentially contentious opposition between *industry* and *finance*. The emergence and development of the modern corporation are inseparable from the development of finance and capital markets.¹⁴ This aspect is, in particular, at the centre of Veblen’s analysis, where it is interpreted as the transition from a “money economy” to a “credit economy”, leading to the domination of industry by what he calls “business” – in other words finance – and

¹² With a notable exception: Frank Knight considered the separation between ownership (and uncertainty-bearing) and control as an illusion. See O’Kelley (2006) on this point.

¹³ Berle and Means forestall this argument by stressing the radical transformation of the characteristics of the corporation (see note 10).

¹⁴ It was in the United States that the development of the stock market and the dispersion of shares in the general public were really important. Whence the importance attached to them by Berle and Means. In other countries, the stock market did not play the same role, either because family capitalism continued to predominate, as in England, or because the banks played a central role in financing industrial development, as in Germany.

thus to the predominance of short-term profit-seeking over long-term growth.¹⁵ Keynes, for his part, emphasized the fact that the dominance of the modern corporation and the development of the organized capital markets that accompany it lent increasing weight to the *speculative activity*, to the detriment of *business activity*, in such a way as to exacerbate the instability of the system.¹⁶

- The fourth feature on which most analysts concur is the rise of *organization*, or even *planning*, as the central element of a new economic order. Galbraith (1967) particularly stressed this point, which had already been mentioned by Coase (1937). This can be seen as a break that has two dimensions: firstly the rise of the role of large organizations – and foremost the modern corporation – *as a substitute to the market*; this conception is central to Chandler's analysis of the "visible hand" of managers;¹⁷ and secondly the increasing importance and power of organizations relative to individual agents, whether in terms of the corporation vis-à-vis the small enterprise or private entrepreneur, or the power of large banks and institutional investors vis-à-vis individual investors, a point that Berle highlighted very early on.

It is in this context of total transformation of the capitalist system, raising new empirical and theoretical questions about the nature of the firm and about the new social and political structures in which it is embedded, that we must situate Berle and Means' book and the subsequent writings by Berle.

1. 2. Berle and Means (1932) and the nature of the large modern firm

Berle and Means' book remains the point of departure and the central reference for reflection about corporate governance. It has given rise to differing, even contradictory interpretations, which explains how it could be used in support of opposing theories, notably on the question of the relationship between shareholders and managers. Thus, it has been used to argue in favor of the shareholder conception that is now dominant, even though it contains, as we shall see, a conception of the corporation that is radically different to the contractualist view that underpins the current doctrine of shareholder primacy. Without aspiring here to present a detailed discussion of the content of this book and all Berle's

¹⁵ On this point, see Ireland (2008) and O'Kelley (2011a), particularly on the Veblen's influence on Berle's analysis of the modern corporation.

¹⁶ See Arena (2010). "With the separation between ownership and management which prevails today and with the development of organized investment markets, a new factor of great importance has entered in, which sometimes facilitates investment but sometimes adds greatly to the instability of the system." (Keynes, 1936, p. 150; quoted by Arena, p. 873).

¹⁷ The 1937 article by Coase on "The Nature of the Firm" can also be read in this perspective, insofar as he clearly views the firm as a form of coordination that is *alternative and/or complementary to the market*.

subsequent thinking between the 1930s and the 1960s,¹⁸ we shall endeavor to show how this thinking played a role in building a new conception of the firm, intended to account for the implications of the rise of the modern corporation and a new managerial capitalism, and to answer the new questions provoked by this new capitalism.

On first reading, it appears that Berle and Means present two views of the corporation, which are not, in fact contradictory, as Bratton and Wachter (2010) demonstrate.¹⁹ The first view, which takes up the position held by Berle in his famous debate with Dodd, seems to support a shareholder conception: managers should be accountable to the shareholders (they should act as trustees for the shareholders). During the 1920s, Berle defended a certain conception of shareholder primacy, still present in the 1932 book, but very different to the view that came to dominance in the 1980s.²⁰ It stemmed from two concerns: the first, and more important, which remained with Berle throughout his life, was the need to control the excessive power in the hands of the managers of large corporations, and to prevent them from misusing the enterprise for their own personal profit, and to the detriment of society. The second concern, more closely linked to his views at the time, relates to the consequences of the growing dispersion of shares over a large number of minority shareholders who have little real influence over management decisions (unlike controlling shareholders and financial institutions). As a result of this dispersion, a strengthening of shareholder power could be beneficial to workers and to the middle classes, the heart of a “shareholder class” that could act as a counter-power.²¹ Shareholder primacy could then be seen as an instrument of democratization of the economy, through the growing dispersion of share ownership in the public (Stewart, 2011). But for Berle, the most important question was certainly how to control the new managerial power. Control by the shareholders remained the most realistic solution, within the legal and political context of the United States, *before the great reforms heralded by the New Deal*,²² even though his primary objective was social welfare (rather than

¹⁸ On this point, see in particular Bratton and Wachter (2008; 2010), Cioffi (2011), Moore and Rebérioux (2010), O’Kelley (2010, 2011a).

¹⁹ “[...] two, apparently contradictory, lines of thought. One line, set out in Books II and III, resonates comfortably with today’s shareholder-centered corporate legal theory... The other line of thought emerges in Books I and IV, where The Modern Corporation encases this shareholder trust model in discussions of corporate power and social welfare.” (Bratton and Wachter, 2010, p. 849).

²⁰ On this point, see Stewart (2011).

²¹ According to Stewart, Berle even envisaged, in a 1921 article, that “the corporation could be used as a tool for the redistribution of wealth and power to “the staff of the plant, including, of course, the chairman of the board, the directors, as well as the oilers and feeders and loomfixers.”” (Berle, 1921, quoted by Stewart, 2011: 1460).

²² In his debate with Dodd, Berle also highlighted the danger that replacing the accountability of managers towards shareholders with an ill-defined accountability to the public interest (or to a

the respect of a principle of ownership that no longer had any reason to exist). In this sense, if Berle championed the shareholders, it was for very different reasons to those advanced by the current advocates of shareholder primacy.

That being so, Berle and Means also present elements of a totally new view of the firm and of the modern corporation, mainly in Book IV, and more especially in the last chapter of their work, with the explicit title: “The New Concept of the Corporation”. According to Berle himself,²³ this chapter encapsulates the main thrust of the book’s theories and doubtless his view of the future of the modern corporation.

As Berle explained in the preface to a new edition of their book, in 1967, the “corporate system” signifies a shift towards “collective capitalism”. The questions that are raised do not relate, initially, to the relationship between managers and shareholders, but more fundamentally to the “nature” of the modern corporation as a new form of firm and a new institution, to the new structure of social and political power that it generates, and to the new public policy approach that it requires. The central role that the new public corporation plays in the economy and in society signifies: (1) a transformation of the nature of the firm and a new concept of the corporation, (2) a new logic of property and consequently (3) new economic, social and political questions.

1. 2. 1. A “new concept of the corporation”

It will now be useful to take a little detour by way of the theories of Walter Rathenau, which Berle and Means took up at the beginning of the last chapter of their book.²⁴ Rathenau (1918) clearly expresses his belief that the modern

more or less well-defined set of stakeholders) was likely to leave the managers with total freedom of action, which was, for Berle, the worst thing that could happen. An argument that clearly deserves attention. As Cioffi notes (2011, p. 1094), “Berle displayed an acute and early awareness of the “too many masters” problem in fiduciary law”.

²³ Berle is believed to have said that this last chapter summarized the book’s main line of argument, according to J. A. Schwartz, “Liberal: Adolf A. Berle and the Vision of an American Era” (1987), quoted by Braton and Wachter (2010, p. 850).

²⁴ Better known as Foreign Minister during the Weimar Republic, assassinated in 1922, Walther Rathenau was in fact a multifaceted character, but in the first place one of the leading German industrialists of the early twentieth century, notably a director of AEG, one of the biggest electrical companies, founded by his father, and member of a multitude of other boards. Walther Rathenau was in no way a socialist. One could reasonably relate some of his ideas to the corporatist view that marked German capitalism, including the period after the Second World War (where it is referred to as “neocorporatism”, “organized capitalism” – a term originally proposed by Hilferding – or the “Rhineland model”). In particular, he suggested employee participation in the management of the company. On (neo)corporatism, see Streeck and Crouch (2006). O’ Kelley (2010) highlights the significant influence of Rathenau on Berle. Rathenau is the only scholar

corporation marks a radical break in terms of the nature of the enterprise and the nature of ownership: “The original form that an enterprise used to take, when several wealthy merchants came together to found a business whose demands would exceed the capacity of any one individual, that form has become a historical fiction”.²⁵

In the new capitalism:

“No one is a permanent owner ... ownership has been depersonalized...The depersonalization of ownership simultaneously implies the objectivation of the thing owned. The claims to ownership are subdivided in such a fashion, and are so mobile, that the enterprise assume an independent life, as if it belongs to no one; it takes an objective existence, such as in earlier days was embodied in state or church, in a municipal corporation...The depersonalization of ownership, the objectivation of the enterprise, the detachment of property from the possessor, lead to a point where the enterprise becomes transformed into an institution which resembles the state in character.”²⁶

So, for Rathenau:

- The firm exists as an independent entity: “This entity has its own accounting, it works, grows, makes contracts and alliances, feeds on its own income and lives as an end in itself.”²⁷
- The shareholders cannot be considered the owners of the enterprise.

referenced in the last chapter of the Berle and Means’s book, and one of the very few scholars quoted in the entire book.

²⁵ Rathenau (1918, p. 151): “Die ursprüngliche Veranstaltung, daß mehrere wohlhabende Kaufleute sich zusammentaten, um gemeinsam ein Geschäft zu errichten, dessen Anforderungen die Kräfte eines einzelnen überstiegen, ist zur historischen Fiktion geworden”.

²⁶ Here we quote the translation given by Berle and Means (p. 809). The original German text (*op. cit.*, p. 152-153) reads: “Fast ausnahmslos tragen diese Unternehmungen die unpersönliche Form der Gesellschaft. Niemand ist ständiger Eigentümer; ununterbrochen wechselt die Zusammensetzung des tausendfaltigen Komplexes, der als Herr des Unternehmens gilt...Dieses Verhältnis aber bedeutet die Entpersönlichung des Eigentums. Das ursprünglich persönlichste Verhältnis eines Menschen zu einer greifbaren, genau bekannten Sache ist zu einer unpersönlichen Anspruch auf einen theoretischen Ertrag geworden. ...Die Entpersönlichung des Besitzes bedeutet jedoch gleichzeitig die Objektivierung der Sache. Die Besitzansprüche sind derart unterteilt und beweglich, da das Unternehmen ein eigenes Leben gewinnt, gleich als gehöre es niemand ein objektives Dasein, wie es vormalig nur in Staat und Kirche, in städtischer, zünftischer oder Ordensverwaltung verkörpert war.”

²⁷ “Dieses Wesen führt eigene Rechnung, arbeitet, wächst, schließt Verträge und Bündnisse, nährt sich von eigenem Ertrage, lebt als Selbstzweck“ (*op. cit.* p. 154).

- There is total separation between the enterprise (and its assets) and private wealth.

Berle and Means explicitly take up Rathenau's theories: the modern corporation should be considered as an institution with the character of a "social organization".²⁸ They stress the fact that the corporation involves a considerable *concentration of power* in the economic domain, "comparable to the concentration ... of political power in the national state" (*op. cit.*, p. 309). Again, it is clear, on reading the last chapter of Berle and Means, that the question of the power of the large firm (and therefore of its managers) is the central question for them, and that it gives the company a radically new "nature", having a political dimension. The modern corporation is fundamentally a *public* institution, which "involves the interrelation of a wide diversity of economic interests, - those of the "owners" who supply capital, those of the workers who "create", those of the consumers who give value to the products of enterprise, and above all those of the control who wield power." (*op. cit.*, p. 310).

This new conceptualization of the firm presents another important feature: the firm exists as a specific entity; an entity that is, as Rathenau says, *nobody's property*. The conception of the enterprise as an entity, to which Berle was to return, is not specific to him.²⁹ The important point here, especially in comparison with agency theory, is the distinction between the legal entity (the corporation or corporations) and the "real" organization (the firm)³⁰. We have seen how the law, through the concept of legal personality, made the public company a legal entity. The conception upheld by Berle, in which the enterprise is seen as a real entity, appears to have inspired the evolution of corporate law in the United States from

²⁸ "The institution here envisaged calls for analysis not in term of business enterprise, but in terms of social organization" (Berle and Means, 1932, p. 309).

²⁹ See Berle (1947) and more generally, on theorizations of the firm as an entity, the different contributions in Biondi et al. (2007). See notably Biondi (2007), and Avi-Yonah and Sivan (2007, p. 155), on the difference between the "aggregate theory", the "artificial entity theory, which views the corporation as a creation of the state" and the "real entity theory, which views the corporation [...] as a separate entity controlled by its managers". See also Phillips (1994) on the real entity theory as it developed in the United States in the late nineteenth and early twentieth century in contrast to the contractual conception that had previously been dominant.

³⁰ "the entity commonly known as 'corporate entity' takes its being from the reality of the underlying enterprise, formed or in formation" (Berle, 1947, p. 344). In this article, the main purpose of Berle is to show how US courts have been led, in various circumstances, to recognize this real enterprise entity even beyond the legal corporate entity: "where the corporate entity is defective, or otherwise challenged, its existence, extent and consequences may be determined by the actual existence and extent and operations of the underlying enterprise, which by these very qualities acquires an entity of its own, recognized by law," (*ibid.*) He was especially concerned with "erection of an entity where legal entity does not exist" (*ibid.*, p. 346); recognition of "de facto" corporations; and "combinations of corporations into an aggregate enterprise entity" (*ibid.*, p. 347). Elsewhere, Berle further stressed the accounting system as a featuring dimension of real enterprise entities, see Biondi (2011a) and, in this issue, Biondi (2012a) for further details.

the beginning of the twentieth century. It involves more than just legal personality: it means treating the enterprise as a real collective entity, distinct from the aggregation of individuals that participate in it. This conception has two complementary aspects: firstly, the enterprise's identity (and boundaries) are fundamentally related to its effective *economic* activities, rather than its legal form, and secondly, the "enterprise entity" cannot be reduced to a set of relations between individuals (and therefore a set of contracts).

While he sometimes distinguishes between corporation and enterprise,³¹ Berle takes the "enterprise entity" as the fundamental object, from both economic and legal viewpoints.³² As he would later write (Berle, 1954, p. 18): "Clearly it is not the law, with its fiction of juristic personality, that supplies the life blood and beating heart of these vast mechanisms. If the law, acting through some instrumentality, declared that they did not exist, the entities would be found to be not fictitious, but factual". Beyond the financial or legal dimensions, the formation of the production and management systems of the large managerial enterprise under centralized control (as analyzed by Chandler) gives the firm its dimension of real, integrated entity, what is described as an *organization*. From this point of view, it is the *economic* reality of the enterprise that matters, and which is recognized as such by the legal system and by society in general. As a specific consequence, it is possible to speak of *the interest of the enterprise* as distinct from the interest of the shareholders (or indeed the interest of the managers or any other stakeholder).

Furthermore, it is necessary to rethink the nature of the relationship between the shareholders (or the other stakeholders) and the enterprise. The large modern firm is radically different from older forms involving partnership: whereas a corporation with a small number of shareholders who manage it directly can still, like a business partnership, be treated as a "collective interaction of its members", it is impossible to do the same in the case of a large listed public company, with a large number of constantly changing shareholders, very few of whom are involved in the management. This firm exists *per se*, on a long-term basis, independently of the changing personality and diversity of the different individual stakeholders. Because of this, it cannot be reduced to a set of well-defined contracts existing at a given moment between clearly identified parties. This leads to new relations between the shareholders and the enterprise, and new

³¹ But not always, as the quotation in the following footnote shows. This can give rise to confusion.

³² "The corporation is emerging as an enterprise bounded by economics, rather than as an artificial mystic personality bounded by forms of words in a charter, minute books, and books of account. The change seems to be for the better" (Berle, 1947, p. 345). Berle (1967) returns to this point, showing how the firm as an entity exists and is legally recognized beyond the boundaries of the legal identity of each company, when industrial groups are formed.

questions about the foundations of ownership of the firm and the relationship between ownership and power.

1. 2. 2. A “new logic of property”

As we know, the view propounded by Berle and Means challenges the role of private property in the capitalist system. For us, this question is important because, as we shall see below, agency theory is closely linked to the new economic theory of property rights (and the law and economics movement) that developed in the 1960s with the aim of re-affirming the central role of private property in the economy and in society.

In what Berle and Means call “the traditional logic of property”, the corporation “belongs” to the shareholders, and the shareholders’ interest is therefore considered the sole object of the enterprise’s activity. It is precisely this conception which, for Berle and Means, can no longer be applied to the modern corporation, since the two attributes of ownership – risk-taking in the investment of capital in an enterprise on the one hand, and control and accountability for the management of that enterprise on the other – have been separated and allocated to different groups.³³

The evolution of the legal system has given rise to a new type of relationship between the shareholders and the enterprise, giving highly discretionary power to managers and drastically reducing shareholders’ rights, to such an extent that they represent no more than one particular category of creditors (whose rights are defined *with respect to the company*, rather than with respect to the managers). This is expressed, notably, in the fact that managers are in the position of *trustees*, a situation that gives them almost complete power and freedom of action in the management of the enterprise.³⁴ According to Berle and Means, this goes so far as to give managers the capacity to manage the enterprise *against the interests of the shareholders*:

“Constantly widening power over the management of the enterprise [...] delegated to groups within the corporation... Since powers of control and management were created by law, in some measure this appeared to legalize the diversion of profit into the hands of the controlling group” (Berle and Means, 1932, p. 294).

And it is possible to consider that the new powers of the managers “have been acquired on a quasi-contractual basis”; so much so that the shareholders

³³ On this point, see also Berle (1965a).

³⁴ Below, we shall examine the limitations of this reference to the concept of trustees.

have accepted in advance the losses they might incur through the managers' actions (*op. cit.* p. 311). We might add that the increasing power of the managers results not only from a decline in shareholder power, but also from a diminution in the role of the state, insofar as there has been an "evolution towards complete freedom of contract in corporate charters and the disappearance of the state as a regulating factor in their drafting" (*op. cit.* p. 142). Among other things, this allowed the gradual adoption of mechanisms enabling the board of directors (sometimes supported by certain shareholders) to manipulate effective powers or rights represented by the possession of shares. The consequence is that a share of stock, while continuing to represent an indirect right over the assets of the company, has become the subject of so many qualifications that "the distinctiveness of the property right has been blurred to the point of invisibility" (*op. cit.* p. 170).

Under these conditions, wrote Berle and Means: "changed corporate relationships have unquestionably involved an essential alteration in the character of property" (*op. cit.*). Property has been split into 'passive property' (that of the shareholders), with neither control nor accountability, which amounts to a (limited) set of rights of the individual *with respect to the enterprise*, but without power; and 'active property' defined by "a set of relationships under which an individual or set of individuals holds power over an enterprise but have almost no duties in respect to it which can be effectively enforced" (*op. cit.* p. 305), and held by the managers (and possibly a few controlling shareholders).

Later, Berle wrote of the *separation of property and power*: the establishment of the modern corporation as the central institution of the American economy heralded the emergence of "power without property" (Berle, 1959), which could only signify a profound change in the position of (private) property in society, and more specifically, of *individual property*³⁵.

Another aspect that radically transformed the position of property was the increasing ownership of assets, including shares, by the enterprises themselves or by financial institutions. Likewise, the development of institutional investors and the ever-increasing (and sometimes obligatory) delegation of asset management to these organizations can be interpreted as a new form of separation between property and "control", and a new step in the reduction of the effective power of individual shareholders and of the role of property. It also signals the emergence of another category of managers, and of a new power, that of managers *of finance* (pension trustees, mutual fund managers, insurance company managers, etc.).

³⁵ Berle (1962) also highlighted other aspects of the transformation of property, marked by "an enormous expansion of the scope of the term 'property'". There is, in Berle's work, a thorough and multifaceted analysis of the transformation of property by modern capitalism, which deserves its own specific study, notably in comparison with the economic theory of property rights that has developed since the 1960s.

After the war, Berle attached great importance to this aspect, which he considered to represent the second great transformation of the twentieth century, after the rise of managerial power.³⁶

The result of all this is that the question of power, of the formation of new powers, detached from ownership and concentrated in the hands of a small number of individuals and groups, is the central issue generated by the transformation of the economic system.

1. 2. 3. “The issue of power and its regulation”³⁷

This is, to our mind, the most important issue in Berle and Means’ book, although it is not expressed clearly in the preface of 1932. Berle was to return to it in detail after the New Deal and the Second World War, as we shall see. The development of the modern corporation signals an unprecedented concentration of economic power and the rise of new economic powers, chief among which is that of the managers, defined strictly by Berle and Means as the board of directors and the senior executive officers. Analysis of the systems of economic power linked to the large firm (and to finance) is in itself a complex matter. As we have just seen, it cannot be reduced simply to the managerial power of the large firm.³⁸ Berle later attempted to develop a more elaborate theorization of this.³⁹

Limiting ourselves here to the question of corporate power, it would be useful to distinguish between *corporate power* in the strict sense of the term, i.e. the power of the enterprise itself as a collective entity, and the *managerial power* held by a particular group of individuals in the firm.⁴⁰ The two aspects are most

³⁶ “The second tendency, pooling of savings, voluntary or forced, in fiduciary institutions now is steadily separating the owner (if the stockholder can properly be called an “owner”) from his residual ultimate power – that of voting for management.” And he adds: “this is gradually removing power of selecting boards of directors from these managements themselves as self-perpetuating oligarchies, to a different and rising group of interests – pension trustees, mutual funds managers and (less importantly) insurance company managements” (Berle, 1959, p. 59). See also Berle (1967, p. xxxiii): “The significance of the intermediate institutions [is that] they remove the individual still further from connection with or impact on the management and administration of the productive corporations themselves”. This development is central to the transformation of capitalism, and of the corporation, over the last thirty years. What Berle says here is essential for appreciating the exact nature of these transformations, and to better judge the validity of the contractual theories now dominant and the idea of a “return of the shareholder”.

³⁷ Berle and Means (1932, p. 310).

³⁸ In their book, Berle and Means attach particular importance to what they call “control”, which is related to financial players.

³⁹ See Berle (1959), and also Galbraith (1983).

⁴⁰ The identification of this group, of those who hold the effective power in the organization - and thus the very definition of managerial power – is far from obvious. On this point, Galbraith has a very different position to Berle: for Galbraith the effective power of senior executives in the management of the firm is actually limited, most of the power having passed into the hands of the

often confused, the main issue for Berle being to understand the nature and foundations of managerial power, and to investigate its legitimacy and above all the conditions under which it can be controlled and regulated.

Given that fundamentally, large corporations have become public institutions, and that “the task of [their] administrators is, fundamentally, that of industrial government” and that “the great industrial managers, their bankers and still more the men composing their silent ‘control’, function today more as princes and ministers than as promoters or merchants”, as Berle wrote in his reply to Dodd, while criticizing the proposals of the latter (Berle, 1932, p. 1367), the problem lies in the fact that the managers do not regard their functions in these terms, and that what Berle called the industrial ‘control’ “does not now assume responsibilities to the community”. For Berle, writing in 1932, the problem was that there was no mechanism “enforcing accomplishment of his theoretical function” (*op. cit.*).

There are two related questions here. Firstly, in whose interest should the corporation be managed, and so with respect to whom should the managers’ obligations be defined? And secondly, how can the corporation be brought to conform to the desirable objectives, in other words how can the managers’ actions be controlled and guided?

Berle and Means see three possibilities⁴¹:

- To continue applying “the traditional logic of property”: the company belongs to the shareholders and should therefore be managed solely in their interests. For the reasons mentioned above, this position is no longer tenable. The shareholders can no longer really be considered the “owners” of the firm.
- To consider that the large enterprise is at the service of the community, that “the modern corporation serve not alone the owners or the control but all society”. And this is, in principle, the fundamental position of Berle and Means. But as Berle wrote in reply to Dodd, it remains purely theoretical, as long as there is no legal and/or public system to ensure the enterprise is effectively managed in this fashion.

“technostructure,” that is to say “the association of men of diverse technical knowledge, experiences or other talent which modern industrial technology and planning require” (Galbraith, 1967-1985, p. 72). Galbraith’s view explicitly highlights the dominance of collective action over individual action. As the epigraph to Chapter 6, he quotes this phrase by R. A. Gordon: “The prevalence of group, instead of individual, action is a striking characteristic of management organization in the large corporation”. Berle’s view appears to remain more individualist, both in his emphasis on the individual behavior of managers (and the risk that they favor their own interests), and in his concern to defend the individual in the face of the growing power of the corporation and of certain particular groups, and the increasing distance created by the new economic system between individuals and the places of power, a distance further increased, according to Berle, by the second great transformation mentioned earlier.

⁴¹ See also O’Kelley (2006).

- To consider that the evolution of the large firm gives managers absolute control over the firm. Berle and Means consider this to be the worst of all solutions.

And this explains Berle's reply to Dodd. From a very pragmatic viewpoint, Berle considers that maintaining the principle that the managers' mission is to serve the shareholders' interests, that they are 'trustees for the shareholders', remains the least bad solution, in the absence of other mechanisms to ensure that managerial power is effectively controlled and that the corporation is managed in the interests of society and/or the different stakeholders (however those interests are defined).⁴² The only alternative would be the *de facto* suppression of any fiduciary obligation, and therefore any limitation on the power of managers.

This is Berle's position before the New Deal. Over the following decades, the major transformations in American capitalism, and in the institutional framework in which the corporation is embedded, completely changed the situation, by producing a set of mechanisms to ensure the regulation of corporate power. This is the viewpoint that Berle defended in his post-war writing.

1. 3. The regulation of corporate power in the post-Second World War US economy

The crisis of the 1930s and then the Second World War generated a series of major transformations of capitalist economies, partly resulting from the continual development of the modern corporation, and at the same time regulating its power through multiform transformations of the economic, social and political system. These transformations led to the emergence of a new capitalism that took complete form after the Second World War, with variations in Europe and the United States.⁴³ In the US, according to Berle, this resulted in a new form of the "American economic republic".⁴⁴ Like most of the other analysts of post-war capitalism, Berle sees a decline in the role of the market, stemming both from the growing role of the organization, which has accompanied the rise of the large managerial firm in the economy, and recognition of the failures of the market

⁴² This is, in itself, a question that can give rise to several different responses. In 1930, Berle envisaged "a tentative classification of the various claims on the corporate wealth and income stream, namely: (1) The security owners. (2) The management. (3) The customer or patron. (4) The workers, including the entire list of salaried or wage earners. (5) Certain general community claims which, however, might best be worked out through taxation." (Berle, 1932, note 3).

⁴³ What some writers, particularly in the French Regulation School, have qualified as "Fordist" systems. One could also speak of managerial capitalism, of which Galbraith proposed one of the most famous analyses.

⁴⁴ See Berle (1963).

brought to light by the Great Depression, which legitimized the development of the economic action of the state.⁴⁵

So how was corporate power regulated in this new context? The first thing to note is a shift in the field of action; for Berle, corporate law can no longer be the appropriate instrument to reconsider and redirect the relationship between the enterprise and society. As he wrote in 1952 (p. 1936):

“Classic corporation law is almost never availed of to adjust relations between the corporate enterprise and the community. That law is vigorously used to adjust relationships between management and stockholders [...] Though true corporation law has abandoned the task of regulating relations between the corporation and the community, the large corporation [...] is encountering a rapidly growing and extremely powerful field of law, quasi-law, and public expectations as to conduct hardening into law”.

Corporate governance in the strict sense of the word, as a question of relations *between shareholders and managers*, therefore tends to become secondary, and one cannot expect any limitation on managerial power to come from this direction.

Berle also dismissed the idea, predominant among economists, at least until the crisis of 1929, that the markets – capital markets or product markets – can seriously control the power of firms and managers. Berle explicitly opposed the dominant view about the virtues of the supposedly competitive free market⁴⁶.

⁴⁵ “The 1929 crash, the slow recovery of 1930, and the ensuing spiral descent into an abyss of unemployment, bank failures, and commercial paralysis was not corrected by market processes. [...] Following established precepts of the American political process, the public [...] increasingly asked that the political state propose a program and act. Necessarily, this meant considerable reorganization of private business. [...] Out of the crisis was born the American economic republic as we know it today” (Berle, 1963, p. 82; quoted by Bratton and Wachter, 2010, p. 857).

⁴⁶ Following O’Kelley (2010), it is possible to consider that one of the main purposes of what he calls “the Five Chapters” (The first and the last four chapters of *The Modern Corporation & Private Property*) was “to refute the still prominent belief that society should be organized on the basis of laissez-faire individualism and its extreme protection of private property rights.” (p. 1158). This position can thus be considered as a response to advocacies of the free-market system in the United-States at that time, including Frank Knight. In his major work, *Risk, Uncertainty and Profit*, the latter supported the idea that separation between ownership and control in the large corporation is illusory, not because shareholders control managers (in line with Berle and Means, Knight thought that managers became independent from shareholders, and that shareholders are not really “owners” of the firm, but rather creditors of it) but because managers behave *like entrepreneurs*, and thus in the interest of the corporation. See O’Kelley (2006, 2010) for an analysis of the Knight’s theory of the entrepreneur, arguing for Berle and Means as critics of the “free enterprise system”. On Knight and the real entity perspective, see also Biondi (2012b).

He wrote (Berle, 1959, p. 87): “we have lost the nineteenth-century comfort of thinking that the voice of the open economic market is regnant and is the voice of God”. In 1962, in a reply to Manne (1962), he clearly stated his opposition to the *laissez-faire* doctrine. Moreover, independently of what one thinks of its virtues, the capital market cannot fulfill the regulatory function insofar as large firms increasingly use their own resources for financing. The importance of the self-financing of enterprises has been one of the distinctive features of managerial capitalism, particularly during the period of growth following the Second World War. This further strengthened the independence of corporate managers from their investors, and of industrial capitalism vis-à-vis financial capitalism.⁴⁷ On the role of competition in product markets, Berle’s position is more nuanced. The rise of large corporations has most often led to oligopolistic market structures and administered prices. This limits the competitive constraints under which firms operate, but does not completely remove them (Berle, 1954).

So the factors that allow a certain control over corporate power are not to be found either in corporate law or in free market competition. The most important elements lie elsewhere, in the introduction of new institutions, new legal norms and new public structures, which have reconfigured the economic system and restricted managerial power. They are of different natures, combining formal and informal aspects, different modes of public action and different types of counter-powers.

The first factor highlighted by Berle concerns the growing importance of state intervention. This can take various forms:⁴⁸ specific legislation to control particular industries, through the creation of rules and regulatory bodies; legislation of more general scope, epitomized by antitrust law; the actions of new government agencies capable of strongly influencing corporate behavior and the development of certain industries (related to defense policy, for example), and situations where the state is led to intervene in or even take charge of production.⁴⁹ In all these cases, the state gives itself the means to influence the

⁴⁷ “A corporation like General Electric or General Motors, which steadily builds its own capital, does not need to submit itself and its operations to the judgment of the financial markets” (Berle, 1954, p. 41).

⁴⁸ See in particular Berle (1952) and Berle (1967).

⁴⁹ Berle (1952) gave the example of the Rural Electrification Authority, created in 1935 with the aim of bringing electricity to rural areas. State action was considerable, after the war, in sectors judged to be of strategic importance, such as the military, aerospace and nuclear industries, in the United States as in France or Great Britain. This is recognition, in a way, of the state’s duty to intervene directly so as to place production and certain companies at the service of what is considered – politically and socially – as essential to the general interest, or national security. This may happen in different ways according to the country and the “type of capitalism” concerned. In France, for example, after the war, it was done through the creation of public companies and other institutions (notably in research), whereas in the United States, production was most often left in

behavior and structures of firms. This legitimizes state intervention with the aim of bending the corporation to the service of the community.⁵⁰ Berle also observed that the development of public spending, a large share of which benefits firms – notably in the case of public investment in R&D⁵¹ –, means that “the American state is an investor in practically every substantial enterprise; without its activity, the enterprise, if it could exist at all, would be compelled to spend money and effort to create position, maintain access to markets, and build technical development” (Berle, 1967, p. xxviii). It thereby becomes legitimate to consider that the state has rights over the enterprise, on the same grounds as the shareholders.

Berle highlights a second factor of a very different nature, concerning the evolution of law: the need to protect individuals, by legal or constitutional rules, from the economic might of private entities, in the same way as they are protected against possible abuse of government powers. This led to the application to business of rules derived from the Bill of Rights; “a quiet translation of constitutional law from the field of political to the field of economic rights” (Berle, 1952, p. 942). Berle felt that this trend would strengthen, and that its justification lay in the characteristics of the corporation:

“The emerging principle appears to be that the corporation, itself a creation of the state, is as subject to constitutional limitations which limit action as is the state itself. If this doctrine, now coming into view, is carried to full effect, a corporation having economic and supposedly juridical power to take property, to refuse to give equal service, to discriminate between man and man, group and group, race and race, to an extent denying ‘the equal protection of the laws,’ or otherwise to violate constitutional limitations, is subject to direct legal action” (*ibid.*).

the hands of private corporations, but their activity was strongly guided, and funded, by government policies and agencies.

⁵⁰ Berle (1962, p. 442) wrote: “it is scarcely accident that almost nowhere in the world, and certainly not in the United States, has the classic free-market system remained free from control, a result effected either by overall national economic planning or by ad hoc national planning affecting key industries. The United States combines elements of both methods, which affect many of the major sectors of her ‘private’ industry.” He wrote this in reply to Manne’s (1962) reassertion of theories about the superiority of the free market, and his criticism of “business statesmanship” and the idea of the social responsibility of management. It led him to acknowledge, in passing, that in the light of economic and political changes, he had come round to the position of Dodd (1932).

⁵¹ The considerable growth in *public* R&D spending (and in the public funding of private R&D) is one of the major features of post-war economic transformation in the big industrialized countries. This clearly played a central role in post-war economic growth in both the United States and France. The neoliberal revolution that brought down the managerial capitalism of the post-war decades never called this aspect into question.

We might add that for Berle, this was a means to respond to the problems caused by the power of the modern corporation, without “a social attack on an enterprise as an enterprise, with nationalization or socialization as the aim. [...] Instead of nationalizing the enterprise, this doctrine ‘constitutionalizes’ the operation” (*ibid.*, p. 943). This idea that the enterprise should be subject to the same obligations as a public body clearly tallies with the view, constantly reaffirmed by Berle, that the “large modern corporation” has the characteristics of a public institution, and that its managers are in a similar position to that of high-ranking civil servants.⁵²

A third line of Berle’s analysis focuses on the considerable development of laws and regulations concerning a central aspect of the firm: the situation of the employees. The growing importance of labor law has been one of the main features in the transformation of Western economies, particularly after the crisis of the 1930s and post-Second World War, in the United States and even more so in Europe. Thus, a body of laws has developed affecting – in various ways – wage setting, working hours and conditions, and the organization of industrial relations, especially the role and power of trade unions. Clearly, this represents a major factor limiting the discretionary power of corporate management, and it has had an important effect on the organization of firms and on the nature of growth in Western economies in the post-war decades.⁵³

There remain two aspects of a nature that is not strictly legal or economic, but more fundamentally political, in which the post-war Berle saw the possibility of limiting corporate power: the role of counter-powers and above all public opinion. Berle took up the idea of “countervailing power” proposed by Galbraith (1952). According to Galbraith, it is thanks to the existence of these counter-powers that the concentration of economic power in the hands of the large corporations has not resulted in more serious abuse and dysfunction, as one might have feared (and as Berle himself feared).⁵⁴ These counter-powers are located outside the corporate world, notably among employees, trade unions or

⁵² Thus, Berle wrote (1952, p. 953): “One may reasonably forecast, in the future, direct application of constitutional limitations to the corporation, merely because it holds a state charter and exercises a degree of economic power sufficient to make its practices ‘public’ rules.”

⁵³ French Regulation Theory gives a central role to what it calls the “wage-labor nexus” - all the rules and institutional forms that govern the conditions of use of labor in the economy – in the analysis of growth in “Fordism”, especially in explaining the nature of post-war growth. At the same time, these analyses, like those on the Varieties of Capitalism, have shown the wide differences in the institutional forms of the wage-labor nexus in different countries, especially between the United States and continental Europe. See, for example, Boyer and Saillard (2001) and Hall and Soskice (2001).

⁵⁴ The transformations that accompanied financialization, starting in the 1980s, show that these fears were well-founded. The balance of power that had emerged in the post-war period was without doubt fragile, and linked to a particular political situation (marked notably by the Cold War); it gradually disintegrated.

consumers, but also, apparently, for Galbraith, within that corporate world, because of conflicts of interest between industries or between firms in oligopolistic structures.⁵⁵ In the new capitalism marked by the concentration of production in the hands of a small number of very large firms, the system of countervailing power can, for Galbraith (1952), partly replace market competition as a mode of regulation of economic activities. He holds this to be a radical departure.⁵⁶ He also emphasizes the close link between state intervention and the development of countervailing power in the United States.⁵⁷

The main “institutional force” that could act as a counterbalance managerial power, according to Berle, is the power of the “great industrial labor unions”. He also adopts the idea of a possible balance of power in the relations between firms: “the system of oligopoly [...] does erect a substantial limitation in the power of each unit in it” (Berle, 1959, pp. 89-90).⁵⁸ However, Berle appeared to doubt that union power could really balance managerial power, at least in the United States.⁵⁹ That is probably why he attached such importance to state action and public opinion.

The role of public opinion appears repeatedly in Berle’s work,⁶⁰ as a means to control corporate action and guide it towards satisfaction of the “community’s desire”, either directly, or through pressure aiming to obtain state intervention or public regulation.⁶¹ This presence of public opinion, founded on the “public consensus”, “the body of these general, unstated premises which has come to be accepted” (Berle, 1959, p. 111), obliges corporate managers to

⁵⁵ On this point, see Mizruchi and Hirschman (2010). Galbraith doubtless had a more optimistic view of post-war managerial capitalism than Berle, particularly as regards the regulatory role played, according to him, by the system of countervailing powers. Berle did take up this idea, but with reservations. As we have seen, Galbraith later saw the “technostructure” as a drastic limit on the power of corporate management. It is doubtful that Berle shared this point of view.

⁵⁶ “The contention I am here making is a formidable one. It come to this: competition which, at least since the time of Adam Smith, has been viewed as the autonomous regulator of economic activity and as the only available regulatory mechanism apart from the state, has, in fact, been superseded” (Galbraith, 1952, p. 119).

⁵⁷ Galbraith’s analyses, like Berle’s, are tied to the specificities of American capitalism. The conditions under which corporate power was – partly – counteracted during the post-war period in France or Germany are perceptibly different. In Germany, for example, the counter-power came from an institutional system that has often been qualified as “neo-corporatist”. Nevertheless, the general approach of these two authors to power – and more precisely corporate power – and the conditions under which it can be controlled is of very broad theoretical scope. In particular, as we hope to show, it contains the ingredients of an institutionalist theorization of the firm, and of the corporation, radically opposed to the contractualist theory that is dominant today.

⁵⁸ Perroux (1961) proposed a similar idea.

⁵⁹ “I am not convinced that big labor unions emerged as a response to big corporations” (Berle, 1959, p. 19).

⁶⁰ See, for example, Berle (1952, 1954, 1959, 1962).

⁶¹ On this question, see Moore and Rebérioux (2010).

legitimize their power and their action. They are therefore accountable to the community. For Berle, the influence of public opinion on corporate behavior became important after the war: “Whereas in the past public opinion had little influence on the conduct of corporate managements, today it is crucial, and every management knows it. [...] The preventive effect of a public consensus on standards of conduct cannot be precisely measured. Undeniably it is great” (Berle, 1962, p. 438). It remains to understand how a certain public consensus forms in any given domain, and how it is translated into public opinion. Berle highlights the role played by the “conclusions of careful university professors, the reasoned opinions of specialists, the statements of responsible journalists, and at times the solid pronouncements of respected politicians” and, he adds, “these, and men like them, are thus the real tribunal to which the American system is finally accountable” (Berle, 1959, p. 113). One might well question the political conception expressed here, and judge Berle over-optimistic in his view of the formation of enlightened public opinion, in the light of what our societies have experienced since those lines were written. But the essential thing is that for Berle, it is indeed the political and social system and the civil society that are the precondition for the control of corporate power and of more general economic powers, and for the regulation of the economic system, through the way in which it enables the formation and expression of an active public opinion.

At this point, it is possible to say that Berle has gradually constructed an almost complete theorization of the corporation and of corporate power. It can be summarized in a few key propositions:

- 1) The ‘modern corporation’ as it has developed since the second half of the nineteenth century constitutes a radically new institution. Its “nature”, resulting from legal and economic developments and from the global transformations of capitalism, are encapsulated in two fundamental attributes: it is a *real entity* and, because of its size and power and the functions it performs in society, it has the characteristics of a *public institution*. As such, the large corporation should be managed in keeping with the interests of society.
- 2) The separation between property and control does indeed mark a radical break with the past. In the corporate system, managers form a new social group endowed with unprecedented autonomy and power, due to both changes in corporate law and economic evolutions, affecting the enterprise itself, of course, but also the characteristics of capital markets and product markets. This separation has totally transformed the relationship between the investors (and therefore the shareholders) and the firm, in such a way that the shareholders can no longer be considered the owners of the firm. More fundamentally, in the economic world, managerial capitalism

establishes a separation *between property and power*, and consequently what can be considered a new system of power.⁶² One of Berle's overriding concerns was that this system tends to widen ever further the distance between individuals and the places where economic power is concentrated.⁶³

- 3) The fundamental challenge posed by this transformation of the economic system is the question of how to control this new power, which represents a potential threat to the economy, perhaps even to society, and how to ensure that the large corporation is really managed in keeping with the interests of the community. The question of the relationship between managers and shareholders is therefore a secondary issue that can only be understood in relation to this fundamental question. In the light of the profound transformations that followed the New Deal and the Second World War, Berle came to the opinion that managerial and corporate power could be controlled neither legally, through corporate law, nor economically, through market discipline. He felt that it could (and was, to some extent) be controlled only through transformations in the American social and political institutional system, marked by the development of public action, the emergence of counter-powers and the action of public opinion. And that applied equally well to the new powers that Berle saw emerging with the rise of institutional investors and their managers.

One might say that Berle thereby proposes an institutionalist and historical theorization of the modern corporation, embedded in what some writers today would describe as a theory of institutional complementarities. In many ways, this representation of managerial capitalism, which it would certainly be interesting to compare with others,⁶⁴ was in accordance with the main features of American capitalism from the post-war years to the 1970s.

The new contractualist theorization of the firm, especially agency theory, opposed the theories we have just presented, point by point. And it did so within the framework of a project for the radical transformation of the American economy extolled by the advocates of a return to strict economic liberalism, and even to a new economic order that is often described as "neoliberal", particularly

⁶² This is developed in Berle (1959), in particular.

⁶³ For Berle, as we have seen, this is one of the consequences of the post-war development of institutional investors (Berle, 1967).

⁶⁴ Particularly that of Galbraith, with which it shares similarities, notably in the central place given to the analysis of power, but also notable differences as to the nature of the powers at work in the industrial system, their foundations and the conditions under which they had been regulated. It would also be interesting to consider the theories developed in France, during the same period, by François Perroux.

supported by the Chicago School, and which was effectively established in the 1980s.

2. Jensen and Meckling and the new contractual economic theory: the firm, and the corporation, as private contractual arrangements

It was inevitable that the theories developed in Berle and Means' book, and even more Berle's later theories, would provoke reactions, both in terms of mainstream economics and from a more political perspective, from all those who believed private property to be the foundation of society. In particular, this concerned the questioning of the idea that shareholders are, by nature, the owners of the enterprise and that managers can only be at their service. As Ireland (2001) observed, faced with these theories of Berle (and others), certain writers felt it was important to impose "the reprivatization of the corporation".

This was notably true for Henry Manne and Milton Friedman. Henry Manne⁶⁵ endeavored to highlight the disciplinary function of the capital market, arguing that it imposes the primacy of the profit maximization objective on the managers of a corporation, whatever its size. Shareholders can engage in various forms of proxy fights; they can threaten the incumbent management, through the effect of their buying and selling on the share price, and initiate a "market for corporate control" so as to favor the optimal allocation of capital, according to the most standard economic view. Manne also highlighted the growing role of financial intermediaries as a major factor in the reaffirmation of shareholder control, giving a very different interpretation of them to that of Berle, which we described above.⁶⁶ Manne was almost certainly the first to express what was to become the line of reasoning underlying the new contractualist economic theorizations (and notably agency theory), marked, as Ireland (2001) observed, by a shift from a justification in terms of the shareholders' natural rights as owners of the firm to a justification in terms of economic efficiency. For his part, Friedman, faced with the rise of the theme of corporate responsibility, used the whole weight

⁶⁵ See Manne (1962), and the analysis by Ireland (2001). Long before Manne and Friedman, Frank Knight can be considered as a precursor of the modern contractual theories of the firm. See O'Kelley (2006 and 2012), supporting this interpretation and proposing a "Knight-Coasian" theorization of the firm.

⁶⁶ And indeed, Berle wrote a severe critique of Manne's theories, drawing notably on the fact that large corporations are largely self-financing (Berle, 1962). To which he added an essential distinction: "the stock market is an allocator, not of capital, but of wealth - a quite different proposition" (*ibid.* p. 446).

of his authority to argue that the firm belongs to the shareholders, and that profit-seeking is its only legitimate objective.⁶⁷

But the desire to “reprivatize the corporation” was founded essentially on the construction by economists of a new representation of the firm, embedded in a recasting of the neoclassical microeconomic foundations that accompanied the affirmation of neoliberal thought from the 1960s.⁶⁸ It is in this context that agency theory must be analyzed, if we are to capture its full significance and implications, and understand how it fits into a reaffirmation, stronger than ever, of the primacy of the market as the fundamental institution of society, in a return to the “nineteenth-century comfort of thinking that the voice of the open economic market is resonant and is the voice of God”, to quote Berle.

2. 1. The theoretical foundations: property rights and contracts as the foundations of economic relations

Neoclassical economic theory in the 1960s, founded on the Walrasian general equilibrium model and microeconomic theory of markets and prices, came up against a major problem, from the viewpoint of the free marketeers: the revelation of market failure, i.e. the fact that if certain very restrictive conditions are not satisfied, the market becomes inefficient (or ceases to function). This is, for example, what standard microeconomics predicts when there are externalities. Consequently, this theory could perfectly well provide a justification for state intervention in all the many cases where it appears that regulation by the market does not spontaneously lead to a social optimum.

It was the seminal article by Coase (1960), proposing a solution to the problem of externalities based on negotiable property rights, that formed the main foundation for the development of a new microeconomics, based on a theory of property rights and a theory of contracts and rethinking the conceptualization of market relations and serving as the basis for a new theorization of the firm and organizations. The same article also served as the starting point for the construction of the “law and economics” movement. Although the majority of neoclassical and liberal economists, and indeed most of the critiques of neoclassical economics, did not see this as a significant departure, we believe that

⁶⁷ In a famous article published in the New York Times in 1970: “The Social Responsibility of Business is to Increase its Profits”. See Robé (2012a) for an incisive criticism of Friedman’s reasoning. A few years before, in a book that expressed his social and political vision, Friedman had written: “Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for the stockholders as possible,” and later: “The corporation is an instrument of the stockholders who own it” (Friedman, 1962, pp. 133 and 135).

⁶⁸ In which the Chicago School of Economics obviously played a central role. On this point, see Van Horn and Mirowski (2009).

it marked a major change in the way the free market economy was analyzed and defended.⁶⁹ And this became apparent notably in the theory of the firm.

Without going into the detail of Coase's analysis – which can give rise to varying interpretations – the important thing is to see how it has been used and expressed in what is called the “Coase Theorem”. This theorem affirms that in a situation with externalities, it is perfectly possible to attain a Pareto optimum *without resorting to public intervention* (notably intervention on the form of taxes or subsidies, which is the solution proposed by Pigou), simply by allowing free economic relations, free bargaining, to take place between the individuals concerned.⁷⁰ More precisely, what is important is that the rights of each individual are perfectly defined, that these rights are transferable, and that individuals should then be free to negotiate contracts with each other whenever they see fit. This should, we are told, spontaneously lead to a solution – an equilibrium contract – that is optimal, whatever the initial distribution of rights between the parties.⁷¹ Property rights and contracts thus become the central categories in the analysis of a free market economy. The definition and respect of private property rights, and contractual freedom (and indeed, individual freedom in general) become the primary conditions of economic efficiency.

This new approach involved the construction of the theory of property rights, hitherto absent from economics. It was developed largely by Alchian and Demsetz.⁷² We cannot examine the theory in detail here, but let us recall a number of essential points. A property right is “a socially enforced right to select uses of an economic good” and a private property right is a right that is “assigned to a

⁶⁹ Let us just say that there was a shift from a representation of the market order as a multilateral system of simultaneous, anonymous relations to a representation in terms of bilateral relations that are necessarily personal, and from coordination through prices (and equilibrium) to coordination through negotiation and contracts. This made it possible to reduce the opposition between market and firm, or even to reduce the firm to a particular form of market.

⁷⁰ See Biondi (2011a) for a comparative institutional analysis of the different solutions that moves beyond this approach.

⁷¹ Which Milgrom and Roberts (1992, p. 24), in an advanced textbook, expressed as follows: “If people are able to bargain together effectively and can effectively implement and enforce their decisions, then the outcomes of economic activity will tend to be efficient (at least for the parties in the bargain)”. Efficient choices are those “for which there is no available alternative that is universally preferred in terms of the goals and preferences of people involved” (*ibid.* p. 22). Simply on reading these propositions, one suspects that their validity and effective impact raise many questions, which we cannot, unfortunately, develop here, but of which Milgrom and Roberts were perfectly aware. In particular, they concern the consequences of transaction costs, a central aspect for Coase himself. The very precise and very restrictive definition of the concept of efficiency, which at least had the merit of being given, also deserves attention, given the ubiquity of this concept not only in economic discourse, of course, but also in legal discourse, following the work of the law and economics movement.

⁷² Alchian (1987) gives a clear synthesis. See also Alchian (1977), Demsetz (1967) and Alchian and Demsetz (1973).

specific person and is alienable in exchange for similar rights over other goods” (Alchian, 1987-1989, p. 232). So the conception of property - and notably of private property - that is proposed here is very broad. It allows accounting for and justifying the continual extension by capitalism of rights that are prone to become objects of property. In this view, the primary function of property rights is to generate incentives for the creation, conservation and exploitation of wealth. And this would be best achieved, in most cases, by the allocation of *private* property rights.⁷³ Indeed, the economic theory of property rights aims primarily to show that only private property, in conjunction with the free market, is capable of ensuring the optimal allocation of resources and economic development,⁷⁴ while at the same time respecting individual liberties. This is very much in line with the historic changes to the concept of property wrought by capitalism, which systematically favors exclusive private property.⁷⁵ Here, although it is not self-evident, the link between property and market is essential: as *negotiable* rights, property rights allow the construction of markets, and thereby efficiency and growth. Supposed “market failures” are generally blamed on the absence of certain property rights,⁷⁶ making it impossible to create a market (leading to missing markets). Following this approach, the solution proposed to deal with externalities, such as problems of pollution, consists in creating alienable rights (e.g. to pollute), to allocate them to individual agents, and to create a market for those rights (rather than imposing regulations on companies, in the form of norms limiting pollution).⁷⁷ This theory tends to take economic efficiency as the fundamental criterion for evaluating property systems (and institutions in general).

⁷³ See Kennedy (2011) for a legal-economic critique of this position.

⁷⁴ “All private owners have strong incentives to use their property rights in the most valuable way” (Alchian and Demsetz, 1973, p. 22). The two authors make a particular point of demonstrating the inefficiency of communal land ownership. In the same vein, a certain number of neo-institutionalist works assert that the institution of private property and the development of markets that explain the economic development of the West.

⁷⁵ On this point, see Macpherson (1975). There were two stages in this transformation. In the first stage, private property was essentially linked to labor, and justified as “the incentive to necessary labor” (*op. cit.* p. 112). In the second stage, following the emergence of corporate capitalism, property was conceived (as it was before capitalism) primarily as the right to an income, according to Macpherson. We could no doubt relate the evolution of the conception of property to that of political economics, from the classical school to the neoclassical school.

⁷⁶ “Under the Coase Theorem we know externalities can exist only if some alienable decision rights are not defined or assigned to someone in the private economy” (Jensen, 2002, p. 239). See also Jensen and Meckling (1992).

⁷⁷ “The existence of externalities in the case of pollution is obvious; but the solution for those problems is not to politicize the corporation but to define the rights in air and water so that both potential polluters and consumers of clean air and water are motivated to perceive the costs of their actions on others” (Jensen and Meckling, 1983, p. 18).

Two other dimensions are important, notably in terms of the analysis of the firm. The first relates to the general view of the economy and of society conveyed by this new conceptualization: a position of radical individualism, which refuses any form of collective entity. A social organization, in whatever domain, can and should only be understood as a set of relations *between individuals*. This entails a refusal of the standard microeconomic treatment of the firm, as an economic agent in its own right, and therefore a refusal to speak of the behavior, interest or income of the firm, as we shall see.

The other important aspect is the idea of treating property as a “bundle of rights”. The object of property and exchange is not so much a good or a resource, but rights over that good or resource.⁷⁸ This is particularly important for analysis of the firm, and even more so for the corporation. What matters here is the possibility of partitioning a property right into several different rights which can then be attributed to different individuals and be the object of separate transactions. And this is the foundation from which this theorization sets out to explain and justify what Berle and Means called the separation between “property and control”, and more generally the characteristics of corporations (limited liability, for example): “the partitionability, separability and alienability of private property rights enables the organization of cooperative joint productive activity in the modern corporate firm” (Alchian, 1987-1989, p. 233).⁷⁹

On this basis, a particular organization or governance structure is determined by a mode of definition of various rights on its assets, and their allocation among individuals, in other words the design of a structure of property rights, established by a system of contracts. The choice between different forms of organization, i.e. between different contractual systems, is assumed to be based on a rationale of efficiency. If individuals can negotiate and sign contracts in complete liberty, they will choose the most efficient system (after a possible period of learning). It is this reasoning that is applied to analysis of the corporation.

2. 2. The ideological and political context: the defense of the corporation against the state

Before looking more closely at how a new representation of the enterprise, and justification of the shareholder value principle, are built on these foundations, it

⁷⁸ “The domain of demarcated uses of a resource can be partitioned among several people. [...] It is not the resource itself which is owned; it is a bundle, or a portion, of rights to use a resource that is owned” (Alchian and Demsetz, 1973, p. 17).

⁷⁹ This line of reasoning leads Demsetz to state explicitly that the shareholders are not the owners of the firm: “De facto management ownership and limited liability combine to minimize the overall cost of operating large enterprises. Shareholders are essentially lenders of equity capital and not owners” (Demsetz, 1967, p. 358). See also Fama (1980). We shall return to this point later.

will be useful to consider the ideological and political context in which agency theory was developed. Two non-academic articles by Jensen and Meckling (1978, 1983), following faithfully in the footsteps of Friedman (1970), reveal this dimension.

In them, Jensen and Meckling clearly explain the sense of their work: above all their aim is to denounce the growing weight of public regulations which are, they say, undermining the corporation – which has proved itself historically as the most efficient form of organization of the firm – *by restricting the managers' freedom of action*. Likewise, they denounce the idea of imposing any objective on the enterprise other than profit-seeking (for the shareholders), whether it might be defending the interests of the other stakeholders or assuming a degree of social responsibility (expressed by consumer movements, environmental protection policies or affirmative action programs) (Jensen and Meckling, 1978). Regulations and anything else that restricts the freedom of action of corporate managers are denounced as an attack on contractual freedom, and thus an attack on individual freedom in general. The development of state intervention represents an “attack [on the] private rights system” (*ibid.* p. 4), and is the main cause of the decline in growth of the US economy. Here the authors are perfectly clear about their guiding social philosophy:

“Our government is destroying two vital instruments of that growth—the system of contract rights and the large corporation. [...] The corporate executive’s power to make decisions affecting owners of his firm, employees of the firm and consumers of the firm’s products is becoming more constrained every day. [...] Government is destroying the system of contract rights, which has been the wellspring of our economic growth” (Jensen and Meckling, 1978, pp. 2-3).

Or again:

“The Nader proposals for “Taming the Giant Corporation” and the recent campaign for “economic democracy” and “corporate democracy” are an important part of the current campaign to use governmental powers to benefit some special interest groups at the expense of people in general” (Jensen and Meckling, 1983, p. 2).

Thus, Jensen and Meckling’s economic and political viewpoint, which is neoliberal, is based on a number of fundamental principles:

1. *The absolute respect of contractual freedom and private rights is of primordial importance.* Any governmental action that restricts or removes those rights is

reprehensible, which would be the case for almost any policy directed at enterprises. And that could only have a negative effect on economic efficiency.⁸⁰

2. *Affirmation of a strictly individualist point of view*: the only rights (and duties) are those of individuals. Private property rights are the archetypal rights. No distinctions and above all no hierarchy should be established between different categories of rights: neither between rights of individuals and rights of enterprises – which are non-existent because only individuals can have rights – nor between different types of individual rights (for example between property rights and human rights).⁸¹ The only issue is to clearly define the rights of individuals (and their allocation). This leads to a refusal to consider that the enterprise as an entity having rights (and duties) *or having its own income and wealth*. “Corporations are not human beings. [...] Thus, contrary to what those in the “corporate democracy” movement would have us believe, it is impossible to impose costs or benefits on the corporation” (*ibid.* p. 3).⁸²

From this perspective, any regulation of corporate action and any “attack on the corporation” is in fact an attack on *individual freedom* and a confiscation of the wealth of *individuals*:

“The lists of non-corporate and corporate use of the police powers to confiscate the wealth of others is far longer than most of us dare to realize. In fact, I believe it represents the overwhelmingly predominant use of the police powers today—and the corporate governance campaign is just another example” (Jensen and Meckling, 1983, p. 21).

3. *The main problem is not the control of the managers, even by the shareholders*. On the contrary, for Jensen and Meckling, it is *to defend the managers’ freedom of action*, and to denounce the different public interventions and regulations that

⁸⁰ “In our political, or rule-changing, activities we generally make other people worse off, for two reasons:

1. we directly transfer wealth from them to us, and

2. we indirectly cause reduction in incentive to produce — through such devices as income taxes, production restrictions (common in agriculture), licensing restrictions preventing entry into various professions and markets and attenuation of property rights caused by significantly increased uncertainty over what the future rules of the game will be” (Jensen and Meckling, 1978, pp. 14-15).

⁸¹ “[...] the brilliant fallacy of drawing a distinction between so-called “human rights” and “property rights.” But all rights are, of course, human rights; there can be no other kind. [...] Since all rights are human rights, the only possible conflict is between individuals, i.e., conflict over which individual will have what rights” (Jensen and Meckling, 1978, p. 16).

⁸² To say that corporations are not “human beings” seems quite reasonable. It is the consequences drawn by Jensen and Meckling that are in question, and their analysis of the “nature” of the corporation. We shall return to this point.

restrict this freedom of action. The only power that needs to be controlled and limited is that of the state. Saying that the managers are only accountable to the shareholders means, above all, that they are not accountable to anyone else, whence the condemnation of ‘corporate democracy’. The implicit idea is that the managers’ freedom of action is in the interest of the shareholders (or even in the interest of all the stakeholders).⁸³

Jensen and Meckling do address the question of corporate control. But for them – unlike Berle – this control is perfectly achieved without public intervention (and without counter-powers or the pressure of public opinion), through the combined influence of the board of directors, market constraints (market for corporate control, product markets, labor market) and contractual obligations.⁸⁴ One might say, following Braton and Wachter (2010), that the control of managerial power has thus been *privatized*.

4. *The corporation should not be treated as a public institution.* This probably represents the core of the opposition to Berle (or Rathenau). In the words of Jensen and Meckling (1983), it is important to denounce “the fallacy of the corporation as state” and the idea it implies of “corporate democracy”. The underlying reason is still the primacy of individual freedom: “The basic issue lying behind the “corporate democracy” and federal chartering movement is the use of the police powers of the government to restrict the freedom of individuals to enter into contracts with each other through the organizational form known as the corporation” (Jensen and Meckling 1983, p. 3).⁸⁵ The public corporation is simply a particular form of organization, *resulting from the contractual relations freely chosen by individuals*. It should be noted straight away that implicitly, Jensen and Meckling totally equate (public) *corporation* with *enterprise*, that is to say legal form and organizational form. This confusion,⁸⁶ of which Berle is also sometimes guilty, as we have seen, is constituent of their theory of the firm. We shall return to this point.

⁸³ This is not necessarily open to question, but what is lacking is a study of corporate managers, their interests, their position in society and their modes of behavior. This requires an overall analysis of the corporate system, and of the effective conditions of control of corporate power.

⁸⁴ See Jensen and Meckling (1983), p. 24.

⁸⁵ And later, they add: “the proposed corporate democracy act, as I understand it, would
1. establish rules that limit the freedom to form contractual agreements and organizations;
2. limit individuals to work for, buy from, sell to, lend to, or own stock in corporations that do not meet certain rules regarding the membership of the board of directors;
3. limit individuals’ freedoms to work for, buy from, sell to, lend to, or own stock in a corporation that does not include certain contractual guarantees against discipline and firing of employees” (*ibid.* p. 14).

⁸⁶ The importance of the distinction between the enterprise, as an economic reality, and the legal form that it takes, or more precisely the “micro-legal structure” on which it is based, has been analyzed in depth by Jean-Philippe Robé. See in particular Robé (1999, 2011).

A last essential aspect appear in both the political and theoretical writings of Jensen and Meckling (and Fama): the importance attached to the financial dimension of the firm. This is consistent with the way the analysis is focused on corporate governance defined as dealing with the relations between managers and the (supposed) providers of capital, the shareholders.

Thus, for these authors, the main indicator of the dangers threatening the enterprise- and of the US economic crisis in general – is the decline in the stock market since the 1960s,⁸⁷ which they blame above all on public intervention and regulation. Once again, their reasoning returns to the supposed undermining of private rights and contracts:

“The corporation depends on the viability of the system of financial claims. Financial instruments are contracts. Their value depends on the rights they confer on the owners. [...] When potential investors become convinced that the rights of managers to use the assets of corporations in the interest of stockholders and creditors is very tenuous. [...] they will simply stop investing in corporations. [...] The effect of the erosion of private rights will show up first as a reduction in the capitalized values of the claims on assets of firms” (Jensen and Meckling, 1978), pp. 16-18).⁸⁸

Thus, the problems of the enterprise, and of the American economy in general, were expressed in the declining stock market performances of companies, resulting from the restrictions imposed on contractual freedom and on the freedom of action of the corporation.⁸⁹ For our economists, this was due to a lack of scientific understanding of what the corporation really is, and agency theory set out to remedy this shortcoming. This new theory of the firm was radically opposed to the view of the large managerial firm as presented by Berle and Means (and others like Galbraith and Chandler).

⁸⁷ A fall of 60% in the market value of Dow Jones stock between 1964 and 1980 (in real terms, net of inflation), and low dividend yields (also in real terms), according to Jensen and Meckling (1983).

⁸⁸ Here, the authors appear to consider shares as a right *on the assets of the firm*, which remains with the idea that the shareholders are the owners of these assets. This is clearly wrong: the only thing the shareholders own is their shares (which they can sell), not the assets of the enterprise. On this point, see Robé (2011).

⁸⁹ During the same period, faced with the problems of the American economy at the end of the 1970s, certain economists and management scientists highlighted, on the contrary, problems of competitiveness attributed mainly to a productivity crisis, and the shortcomings of production management methods in large enterprises (compared with the Japanese system). For some of them, this is at least partly due to *the increasing predominance of financial criteria in management*.

2. 3. *The new conceptualization of the firm and its implications*

As we have seen, Jensen and Meckling's 1976 article, one of the most cited economic articles of the last forty years, set out a new theory of the firm, based on "the theory of (1) property rights, (2) agency, and (3) finance (Jensen and Meckling, 1976-1998, p. 51). It aims to go beyond the standard neoclassical theory's treatment of the firm as a "black box"; it also opposes the managerial theories of the 1960s, proposed notably by Baumol and Marris, in which the priority for the managerial firm was held to be maximization of the size or growth of the firm.⁹⁰

It is indeed a new representation of the (capitalist) firm that is proposed, conceptualized as a system of free contracts between individuals. The relation between managers and providers of capital is at the centre of the analysis, based on the postulate that the managers are the *agents* of the shareholders. By the very definition of an agency relationship, this means that the shareholders are supposed to have hired the managers by contract, entrusting them with certain missions and delegating to them the right to make certain decisions. Clearly, this is a very particular hypothesis, and we shall return to this point. Property rights are one of the cornerstones of this theory, but the theory of property is used, as far as the corporation is concerned, in a completely different manner to that found in the "traditional logic of property". Agency theory leads to the legitimization of shareholder primacy, not because the shareholders are the owners of the enterprise, but because the contractual system that treats the shareholders as residual claimants and the managers as their agents is held to be the optimal contractual system, when the structure of production presents certain characteristics: large-scale production based on specialization and the combination of diversified skills.

We know the essential point of departure for agency theory, which can be found in different variants of the contractual theory of the firm: firms are "legal fictions which serve as a nexus for a set of contracting relationships among individuals" (Jensen and Meckling 1976-1998, p. 56). These contracts, "written and unwritten, among owners of factors of production and customers [...] specify the rights of each agent in the organization, performance criteria on which agents are evaluated, and the payoff functions they face", specify Fama and Jensen (1983, p. 302). The public corporation is defined by certain particularities of the contracts on which it is founded: "the existence of divisible residual claims on the assets and cash flows of the organization which can generally be sold without permission of the other contracting individuals" (*ibid.*). Jensen and Meckling borrow from jurists the concept of "legal fiction" to oppose the conception of the

⁹⁰ On this point, see Weinstein (2012).

firm as a *real entity*, distinct from the individuals that make it up. The firm only exists as a *legal fiction* that serves as a recipient for contracts between individuals.

Before analyzing this theory in more detail, it should be noted that it is based, as we have seen, on a total identification of the legal form – corporation or other form of commercial company – with the enterprise in its economic and organizational dimension. The former relates to what Robé (1999) calls the “micro-legal structure” of the enterprise, the latter to the whole apparatus of organization and power that ensures the economic unity of the enterprise. This confusion between legal form and organizational form can only be the source of numerous confusions. Thus, if one can effectively consider a *company* as a “legal fiction”, it makes no sense to do the same in the case of the enterprise, which does not exist as such in the eyes of the law and does not even have its own moral personality, as Robé observed. The question of the relations between legal forms and forms of enterprise is in itself an essential and complex question. Without being able to address it here, let us simply observe that by confusing the two dimensions, agency theory fails to treat either of them correctly. It does not examine with any rigor the “micro-legal structure” and the characteristics of the contracts on which the activity of the enterprise is based, analysis of which shows, in particular, that the commercial company cannot be reduced to a nexus of contracts between individuals (see Robé, 1999). But it also fails to treat essential aspects of the organization of the large enterprise, particularly everything that concern the organization of labor and production⁹¹.

Which brings us to another key feature of the contractualist approach: the enterprise is not really considered as an institution of which the central function is

⁹¹ From a different perspective, O’Kelley (2006 and 2011b) points how the confusion between the firm and the corporation leads to focus the analysis of the firm on the sole relationship between shareholders and managers, “because they are the only constituents of the corporation”. Following O’Kelley, the distinction between firm and corporation allows to recognize that corporate law concerns only the relations among shareholders and managers (and not the relations with the other stakeholders). This further leads him to consider that “the corporation (the set of relations between shareholders and managers) is the artificial *sole proprietor* that owns and manages the incorporated firm” (O’Kelley, 2006, p. 766), and after that, following Knight, to see the managers as *entrepreneurs*. This view results in a “theory of entrepreneur primacy” as a central component of a theory of the modern corporation. We cannot properly address these complex issues here, but only two brief comments. First, O’Kelley seems to propose a reformulation of the standard “nexus of contract” approach through a two-level contractual system which avoids two key shortcomings of contractual theories of the firm: the ignorance of the fact that the firm itself (or more precisely the corporation) owns its assets, and thus that most contracts related to the firm’s activities are passed between stakeholders and the corporation (and not among stakeholders, including shareholders). Second, that the hypothesis that managers behave like entrepreneurs (according to the Knight’s conception of the entrepreneurial activity) requires a careful examination of the managerial position and behavior in the context of modern capitalism in general, (and more precisely the managerial capitalism of the post-war period, and the financial capitalism of the last thirty years).

to produce goods and to organize production. Agency theory tends to treat the corporation fundamentally as an organization with a financial purpose, as the previous quotation clearly shows, with its emphasis on “residual claims on the assets and cash flows”.

It is possible to consider three major conceptions of the corporation:⁹² as real entity, moral person or legal fiction. The first of these is, we believe, the only one that can account for the large modern corporation, as analyzed by Alfred Chandler as an integrated and unified whole, as a collective entity that cannot be reduced to the sum of individuals that it comprises. Contractualist theory, especially in the work of Jensen and Meckling, is totally opposed to this view, through its choice of radical individualism. As a result, it oscillates between two different conceptions. The more extreme of these two conceptions treats the firm – equated with the company, let us remember – as nothing more than a pure (legal) fiction. This appears to be the conception favored by Jensen and Meckling, insofar as they oppose any formulation that treats the enterprise as a person and that aspires to attribute rights, responsibilities and even income to it. But at the same time, because it is difficult to ignore the fact that the moral personality of commercial companies has long been recognized (like other institutions before them), contractualist theory must treat the firm (confused with its legal form) as a legal person.⁹³ It does so, in particular, by recognizing that the contracts of the different stakeholders are made *with the company* (and not with each other). But it does not draw all the consequences of this, for example when it appears to consider the shareholders, and not the commercial company itself, as the owners of the assets of the enterprise, whereas, because of the radical separation between the capital of societies and shareholders, the latter have no property rights over the assets of the companies in which they own shares.

Nevertheless, the essential, for Jensen and Meckling, remains: *the firm (whether considered in its legal or organizational dimension) does not exist as a real entity*; the only reality that counts is that of the contracts made *between individuals*. For example, it is just as if there was a contract between the managers and the shareholders. These contracts – freely negotiated – specify the rights and obligations of each individual, the criteria of performance, and the conditions of payment of each one. In this way, the firm, including the large corporation, is treated fundamentally not as a social institution, but as a pure *private arrangement*. Under these conditions, any regulation of the organization or

⁹² See footnote 28.

⁹³ Whence their definition of legal fiction as “the artificial construct under the law which allows certain organizations to be treated as individuals” (Jensen and Meckling, 1976-1998, note 12, p. 56). As Biondi (2011b) observes, the corporation is thus recognized as an *object*, but not as a *subject* of rights. Here again, one can see the confusion between the enterprise as an organization and the legal form on which it is based.

activity of a firm (and its directors) amounts to controlling the contracts, and therefore constitutes a restriction on contractual freedom.

In itself, the contractual definition of the firm has strong implications, which apply to practically all contractualist theories. They can be summarized in the following simple propositions:⁹⁴

- 1) As we have seen, since the enterprise does not exist as such, *it makes no sense to speak of the interests, income, or behavior of the firm*. Asking whether the firm maximizes its profit or growth, for example, has no meaning. The only relevant questions concern the income and behavior of *individuals*, assuming that their objective is to maximize their wealth or utility.
- 2) *There is no fundamental difference between firm and market*. The firm is, in the words of Demsetz, a form of “private market”. The only things that matter are contracts between individuals, and the relations between individuals on a market and in the context of a firm are simply governed by different contractual forms. This allows to do away with a whole current of thought which, as we have seen, drew a contrast between the organization and the market, or between the “visible hand of managers” and the invisible hand of the market. And this in turn makes it possible to restore the view of the market – seen through the lens of the contractual paradigm – as the central institution of society. This has another consequence, namely that “it makes little or no sense to try to distinguish those things that are “inside” the firm from those things that are “outside” of it” (Jensen and Meckling 1976, p. 9). There is therefore no reason to distinguish between contracts made between agents within a firm and contracts made between the firm and the outside world. Which is, the reader will understand, very important from the employees’ point of view. Jensen and Meckling have practically nothing to say on this question (which is rather embarrassing when one is building a theory of the firm), except to adopt the proposition of Alchian and Demsetz (1972), according to which there are no hierarchical relations in the firm, in the sense that there is no fundamental difference between the contracts made with, for example, suppliers of equipment or materials and the contracts made with employees.⁹⁵ This negation of the specificity of the

⁹⁴ On these points, see Coriat and Weinstein (1995).

⁹⁵ “Alchian and Demsetz (1972) object to the notion that activities within the firm are governed by authority, and correctly emphasize the role of contracts as a vehicle for voluntary exchange.” (Jensen and Meckling, 1976-1998, p. 56). The contractualist view does not necessarily entail such a conception. Williamson’s theory of transaction costs, like Grossman and Hart’s theory of incomplete contracts, recognizes the existence of a relationship of authority. The central issue here

employment contract and labor relations, and of the characterization of the firm in terms of a relationship of authority is obviously essential when seeking to affirm the fundamental equivalence between market and organization.

- 3) Last but not least, *it makes no sense to ask who the owner of the firm is*. Nobody can be the owner of an enterprise. Individuals are only owners of the factors of production, or of rights over those factors. *The shareholders cannot therefore be considered owners of the corporation.*⁹⁶ This proposition may seem surprising, in the context of agency theory, but it is indeed the logical consequence of defining the firm as a nexus of contracts. Fama (1980, p. 290) states this very clearly:⁹⁷

“Ownership of capital should not be confused with ownership of the firm. Each factor in a firm is owned by somebody. The firm is just the set of contracts covering the way inputs are joined to create outputs and the way receipts from outputs are shared among inputs. In this “nexus of contracts” perspective, ownership of the firm is an irrelevant concept.”

In fact, since the enterprise is considered as a nexus of contracts, notably contracts with the different suppliers of inputs, there is, *a priori*, no reason to attribute preferential treatment to the shareholders (who are simply providers of a particular input). This appears to strip all legitimacy from the central hypothesis of agency theory, which underpins the shareholder conception: the managers are the agents of the shareholders alone. To justify shareholder primacy, another line of reasoning was needed, not based on ownership of the firm. It was provided by application of the general principles of the contractual paradigm: the managers

concerns the characteristics of the employment contract and the status of the employees, which contractual theories of the firm most often fail to address.

⁹⁶ Which is, it must be remembered, perfectly in keeping with corporate law, as a number of jurists have remarked. See, for example, Blair and Stout (1999), Robé (1999, 2012a) and Stout (2012). The shareholders are only owners of the securities issued by the corporation, which is obviously very different.

⁹⁷ Like Demsetz (1967), as we have already seen. Note that Fama’s expression of “ownership of capital” is itself ambiguous, if not erroneous. The shareholders of a public corporation are not the owners of the assets *of the enterprise*; they are simply the owners of securities, the shares which, according to the very terms of property rights theory, carry certain specific rights: the right to receive a share of the profits of the enterprise (at the discretion of the directors), the right to participate in shareholders’ general meetings and there to vote *on certain questions* – which gives them very limited powers – the right to transfer their shares, etc. It is interesting to see how the theory of incomplete contracts, which also treats the firm as a nexus of contracts, while at the same time maintaining that the ownership of assets is the foundation of power in the enterprise (Hart, 1995), has difficulty in deciding who (the director-owner, or the firm itself) is the owner of what (the assets, the means of production, or the firm itself). See Weinstein (2007).

must be considered the agents of the shareholders because that is how the greatest economic efficiency is achieved.

2. 4. The “separation between property and control” and the problem of corporate governance

In their analysis of the corporation, Jensen and Meckling started by deconstructing the main theory of Berle and Means. For Jensen and Meckling, the delegation of decision-making powers to certain individuals (the managers) is no more than a traditional operating method of various types of institutions. There is nothing fundamentally new in the case of the “modern corporation”. This is also the argument put forward by Hessen (1983), and we have seen the answer that can be given. The contractualist view adds that this sort of delegation of power is simply the exercise of the contractual freedom of individuals, and that it is based on the possibility of partitioning property rights and allocating different rights on the same objects (decision-making powers in resource management, for example) to different individuals, under conditions that are freely chosen by the parties concerned. In brief, the “separation between property and control” is perfectly in keeping with the fundamental principles of private property and contractual freedom.

Why should the governance of large corporations be based on such a delegation of decision-making powers to managers? And above all, why should these managers be considered the agents of the shareholders alone? Fama and Jensen (1983), in a text written for a conference specifically on the work of Berle and Means, attempted to give a reasoned reply to these questions and thus justify the principle of shareholder primacy.⁹⁸ Let us just run through the main lines of their argument.

Different types of organization are distinguished by their contractual structure. “The central contracts in any organization”, according to Fama and Jensen, “specify (1) the nature of residual claims and (2) the allocation of the steps of the decision process among agents.” The “residual claimants” or “residual risk bearers” are the agents that bear the risk of the enterprise’s activity. The decision process can be broken down into two main functions: “decision management” and “decision control” (ratification and monitoring of decisions). The optimal organization, which can be found in the classic entrepreneurial firm of limited size, is one in which the agents who have the decision-making powers are also the residual claimants, who bear the risk (in the form of proprietorships, partnerships and closed corporations) (*op. cit.*, p. 308).

⁹⁸ See also Jensen and Meckling (1992).

However, in complex, large organizations, it is necessary to take into account the importance of the diversified skills needed to ensure good management, and therefore the advantages of the division of labor. Organizational complexity means that the “specific knowledge”⁹⁹ that is useful for decision-making is possessed by a small number of agents. There is a problem if the holders of a right over the management of capital are not the same as those who possess the knowledge. The solution lies in the definition of transferable rights: “capitalist economic systems solve the rights assignment and control problems by granting alienability of decision rights to decision agents” (Jensen and Meckling, 1992-1998, p. 103).

Delegation of the *management function* to those who have the necessary knowledge – the managers – creates problems (and costs, known as “agency costs”). The trick is to find the contractual structure that minimizes these problems and costs. What Fama and Jensen endeavor to show is that the public corporation, directed by managers, who hold the decision-making powers, and controlled by investors, who are given the status of residual claimants (shareholders), constitutes the optimal contractual system. More precisely, the “optimal” solution consists in separating the functions of control and management, and separating the bearing of residual risk from the management function. The shareholders, the owners of the capital, are paid, by contract, on the basis of the “residual income”, and in return for the loss of decision-making powers, they have a right of control over the actions of the managers. This is what justifies the view that the managers are the agents of the shareholders. It is because it is the most efficient form of organization (in the case of “organizational complexity”) that the large corporation, run by managers, under the control of shareholders, became established historically as the dominant organization of the enterprise.

In the agency theory approach, this reasoning lies the heart of the analysis of the corporation, and of the justification of the shareholder conception of governance that it proposes, without treating the shareholders as the owners of the enterprise (which would not make any sense, in this theory). The demonstration is, dare we say, extremely acrobatic. One point should be noted from the outset: the very manner of setting out the initial problem (concentrating on decision-making and risk-taking) tends to focus the analysis on the relationship between directors and investors, neglecting all the other stakeholders, foremost among whom are the employees, including the largest part of the managerial apparatus (Galbraith’s “technostructure”), i.e. what constitutes, for Chandler among others, the heart (and the brain) of the large modern enterprise. Beyond this first point,

⁹⁹ Here the authors take up Hayek’s theory of knowledge (1945). It is particularly developed in Jensen and Meckling (1992-1998).

which is not negligible, the analysis raises a multitude of questions, of which we shall only consider a certain number.¹⁰⁰

A first question is whether this representation of the public corporation, where the managers have the status of agents of the shareholders, is in keeping with the legal reality. This question was raised in the context of the French legal system, notably by Robé (1999), and in the context of the US legal system, notably by Blair and Stout (1999). Robé presents an in-depth analysis of the legal structure of the large enterprise (the group of companies), leading to a global critique of the dominant analysis of corporate governance (*op. cit.*, chapter 3). He also shows the importance of the “fragmentation of shareholder support” of the enterprise (*op. cit.*, p. 34), an essential aspect for understanding the current characteristics of capitalism. Blair and Stout, for their part, emphasize the idea that the managers should be considered not as agents but as ‘trustees’. The difference between these two statuses is important in terms of the degree of autonomy and power effectively held by the directors of large enterprises. The status of agent implies a “duty of obedience” and the power of the shareholders to directly control the managers’ actions. But throughout the twentieth century, the law increased the autonomy of managers and reduced the power of shareholders.¹⁰¹ To which Blair and Stout add that the shareholders have no more property rights than the managers over the assets of the enterprise. It is in this sense that the status of CEOs is more that of trustees, and cannot, on any account, be treated as an agency relationship.

However, it is doubtful that this seriously undermines the analysis proposed by Jensen, Meckling and Fama. In fact, as we have seen, Jensen and Meckling defend both the managers’ freedom of action (which can be justified by the fact that they are the only ones to possess the “specific knowledge” necessary for management) and contractual freedom, which is the most important thing for these authors, but which does not prevent the shareholders from accepting a contractual system that endows the managers with a high degree of autonomy. In fact, in the view of agency theorists, the managers should be controlled essentially *by the markets*. Moreover, the trust has historically been an institutional form aiming to *protect owners* deprived of the right to manage their capital (because of their inability). This legal mechanism was used in the nineteenth century by merchant bankers, *with a view to maintaining their control over enterprises*.¹⁰² If the managers are the trustees of the shareholders, they must protect the capital of the latter, who are the ultimate owners of the capital whose management is entrusted to the managers. The difference between ‘agent’ and ‘trustee’ deserves to be taken into consideration, but it is not of a nature to radically challenge the

¹⁰⁰ On this point, see also Coriat and Weinstein (1995, chapter 3) and Weinstein (2007).

¹⁰¹ Which has led some commentators to speak of “director primacy” (Bainbridge, 2002).

¹⁰² On this point, see Montagne (2006).

shareholder view of Jensen and Meckling. Robé, for his part, proposes an analysis that takes the criticism further, in terms of the issue of powers, a central aspect that is totally absent from nearly all the contractual analyses.¹⁰³

The most fundamental problem raised by the above analysis is that it entirely reduces the problem of governance to a face-to-face between managers and shareholders, against a background of the representation that is proposed of the public corporation. The first issue, the one raised in the debate between Dodd and Berle, is to decide to whom the managers should be considered accountable. For whom are they the trustees (or agents)? And correlatively, what objectives should they have in the management of the enterprise (shareholder value or value of the enterprise, maximization of profit or of growth?) The answer one gives to these questions depends on one's conception of the large modern enterprise: a simple private arrangement, like an entrepreneurial firm of limited size, or a veritable public institution. It is when the large corporation is considered as a real entity (with the function of producing goods and services) and as a social institution that it becomes necessary to rethink the principles guiding its mode of organization and governance, its structure and strategies¹⁰⁴.

And even if we accept that managers are in an agency relationship, within the framework of a system of private contracts, why should they be the agents of the shareholders alone (and not also or alternatively the agents of other parties involved in the "nexus of contracts")? As we have seen, the justification cannot be founded on ownership of the enterprise. The shareholders cannot even be considered the owners of the capital of the enterprise: when the commercial company that serves as legal support to the enterprise is recognized as a legal entity, the assets become the property of the company itself. Logically, the conception of the firm as a "nexus of contracts" should in fact lead one to consider the managers as the agents (or trustees) of several principals, *of diverse stakeholders*. Combined with the idea of directors as trustees who "are expected to serve their beneficiaries' interests unswervingly and to settle conflicts between beneficiaries with competing

¹⁰³ In works addressing, in particular, the question of the "constitutionalization" of the enterprise. See, for example, Robé (2009, 2012b).

¹⁰⁴ From this perspective, one crucial issue is to take into account – in an institutionalist vein – the role of non legal (and non contractual) norms and conventions in framing and shaping firm's and managerial structures and behaviors. This role has been fundamental to the progressive domination of these practices by shareholder primacy emerged since the eighties. On this issue, Rock and Wachter (2012) analyse the role of "non legally enforceable rules and standards" in the governance of firms, by adopting a transaction cost and (new) property rights theoretical framework. They emphasize the rules created by the firms themselves. However, also rules and norms created and enforced by other institutions and organizations, through various – and non-legal – enforcement procedures, including diffuse social control, are (and have been) extremely important. This leads here to stress again the importance of "institutional complementarities" for understanding the "nature" and historical transformations of the modern corporation and firm.

interests fairly and impartially” (Blair and Stout, 1999), this leads to another conception of the corporation, closer to the “stakeholder” view.¹⁰⁵

In fact, as we have just seen, the only justification for the dominant position given to shareholders is based on the principle of efficiency, one of the pillars of standard economics. It is argued that shareholder governance and the principle of shareholder value lead to the optimal situation.

This raises at least two types of question:

- Theoretical: is the corporation and, within this framework, the choice of the “shareholder model”, really the most “efficient”? As explained above, the demonstration of this proposition is fragile, to say the least. But in addition, the very concepts of efficiency or optimality used in these analyses (as in almost all mainstream macro- and microeconomics) call for clarification. On this point, let us simply say that it is useful to bear in mind Fligstein’s observation (1994): efficiency is a social construction. The conception of the efficiency of the firm, and the way it is evaluated, evolved throughout the twentieth century, in parallel to the transformation of the large enterprise and capitalism. The shareholder model built its own conception and measurement of efficiency, notably through the formulation of performance indicators, in connection with developments in accounting systems.
- Empirical: the argumentation is based crucially on the idea that in the optimal configuration, the shareholders are the residual claimants, and thus bear the risk of the enterprise’s activity. The paradox is that transformations in management methods, directly inspired by the shareholder view, have had the intentional effect of *reducing the risks borne by the shareholders*, and in parallel, increasing the risks borne by the other major stakeholders in the enterprise (about whom agency theory remains silent): the employees. The management principles that accompany the shareholder model – priority given to paying dividends and supporting share prices; increasing job “flexibility” and wage variability, and the constant reorganization of business units through mergers, acquisitions and disposals – have had the effect of transferring a large share of the risk from the shareholders to the other stakeholders, in particular the employees.¹⁰⁶

In fact, the idea that managers are the agents of shareholders alone – and its corollary of shareholder primacy – appears as an ideological coup, a postulate (im)posed from the start. Agency theory then serves as the justification and legitimization of a profound transformation in the structures and operating modes of large enterprises, within the framework of broader policies of deregulation, development of market finance, and affirmation of the primacy of property, contractual freedom and the free market as the foundations of the economic order.

¹⁰⁵ Which itself raises questions.

¹⁰⁶ Paradoxically, it is in the managerial firm, based on a labor compromise (notably around the wage-profit distribution) and on the priority given to an objective of growth *by self-financing*, that it would be easiest to consider the shareholders’ income – the dividends – as a residual income.

3. Conclusion: two radically different conceptions of the modern corporation, embedded in two different views of what is (or should be) developed capitalism

Beyond the question of shareholder primacy and corporate governance, comparison of Berle and Means' analysis with that of Jensen and Meckling brings to light two alternative representations and theorizations of the large enterprise structured around one or more corporations: as a "social institution", real entity and form of collective action (organization) on the one hand, and as a simple private contractual arrangement – a nexus of contracts – and a particular mode of interaction between individuals, on the other. These two theorizations only assume their full significance when they are examined within the context of the social and political vision that has inspired them. On the one hand there is organized (managerial) capitalism, where the coordination of productive activities and the allocation of resources are increasingly performed by the "visible hand of management", to borrow Chandler's expression, which also radically changes the conditions of competition and the "structure of the free market system" (Means, 1983, p. 467), and where different forms of public action and the influence of counter-powers and the civil society counteract (or seek to counteract) the power of the large industrial and financial organizations. On the other hand, there is the free-market society where the "free" interaction of individuals – based on private property and contractual freedom – is supposed to provide the optimum regulation of the economy and society, in the assumed absence of any problem of power struggles, and where the free market system, assumed to be fundamentally competitive and efficient (in the absence of public intervention) thus remains the central institution of the economy. The table 1 below shows, point by point, how these two visions are opposed.

The opposition between these two visions can be looked at in two ways:

- Either as the opposition between two positive theorizations, both aiming to explain the nature of the firm or corporation. This is the view that economists (more than jurists) like to give of their work, presented as a scientific activity: their concepts and theories simply aim to describe and analyze the economic reality as well as possible. The issue is then to determine which of these two theorizations best explains the characteristics of the modern corporation in contemporary capitalism.
- Or as the opposition between two prescriptive (or, as Michel Callon, 2007, puts it, "performative") representations, in other words theorizations that play a role in constructing the reality they are meant to describe, by influencing the behavior of economic agents and the structure of organizations and institutions. In the present case, the analyses that we have studied do indeed appear to have the conscious

objective of defining and justifying (and imposing) the basic principles on which the organization, governance and purpose of the large enterprise should be founded.

Berle's work, and more particularly his postwar writings, explicitly present both dimensions. His purpose is both to explain how a certain mode of regulation of corporate power was constructed – and thereby propose a positive analysis of the characteristics of post-war managerial capitalism – and to define the principles and modalities by which a corporate system at the service of society can be perfected. We believe that it does indeed provide the basis, still valid today, for understanding the nature of the modern corporation. Moreover, it brings to light the major questions – economic, social and political – posed by the rise of corporate power and, in the current phase of capitalism, the growing weight of financial power.

Agency theory is presented by Jensen and Meckling as a positive theory, aiming to account for the fundamental nature of the firm and the corporation, and to explain why it has become established, through its efficiency, as the dominant form in modern capitalism. As we have seen, there are numerous reasons why this agency theory, and contractual approaches to the firm in general, do not conform to the reality of the large corporation, even when it is managed according to the principles of shareholder value. But it is above all in the “performative” perspective that this theory should be understood, from a historical institutionalist and *political* economic viewpoint. Considering the directors as agents of the shareholders does not relate to the nature of the corporation or to the choice of the most efficient mode of governance; it expresses the choice of what one might, following Orléan (2004), call a “legitimate convention”, deriving from the choice of a certain social order.¹⁰⁷ This view concurs with the idea that the founding principles of corporate law are of the nature of “constitutional” rules: “Corporate law is constitutional law; that is, its dominant function is to regulate the manner in which the corporate institution is constituted, to define the relative rights and duties of those participating in the institution, and to delimit the powers of the institution vis-à-vis the external world” (Eisenberg, 1969).¹⁰⁸ But it still remains to see what it actually means to give shareholder primacy the status of “legitimate convention”. It expresses the fact that certain economic and financial powers have been able to shape “public opinion”, as defined by Berle (the “conclusions of careful university professors, the reasoned opinions of specialists, the statements of responsible journalists, and at times the solid pronouncements of respected

¹⁰⁷ A ‘convention’ is classically defined in economics as a norm or mode of behavior that is followed by almost all the members of a group. A ‘legitimate convention’ also has a value-judgment dimension: it defines behavior *that it is appropriate* to follow. This conception ties in with the notion of *legitimate order* proposed by Max Weber. See Orléan (2004).

¹⁰⁸ This question of the “constitutionalization” of the enterprise has been developed in several works by Robé. See note 99.

politicians”, Berle 1959, p. 113), to establish shareholder primacy as an inescapable norm.

The primary objective of agency theory was to justify and impose new norms of governance and organization of the large enterprise, and to *legitimize*, precisely, on new foundations, the principle of shareholder primacy, by proposing a new representation of the firm. From this point of view, one can safely say that it has largely accomplished its mission, as Hansmann and Kraakman explain so well. But this theory, as one component of a more general contractual and neoliberal vision, has done more than that: it has played a role in the profound modification of the characteristics of the large corporation which is one of the key features of the transformation of capitalism since the 1980s. The transformation of the large modern enterprise, from the integrated, diversified managerial model analyzed by Chandler, into a new form marked by disintegration, the outsourcing of a growing proportion of activities and organization into autonomous profit centers (often subsidiarized) surrounded by networks of subcontractors, has been the result of a combination of different technological, economic and political factors, but it has been in tune with the rise of the contractual and shareholder view.¹⁰⁹ The financial conception, expressed in the primacy of shareholder value, lies at the heart of the transformations of the large enterprise since the 1980s: in its most extreme form, the new “post-Chandlerian” corporation is managed as a portfolio of activities, almost like a portfolio of assets. It is also interesting to see that, in the questions and debates provoked by these transformations of industrial organization,¹¹⁰ the idea has emerged of a decline of the managerial system and a return to the market as the fundamental form of economic coordination; in brief, the revenge of the invisible hand of the market over the visible hand of managers (Langlois, 2004).

The most important issue is then to understand how this new conception of the enterprise and its norms of governance and management has succeeded in imposing itself both at an academic level and in corporate practices. This involves explaining how new ‘legitimate’ representations can emerge and become established, how the norms governing the corporation could have changed from the managerial form, dominant for most of the twentieth century, to the shareholder form which, according to Hansmann and Kraakman, heralds “the end of history for corporate law”. In other words, it is a question of explaining how the legitimacy of a norm and social representation has been constructed and imposed. This is a problem of institutional and political dynamics, since it is clear that one must recognize “the fundamental political nature of the corporation” (Blair and Stout, 1999).

¹⁰⁹ On this point, see Weinstein (2010).

¹¹⁰ See in particular the debate of the 2004 Business History Conference, the most important speeches of which were published in *Enterprise & Society*, vol. 5, n° 3.

Table 1 – Two theoretical frameworks

Berle and the analysis of managerial capitalism	Jensen and Meckling and the contractual theory of the firm
The “nature” of the corporation	
A real entity	A legal fiction – a nexus of contracts
A collective entity	A particular mode of interactions between individuals
A public institution	A private contractual arrangement
Based on “a new logic of property” and increasing separation between property and power.	Based on the fundamental private property foundations of a market economy: well-defined and secure private property rights, and free contracting.
Embedded in a new form of managerial ‘organized’ capitalism (regulatory capitalism in the US; neo-corporatist or coordinated capitalism in Germany)	Component of a pure market capitalism
The leading role of organization. The large enterprise (the “visible hand of management”) is the dominant economic institution in industrial capitalism.	The market is the dominant institution; the corporation (like other types of firm) is a form of ‘private market’.
The issues of ‘corporate governance’	
The rise of managerial power (<i>and of the large corporation</i>): a radical novelty	The delegation of decision rights to managers: a very long-established practice
The managers must act in the interests of the different stakeholders, or of society as a whole (or of the corporation itself).	The managers must act in the interests of the shareholders alone.
Social welfare must be the fundamental objective of the corporation (and/or growth?)	Shareholder value must be the primary objective of the managers.
The central issue is: how can the society control the behavior of the managers (and of the corporation)?	The main problem is to restore and to preserve the freedom of action of the managers. And to align the interest of the managers with the interest of the shareholders.
Internal agreement between stockholders, the external institutional environment – legal and regulatory rules, countervailing power, political and social compromises, and ‘public opinion’ – will control and guide managerial and corporate behavior.	The (deregulated) market environment and the mode of compensation of managers will guide managerial behavior.

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