Alexander Styhre*

The Making of the Shareholder Primacy Governance Model: Price Theory, the Law and Economics School, and Corporate Law Retrenchment Advocacy

DOI 10.1515/ael-2016-0021

Abstract: Shareholder welfare (also addressed as shareholder primacy and shareholder value in the corporate governance and economics theory literature, and here used interchangeably with the more generic term shareholder welfare) has been fortified in the present regime of investor capitalism and is today widely normalized and taken for granted. However, when examining the theoretical tenets, operative methodologies, and stated preferences regarding the virtues of efficiency as a primary economic objective, and wider assumptions regarding alleged costs generated in the corporate system on the basis of managerial discretion and extant corporate legislation and court rulings, the advocacy of the benefits of shareholder welfare is compromised considerably; i. e., it is based on unjustified preferences and far from irrefutable propositions. Tracing the roots of agency theory and its forceful defence of shareholder welfare back to Chicago economics price theory and its application in law and economics scholarship, instituted in the early 1960s, theoretical inconsistencies in the predominant corporate governance model are demonstrated, accompanied by empirical materials that discredit the claim that the market for corporate control can replace, at low cost, the management discretion governance model. The study thus contributes to the critique of the role of shareholder welfare advocacy in investor capitalism.

Keywords: corporate governance, market for corporate control, market efficiency

Table of contents

- 1 Introduction
- 2 From legally- to market-based corporate governance regimes
- 3 Undermining legal theory: Free market advocacy and the law and economics program

*Corresponding author: Alexander Styhre, School of Business, Economics and Law, University of Gothenburg, Business Administration, Gothenburg 40530, Sweden,
E-mail: alexander.styhre@handels.gu.se

- 4 The market pricing model in practice: Is market pricing conducive to increased economic efficiency?
 - 5 Discussion
 - 6 Conclusion
- References

Introduction

Among the many institutional innovations that constitute competitive capitalism, the corporate system, based on limited liability and (in the case of listed companies) dispersed ownership (Williamson, 1981, p. 1537), is arguably the most important vehicle for enterprise and finance capital accumulation and protection. Kaufman (2008, p. 402) refers to the “corporate organizational form” as “one of the defining innovations of the modern era.” The incorporation of a business venture grants certain benefits and privileges, including the legal protection of corporate assets, but corporate assets are also subject to taxation and regulations (Kaufman, 2008, p. 403). As business ventures are collective human activities, there is a need for corporate legislation and corporate governance practices which define the rules and the responsibilities of the business partners and their collaborators and which implement practices in accordance with the legislator’s intentions. Such corporate law statutes need to balance, as Lamoreaux (1998, p. 18) emphasizes, the risks of “laxness and corruption” and the rigidity derived from “excessive regulation.”

Moore and Rebérioux (2011, p. 85) address corporate governance scholarship as “the enquiry into the causes and consequences of the allocation of power within large economic organizations.” Campbell and Lindberg (1990, p. 636) provide a more generic definition, regarding corporate governance as “[t]he institutionalized economic processes that organize and coordinate activity among a wide variety of economic actors.” In contrast to these two social science definitions, La Porta et al. (2000, p. 4) say that, for economists, corporate governance addresses the narrower problem of how “outside investors protect themselves against expropriation by the insiders.” That is, for mainstream economists, the corporation arises, *ex hypothesis*, from market failure since the aggregated transaction costs for organizing the production activities of a firm are lower than the comparable market transactions; i. e., there is a premium on skilled managerial practice. The corporate system in turn creates a governance problem as managers operating inside the corporation may have interests diverging from those of the corporation’s capital investors, i. e., its shareholders. In this view of the firm, corporate governance practices are essentially a matter of ensuring that the investors’ interests are looked after by the assigned

managers, i. e., a question of how to minimize so-called *agency costs* – “the costs of structuring, monitoring, and bonding a set of contracts among agents with conflicting interests” (Fama and Jensen, 1983b, p. 304).

On basis of these premises, the corporate governance literature includes a variety of complementary or competing views of how to govern the corporate system to the benefit of, for instance, economic stability or efficiency. Some scholars and pundits argue in favour of a retrenchment of corporate legislation in order to strengthen the market for managerial control, while others contrastingly argue that finance markets are inefficient at monitoring intra-firm managerial performance.¹ Lipton (1987, p. 7) advocates this latter position and suggests that “satisfactory solutions” to corporate governance problems “cannot be created from abstract formalisms or idealized models of the corporation.” Instead, an effective and considerate corporate governance system needs to examine existing relationships between the corporation’s constituencies and its interests (Biondi, 2013). In the light of these debates, this paper will review the relevant corporate governance literature and demonstrate that the corporate system cannot be effectively governed on the basis of what free-market protagonists refer to as the market for corporate control since (1) the advocacy of market-based control ignores corporate law and existing court rulings, thus increasingly advocating legal reform in order that corporate legislation better conforms to the ideal corporate governance model that benefits shareholder welfare, and (2) the market-based governance model is based on faulty assumptions regarding market efficiency and fails to be substantiated by empirical evidence advocating its underlying axiomatic principle, i. e. that market prices effectively accommodate and reflect the quality of internal managerial decision-making. The former argument will be advanced on the basis of references to existing legal theory scholarship work, while the latter argument draws on a variety of empirical studies, including research into credit rating agencies, finance market trading, and studies of regulatory control on the basis of quantitative data. Taken together, the article provides strong evidence in support of Lipton’s (1987) claim that no efficient corporate governance model can rely solely on one single proposition as regards, for instance, market pricing. Instead, corporate governance practices need to be

¹ The *de facto* market for the control of the corporate system in contemporary competitive capitalism, structured around the principle of shareholder welfare – a term rooted in legal theory (see, for instance, Coffee, 1984) and complemented by more or less synonymous economic theory terms such as *shareholder primacy* and *shareholder value* in the corporate governance and economics theory literature.

negotiated and formalized on the basis of existing heterogeneous actors, interests, and performance metrics. That is, as legal scholars knew from the outset, but was forcefully disputed by economists, who maintained a strong belief in the analytical merits of formalist and mathematized modelling, corporate governance is not primarily a matter of formulating one single master model that can explain all of the variations across situated practices and local contingencies, but of stitching together a serviceable and functional model of governance practices whereby legal statutes, and not market valuations, serve as the foundation of the corporate system.

From legally- to market-based corporate governance regimes

Campbell and Lindberg (1990, p. 636) distinguish between *governance regimes*, i. e. “[c]ombinations of specific organizational forms, including markets, corporate hierarchies, associations, and networks (e. g., interlocking directorates, long-term subcontracting agreements, bilateral and multilateral joint ventures, pools, cartels) that coordinate economic activity among organizations in an industry or economic sector,” and *governance mechanisms*, i. e. either of these individual governance regimes. Practically speaking, the legal theory-based governance regime includes certain governance mechanisms, e. g. *fiduciary duty*, while a market-based governance regime includes other governance mechanisms, e. g. the market pricing of the corporation’s stocks and bonds.

In the turmoil that ensued after the 1929 Wall Street crash, an entirely new governance regime was widely regarded by policymakers as imperative to securing economic growth and prosperity, and, not least, social stability in the US. The New Deal programs initiated by the newly-elected Franklin D. Roosevelt largely set the framework for the corporate governance regime that would prevail well into the 1970s (Fraser & Gerstle, 1989; Hawley, 1966). As the Great Depression indicated that the economic system of competitive capitalism did not embody a sufficient number of self-stabilizing mechanisms, but encouraged the speculation and rampant risk-taking that led to its derailment, the designers of the New Deal corporate legislation tinkered with combinations of regulations and state-governed economic planning, but neither model appealed to the business community (Jones, 2012, p. 93). Ultimately, the Roosevelt Administration favoured regulation as advocated by, for instance, Judge Louis D. Brandeis since this encouraged enterprise and private ownership, but within the stricter regulatory control of the federal state (Carosso, 1970, p. 428).

In 1932, Adolf A. Berle and Gardiner Means published their treatise *The Modern Corporation & Private Property*, one of the “[m]ost influential social-scientific works of the twentieth century” (Moore & Rebérioux, 2011, p. 86), and a foundational text for modern corporate governance for both legal theorists and economists (Weinstein, 2012). *The Modern Corporation & Private Property* was a summary of the work conducted primarily by the legal scholar Adolf A. Berle and addressed the corporate system that had been in existence since the mid-Nineteenth century, and more specifically since the enactment of the principle of limited liability – the principle that corporations were autonomous legal-economic entities, carrying their own risks and protecting their shareholders from costs in excess of the sums invested as shareholder equity in these corporations (Bryer, 1997; Djelic, 2013; French, 1990). In Berle’s view, presented in a seminal *Harvard Law Review* article in 1932, the present corporate system engenders an “[u]nprecedented degree of financial concentration” (Berle, 1932, p. 1366), which in turn makes “the great industrial managers and their bankers” the “princes and ministers” of competitive capitalism. That is to say, Berle (1932) was concerned about the legitimacy of these corporate elites and questioned whom these executives were responsible to: In Berle’s (1932, p. 1372) view, the corporate elite should not merely serve shareholders’ interests, and need to satisfy “[t]he respective needs of investors, workers, customers, and the aggregated community.” Thus, Berle (1932, p. 1372) was calling for regulatory control, a combination of legislation and monitoring, in order to “[c]onstruct the economic commonwealth which industrialism seems to require.”

The system of managerial capitalism developed on the basis of principles of economic enterprise and private ownership, under the regulatory control of the federal state and court rulings (in cases of disputes between corporate constituencies). It led to large-scale oligarchies dominated by executives, but also to a period of unprecedented economic growth and stability in the post-World War II period (Galbraith, 1958). However, despite the socio-economic benefits, including the expansion of welfare state provisions on the basis of the taxable income from employment provided by the corporations, and the accompanying mass consumption economy, there was still a lingering concern that, for instance, executives could not legitimately justify their central position in the corporate system (Kaufman & Zacharias, 1992, p. 525). In the mid-1970s, Berle’s (1932) scepticism regarding the corporate elites resurfaced and was expressed in novel ways. While Berle (1932) had been concerned about executives’ social responsibilities more widely, arguing that these should meet a variety of interests, a new generation of economists and legal scholars were advocating a market-based corporate governance regime based on the idea that the pricing of the corporation’s stocks and bonds was the most efficient

way of minimizing costs to shareholders' for monitoring executives (Manne, 1965, 1967). That is, the new regime reduced the complexity of corporate governance practices and made it an exclusive relationship between the firm's "investors" (as the shareholders were now being portrayed), i.e., the firm's *principals* – a term introduced by Berle and Means (1934/1991) but with a partially different meaning – and their *agents*, i.e., the salaried managers entrusted with the task of maximizing the shareholders' returns. This argument in turn was not a very subtle theoretical argument in favour of the market-based model, instead straightforwardly discrediting existing corporate legislation on the basis of *price theory*, in turn based on the key theoretical proposition that market prices (of, for example, shares or bonds) accommodate and signal available public information.

Corporate legislation developed over time and in response to various political, economic, and legal concerns emerging en route; in the US, corporate law demonstrates a long-term commitment to private ownership and market creation, albeit making central legal theory concepts such as fiduciary duty the cornerstone of corporate legislation (Brudney, 1997; Frankel, 1983). The new market-based corporate governance regime either discredited such legal theory concepts or subsumed them under its price theory argument: "Scholars of non- or anti economic bent have had trouble coming up with a unifying approach to fiduciary duties because they are looking for the wrong things. They are looking for something special about fiduciary relations. There is nothing special to find," argue Easterbrook and Fischel (1993, p.438) in a passage indicative of the new discourse. For Easterbrook and Fischel (1993), fiduciary duty is after all a form of *contract* between two or more parties, and contracts are best monitored on the basis of market transactions: "Contract and fiduciary duty lie on a continuum best understood as using a single, although singularly complex, algorithm." The core of the new corporate governance model is that executives should not be seen as fiduciary officers of the corporation, as prescribed by the legal theory underlying corporate legislation; instead, the shareholders are the firm's principals and the executives the shareholders' agents. More importantly, this declarative statement, based on little more than the argument that fiduciary duty is too imprecise a term, both in everyday dealings and in law enforcement through court rulings, in order to effectively check the decision-making quality of managers, also includes one additional key assumption – i.e. what is beneficial to shareholders is beneficial to *all* economic actors. If the first statement can be disputed on the basis of factual conditions, the second is even less robust beyond the stated preferences that shareholders are entitled to the bulk of the economic value

generated during the corporation's production activities. "[A] manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither," declare Easterbrook and Fischel (1996, p. 38). They continue: "Faced with a demand from either group, the manager can appeal to the interest of the other. Agency costs rise and social wealth falls." Fortunately, Easterbrook and Fischel (1996, p. 38) assert that "[m]aximizing profits for equity investors assists other 'constituencies' automatically." Roe (2000), in the following quote, responds more directly to the questions deriving from this counter-intuitive set of propositions laid out with regard to the alleged socio-economic benefits of shareholder welfare:

Why maximize shareholders' wealth, when shareholders make up such a small and already-favored part of society? One answer is that this is the distributional 'price' for getting good capital allocation. Another is that shareholder wealth roughly proxies for total wealth and *no other norm is*, right now, *plausible* to implement in diffusely-owned firms. (Roe, 2000, p. 553. Emphasis added)

In other words, in the new corporate governance model, the agency costs deriving from the principals' monitoring of the agents' decisions is claimed to be substantial in comparison to other comparable costs, and agency costs can only be minimized for the benefit of *all* stakeholders (i. e., are socio-economically beneficial) if shareholders' interests are secured. On the one hand, Easterbrook and Fischel (1996, p. 183) subsume the legal term fiduciary duty under the pseudo-economic term *contract* without caring to review the elementary legal literature (DeMott, 1988; Howard, 1991). On the other hand, they also fail to discriminate between the corporation's principals (shareholders and creditors, respectively) and the different financial assets they hold (stocks and, for instance, bonds) when responding to highly legitimate critiques of the efficacy of market pricing, the key governance mechanism in their model: "Are markets myopic? Why should they be? ... We know that markets value accurately the long-term payment on bonds: why should the same investors turn myopic when investing in stock?" (Easterbrook & Fischel, 1996, p. 183). The principals holding bonds only need to worry about the corporation going bankrupt during the outstanding contract time, since their rights are clearly specified and essentially independent of managerial decision-making (with the exception of the case stated above); shareholders, in contrast, buy shares to bet on the future and have entirely different interests to bond-holders. In addition, it is conventional wisdom that stock markets are volatile and exuberant (Shiller, 2003).

This new corporate governance regime, strongly advocating shareholder welfare, surfacing during the economic hardships of the mid-1970s, becoming gradually entrenched during the 1980s and 1990s, and triumphantly declared to be the “standard model” during the first years of the new millennium (Hansmann & Kraakman, 2000), was not developed overnight but instead formed part of a more deep-seated critique of the New Deal corporate governance model and all forms of “collectivism” *tout court*. In the following, the intellectual roots of shareholder welfare governance will be examined in some detail.

Undermining legal theory: Free market advocacy and the law and economics program

In the 1930s, free-market protagonists, including heterogeneous groups of liberals, libertarians, conservatives, and pro-business advocates, shared the concern that the crisis regarding competitive capitalism in the late 1920s and 1930s would lead to an excessive expansion of state control of the economy, i. e. monitoring and restricting the interests of capital owners and finance market actors (Jones, 2012; Krome, 1987). They advocated the idea that markets are the most efficient mechanisms for pricing commodities and services, and for allocating resources, channeling transactions, and prescribing policies on the basis of this proposition. However, in the era of Keynesian economic policy, the expansion of the welfare state, and the consolidation of the oligarchic managerial capitalism that would dominate competitive capitalism in Western Europe and North-America for decades to come, there was only marginal interest in their concerns. These free-market protagonists had to rely on private money to finance their collaborative activities and research work, making this community essentially a group of outsiders widely regarded as conservative cranks outside of their close-knit community (Philips-Fein, 2009). Early on, some economists at the University of Chicago became active in these circles and participated in seminars and conferences organized by, for instance, Friedrich von Hayek (Jones, 2012; Krome, 1987).

In the 1950s, a small group of economists relocated to the law school at the University of Chicago and embarked on the reformulation of the legislation as a branch of economic theory. Working under the leadership of Aaron Director – Milton Friedman’s brother-in-law – the Law and Economics School that would take shape at Chicago became a key force in the development of the contractual theory of the firm which, for example, Easterbrook and Fischel (1993, 1996)

would advocate in order to justify shareholder welfare governance. Director was committed to defending what he and other free-market protagonists referred to as *economic freedom*, an abstractly-defined sovereignty based on the ability to operate autonomously of and unrestrained by government legislation or regulation on the basis of one's own calculations and decisions, ultimately based on the virtues of the free market in terms of being the superior calculating and price-setting mechanism – a system of “distributed cognition” that could accommodate and process more information than any comparable and competing mechanism. In real life, beyond the theoretical speculations and proposition-making in favour of the virtues of these ideal markets, this economic freedom translated into an ardent critique of the intellectuals that advocated and defended current policies, naming *equality* as a higher political aim than economic freedom. Their claim associated ‘economic freedom’ with ‘political freedom’ using a fairly complex argument based on a series of propositions and assumptions:

Director's primary objection to the intellectuals he criticised was that they stifled individual freedom because they failed to see the inextricable connection between economic freedom and political freedom. Consequently, they neglected to appreciate that only under a system of voluntary exchange would freedom be maximised; in other words, the division of labor between political and economic institutions had to be preserved. (Van Horn & Emmett, 2015, p. 1451)

In order to roll back the welfare state and its ethos of collectivism, its inefficiencies, and its gradual marginalization of economic freedom, Director and the Law and Economics scholars initiated a program to change the legal framework which largely served as the blueprint for the managerial capitalism regime and the welfare state which was institutionalized in the 1950s and 1960s and which, to this day, despite ceaseless conservative and libertarian campaigning against it, has retained support across the political spectrum (Hacker, 2004; Pierson, 1996). At the core of the law and economics program was rendering legal theory and legislation a matter of translating economic theory, and propositions derived therefrom, into legislation, thereby making disciplinary colonialism in favour of economics a not-so-carefully-veiled vehicle used to accomplish stated objectives. Accordingly, legal theory has traditionally had bestowed upon it the greatest prestige in the American educational and constitutional systems, making, for example, economics its sub-branch, or at least something that must operate within the pre-defined statutes of law. This foundational idea, the law and economics scholars claimed, is mistaken; instead, it is “rational,” “calculative,” and “incentive-driven” economic theory that should be granted the privilege of defining how legislation should be formulated, all to the benefit of the

“economic efficiency” that the Law and Economics scholars held in esteem and rated higher than any other comparable political objectives.

From this perspective, law is understood as a vehicle for shaping incentives and encouraging rational decision-making; such incentives and decisions should be based on what Ronald Coase (1960) referred to as *price theory*, i.e. the theoretical proposition that market pricing is the superior mechanism for processing the available information. Rather than the individual engaging in extensive rent-seeking in order to secure favour in his or her interest, now tolerated or even encouraged by the present political system, price theory suggests that free-market pricing should be the primary, perhaps also the *only*, mechanism for allocating resources and for pricing commodities and services. “The main advantage of a pricing system is that it leads to the employment of factors in places where the value of the product yielded is greatest and does so at less cost than alternative systems,” states Coase (1960, p.40). In addition, law and economics scholars make the assumption that governmental regulation, including not least the court system handling disputes, generates costs that reduce the inefficiency of, for example, the corporate governance system. For Coase, the “governmental administrative machine” can, “on occasion,” be “extremely costly.” A decentralised mechanism may then be more efficient. Although few would dispute the cost of handling, for example, major cases of corporate malfeasance (of which the exemplary case *par excellence* remains the American energy company Enron), only a relatively small number of enterprising activities end up in court. Therefore, Coase argues for free-market advocacy by suggesting that state officials and representatives of the legal system are “subject to political pressures and operating without any competitive check,” and that they are therefore unlikely to “increase the efficiency with which the economic system operates” (Coase, 1960, p.18). It is noteworthy that this declaration, arguably of key importance to the advocacy of market-based governance, is made without any reference to empirical studies. In Coase’s view, federal state officials, of necessity operating outside of “competitive checks” – a statement that is erroneous as US companies are free to choose what state to incorporate in, thus creating a *de facto* market for business charters (Lamoreaux, 1998, p.70) – serve to reduce the efficiency of the economic system and, perhaps equally importantly, do not make the court ruling a matter of referring to market-based pricing or other “rational methods”, instead having recourse to, when no alternatives remain, what Coase (1960, p.43) sneers at as “a matter of aesthetics and morals.”

On the basis of price theory, law and economics scholars thus seek to use their own preferred neoclassical economic theory models as bases for legal theory and legislation. “The new economic approach to political behavior seeks to develop a positive theory of legislation, in contrast to the normative

approach of welfare economics,” write Becker and Stigler (1974, p.1), making welfare economics, in the tradition of University of Cambridge economist Arthur Cecil Pigou, the principal opponent of their theoretical pursuit. This “positive theory of legislation” should “improve incentives” and “reduce costs” in the extant legal system, declare Becker and Stigler (1974, p. 1).

In Davies’ (2010) account, the application of price theory in order to advance an “efficiency of law argument,” and to undermine the legal theory, is essentially based on a methodological dogmatism wherein there is no recognition of any qualitative differences between various economic entities such as a corporation, a family, and an individual seeking employment, and so forth. All these “economic actors” obey the same principles of utility maximization and rational decision-making, claim proponents of price theory, thus making Coase’s and others’ primary legacy a hard-core economic empiricist reductionism that renounces all ontological or *a priori* claims about individuals, the economy and society (Davies, 2010, p. 68). Rejecting any claim that social, cultural, and historical conditions should be considered when modelling economic behaviour, Coase and others provide a stripped-down rational choice model that enables purity in hypothesis formulation, its empirical testing (under determinate and highly restricted conditions), and argumentation in favour of the efficacy of the prescribed methodology. “By coupling methodological dogmatism with ontological agnosticism, Coase is able to explain why it is that the economy sometimes does and sometimes does not adhere to the liberal, free market model,” writes Davies (2010, p. 68).

In the 1970s, the price theory model was complemented by a series of theoretical propositions regarding the accuracy of finance market pricing, including: (i) the Efficient Market Hypothesis (EMH), suggesting that markets are “information-efficient,” i. e., all public information is mirrored in the market price (Fama, 1970), (ii) the contractual theory of the firm, representing an entirely new theoretical model of the firm in terms of being a “nexus of contracts,” i. e., no more and no less than a bundle of contracts held by the firm’s stakeholders, most notably the stock market investors (Jensen & Meckling, 1976), and (iii) agency theory (Fama & Jensen, 1983; Jensen, 1986). Agency theory was essentially the corollary to EMH and the contractual theory of the firm (even through contract theory, represented by different orientations, does not necessarily justify shareholder primacy; see, for instance, Blair & Stout, 1999, who treat the firm as a team production entity based on implicit and actual contracts), and agency theory enacted the firm’s shareholders as the principals of the firm and the directors and top management team as the shareholders’ agents. The agency model also prescribes maximal shareholder value creation

as the only efficiency-generating (and thus legitimate) objective of the firm, leading to the optimization of economic output in the economy. By the early 1980s, the new theory of the firm and its prescribed shareholder welfare governance model was theoretically being developed and successfully advocated in policymaking quarters.

While being agnostic regarding social relations – by and large treating anything “social” as an unnecessary and potentially misleading assumption in both economic-theorizing and legislative work ((Davies, 2010) – the neoclassical economic principle of *efficiency* was applied to judicial matters in the law and economics tradition. In this view, legal disputes need to be understood within the horizon of the efficiency criterion i. e., legal disputes and law enforcement do have a cost. Coase (1960, p.15) suggests that legal disputes tend to involve conditions and information that are irrelevant from an economist’s point of view, i. e., legal officials are ignorant of economic conditions pertaining to a case: “The reasoning employed by the courts in determining legal rights will often seem strange to an economist because many of the factors on which the decision turns are, to an economist, irrelevant” (Coase, 1960, p.15). By and large, proposes Coase, the legal system tends to address the wrong types of questions:

[I]t has to be remembered that the immediate question faced by the courts is *not* what shall be done by whom *but* who has the legal right to do what. It is always possible to modify by transactions on the market the initial legal delimitation of rights. And, of course, if such market transactions are costless, such a rearrangement of rights will always take place if it would lead to an increase in the value of production. (Coase, 1960, p. 15)

Posner (1973, p.401), a legal scholar and judge, points to two types of “legal costs” generated within “the legal dispute-resolution machinery”: (1) “Error costs,” are “the social costs generated when a judicial system fails to carry out the allocative or other social functions assigned to it,” i. e., the cost of sub-optimizing the legal-economic system, and (2) “direct costs,” including the cost of “lawyers’, judges’, and litigants’ time.” In other words, the legislative system and legal enforcement may easily impose efficiency-reducing costs: “[The] mistaken imposition of legal liability, or the mistaken failure to impose liability, will reduce efficiency” (Posner, 1973, p. 401).

The price theory argument and its derivate law and economics program demanded to have the concept of efficiency as its primordial and indubitable principle, the Archimedean vantage point from which the entire economic landscape can be surveyed and rendered meaningful. This principle served to transform legislation into yet another branch of economic decision-making and the optimization of utility:

It is assumed that, if individuals choose to act in a certain way, then this must de jure be the rational utility-maximizing choice. It follows that the status quo is efficient, save where some party exercises wide-ranging powers to transform it. ‘Efficiency’ therefore becomes little other than an empirical term for ‘freedom’, and ‘freedom’ an a priori term for ‘efficiency.’ (Davies, 2010, p. 68)

The Law and Economics school, and what Davies (2010, p.80) refers to as the “Chicago Revolution” more broadly, was thus a strategic project of professional colonization of initially the social sciences and subsequently legal theory and, by implication, legislative practices and court rulings, making virtually any human activity amenable to rational choice calculations aimed at utility maximization. This program presented the contrived disenchantment of human lives into a form of ceaseless and life-long application of individually-developed algorithms for calculating the expectancy values of the available choice options, also in the most intimate spheres of life including marriage, child-rearing, and friendship. This economic program appeared absurd and alien in most people’s experience, but the persistency of its advocacy was greatly rewarded over time, and not least in the domain of corporate governance, where law and economics arguments became commonplace as the century came to an end. Davies (2010, p.63) summarizes the program thus: “The achievement of the Law and Economics school was to convince judges and lawyers, not to mention other economists, that competition policy should be exclusively concerned with the goal of maximizing efficiency.”. Nevertheless, not all legal scholars shared this credo, with Rizzo (1980), for example, rejecting the efficiency benchmark *tout court*:

[T]he substantial information requirements that must be satisfied in order to identify efficient legal rules make efficiency impractical as a standard. Unless the efficiency theorists can show how courts can overcome the difficulties outlined here they will continue to argue for a norm that has little operational content. It is all too easy to show that efficiency leads to desirable results within simplified constructs; it is quite another thing to show what this has to do with the world in which we live. (Rizzo, 1980, p. 658)

For Rizzo (1980), the efficiency criterion is simply unrealistic as it is based on a general-equilibrium argument (see, for instance, Kaldor, 1972) that is untenable.

In one of the foundational texts regarding market-based governance advocacy, Henry Manne (1967, p.270) suggests that much corporate legislation is ineffective and irrelevant and therefore “one is almost tempted to suggest that the large corporation system could and would function substantially as it does if there were almost no state corporation statutes beyond provisions for incorporation.” Hansmann and Kraakman’s (2000, p.455) declaration regarding the triumph of market-based governance at the end of history, more than three decades later, repeated Manne’s statement, calling for legal reform that better complies with the

theoretical models disqualifying extant corporate law on the basis of efficiency claims: “We expect that reform of corporate governance practices will generally precede the reform of corporate law, for the simple reason that governance practice is largely a matter of private ordering that does not require legislative action.” Hansmann and Kraakman (2000, p. 455) announced yet another expectation: “We expect shareholder pressures (and the power of shareholder-oriented ideology) to force gradual legal changes, largely but not entirely in the direction of Anglo-American corporate and securities law.” At this point, theoretical reasoning was unhesitatingly declared to be a more robust basis for corporate governance than existing corporate legislation and law enforcement. Needless to say, this triumphalism concerning the shareholder welfare model was not without its challengers, e. g., the team production theory of the firm, advocated by Blair and Stout (1999) and rooted in corporate law but addressing adequate, practical managerial (i. e., the question of motivation and performance reward issues) and governance issues (i. e., the question of how to distribute the economic value generated) (see also Stout, 2012, 2013). Unfortunately, the proponents of shareholder welfare governance ignored this competing analytical model.

The market pricing model in practice: Is market pricing conducive to increased economic efficiency?

The finance theory that was developed and established as a new dominant paradigm in economic theory in the 1960s and 1970s assumed that the finance markets were a superior mechanism for processing information through the price theory model. The efficient market hypothesis served as the basis for the market for corporate control, the contractual theory of the firm, and agency theory, i. e., the theoretical aggregate of shareholder welfare governance. At the same time, both a substantial body of theoretical literature and extensive empirical evidence disqualify such claims that markets are information-efficient. Economics scholars, such as Shiller (2003) and Akerlof and Shiller (2009, 2015), have emphasized the information asymmetries of markets and pointed to the consequences of unregulated markets, including heightened levels of risk. Other commentators have emphasized either the illiquidity of finance markets (Amihud, 2002; Pitluck, 2011; Weiss & Huault, 2016) or, on the contrary, how excessive liquidity generates market dysfunctions (Rajan, 2006; Morrison, 2005). In addition, empirical evidence indicates a series of behavioural aspects of

finance market trading, including, for example, herd behaviour, which indicates that the efficient market hypothesis does not stand up well to empirical evidence (e. g., Froot, Scharfstein, & Stein, 1992).

The notion that economic efficiency is best accomplished on the basis of market valuation and transactions can be tested against existing market practices, providing an elementary “sink or float” test of the reductionist methodologies used to advance changes in corporate legislation. In the following, a series of empirical studies tests the efficacy of the market pricing hypothesis. As will be demonstrated, market-based pricing and calculative practices are far from infallible, nor do they eschew social factors, making the undersocialized argument in favour of shareholder welfare governance untenable as it rests on erroneous assumptions regarding the alleged efficiency of market pricing. The primary implication is that the vast majority of the arguments in favour of shareholder welfare governance are strictly based on a preference, which in turn is rooted in ideology, for shareholders to benefit at the expense of all the other actors participating in the joint production of economic value and of relevant stakeholders who are external to the firm.

Based on the idea that the finance market actors’ pricing of the financial securities issued by the corporation is a superior control mechanism for enhancing the overall efficiency of the economic system, extant corporate legislation has been discredited as a means of protecting unqualified or incompetent managers. Even though managers were traditionally treated as professionals upon whom fiduciary duties have been bestowed, serving society on a broad basis and thus being regarded as having firm-specific know-how which reduces transaction costs and maximizes economic value, in the new regime of corporate governance advocacy, it was widely claimed that the market knew more than the insiders did (Gordon, 2007, p.1470): “The 1950s tendency was to believe that firms could create and manage markets. By contrast, as evidenced by the growth of disaggregated, networked firms, the 1990s tendency was to use market signals to manage the firm,” argues Gordon (2007, p.1535). More specifically, while the New Deal generation of policymakers regarded the volatility of the stock market as a major concern, in the new regime of shareholder welfare governance, it is the stock market per se that is the solution to “agency problems” (Moore & Rébérioux, 2011, p.88). A key question, then, concerns the extent to which finance market-based actors, such as financial traders and credit rating agencies, adhere to the reductionist and calculative methodologies that are prescribed *ex hypothesis*. In the following, these two professional fields will be examined.

Starting with financial traders, a growing body of empirical studies reveals that finance traders do not exclusively participate in calculative practices

devoid of social influence, including market information, interpretations, and what Zaloom (2006) calls “market gossip.” “The first thing traders learn is that *numbers tell very little*,” writes Zaloom (2003, p. 261). Instead, the official and formal view of finance trading as a legitimate and rational procedure, and not mere speculation or informed guess-work (Ailon, 2014; De Goede, 2005), is that “the numbers” play a key role in creating a veneer of mathematized respectability. Beyond this façade, traders engage in the work of “[e]xploit[ing] the informational ambiguities of numerical information” (Zaloom, 2003, p. 261). That is, continues Zaloom (2003, p. 269), “traders know that market numbers carry social content that cannot be computed.” Therefore, the search for “the hidden values and phantom figures that lurk behind the numbers is the anchor in a global marketplace where the only certainty is instability” (Zaloom, 2003, p. 269). In Zaloom’s (2003, p. 270, note 13) account, finance traders are not so much superior calculators as *informational entrepreneurs* who operate on the basis of their interpretations of ambiguous and inconsistent market information and draw on additional information sources, official as well as informal. Chong and Tuckett (2015, p. 315) confirm Zaloom’s (2003, 2006) fieldwork findings, pointing to how finance traders, on the one hand, access the formal models and algorithms used to calculate a certain future market value, while on the other, drawing on a variety of non-calculative sources that may suggest deviations from this value. The choice of whether to buy an asset or not leads to outcomes which either confirm the accuracy of the calculation, and the choice, or which, in the case of losses, cast doubt on the decision-making procedure after the fact, and thus traders need to emotionally balance and understand how and why they make their decisions to maintain and uphold their professional role confidence: “[T]he investment process itself can be conceptualized as a set of skill-oriented conviction narratives, that is, narratives of decision-making that help fund managers to have belief in their skills when evidence of skill is unavailable,” suggest Chong and Tuckett (2015, p. 315). As an implication regarding the various sources of decision-making on hand for traders, the outcome is highly unpredictable: “If we’re right 55, 60 % of the time, that’s a very good outcome in the industry,” said one finance industry manager (cited in Chong & Tuckett, 2015, p. 315). In addition, the view of traders as “informational entrepreneurs” rather than efficient-calculators-benefitting-from-indisputably-accurate-market-prices implies that their access to information is key to these traders’ work, i. e., their work is informed by social conditions that include, for example, the classificatory system used when rating securities (Zuckerman, 1999), or their sheer familiarity with underlying companies (Hayward & Boeker, 1998), that is to say, traders operate under the same bounded rationality as any other

professional or occupational group, leading to certain biases and outcomes not predicted by extant calculative practices:

[R]esearchers found that corporate managers consistently made superior profits when they dealt with their own company's stock ... that small-firm stocks outperform large-firm stocks, even on risk-adjusted basis ... that firms with high ratios of book value outperformed other firms ... and that there was no significant association between stock prices and expected dividend payouts ... Focusing on investors, research in behavioural finance documented that prices reflected certain cognitive biases such as short-term underreaction and long-term overreaction to information. (Mizruchi & Brewster, 2005, p. 292)

Moreover, standard finance theory and trading models such as the Capital Asset-Pricing Model (CAPM), advanced as predictive science theorems and widely regarded as “the jewels in the crown” of neoclassical economic theory (MacKenzie & Millo, 2003), have been criticized for not standing up well in empirical testing and/or providing overtly simplistic models of underlying assets and the value-creation process (Bhagat, Bolton, & Romano, 2008, p. 1861). In summary, therefore, finance traders, the centrally-located and highly-compensated professional groups that should meet the high standards of efficiency and rationality prescribed by market-pricing protagonists, fail to demonstrate the impeccable calculative practices that robust market-pricing efficiency would enable. Instead, if finance traders make the right decisions in roughly 55 percent of cases (Chong & Tuckett, 2015, p. 315), they would be pleased with the outcome.

Credit rating agency analysts constitute another professional category that not only assesses existing market prices but is also granted the authority to inform the pricing of financial securities. If markets are effectively pricing securities, so that all available risks and opportunities are balanced in the financial security valuation issued by the firm, then credit rating agencies (CRAs), a specific institutional actor in the finance industry providing guidance to finance traders, should be able to accurately predict prices, or at least predict default. The existing literature does not support the thesis that CRAs have such capacities. Instead, the inadequate and in some cases misleading grading of assets seems to be endemic within the trade. Alp's (2013) overview of credit rating quality during the 1986–2007 period, up to the brink of the finance industry meltdown of 2008, reveals that “[t]he mean downgrade-to-upgrade ratio is 1.48 between 1986 and 2007” (Alp, 2013, p. 2444). This means that CRAs overrate financial securities on a systematic basis.

Bolton, Freixas and Shapiro (2012, p. 86) argue that there is a widespread “suspicion” that “rating standards had been relaxed during the boom years” (2002–2006), with “substantial ratings inflation” as the primary consequence. Rom (2009, p. 647) examines the rating of MBOs issued by financial institutes in

the quickly-expanding subprime market during the period, questioning whether or not the poor performance of the CRAs could be explained by naive or willful ignorance, two alternatives equally unflattering for the CRAs: “If the former is true, the CRAs simply did not understand the risks they were assessing; this speaks ill of the CRAs competence. If the latter is true, the CRAs lacked integrity,” summarizes Rom (2009, p. 647). Regardless of the causes of deteriorating credit rating quality, Blinder (2013, p. 80) lists the “dismal performances by the statistical rating agencies” as one of many factors that preceded and contributed to the finance industry collapse. Interestingly, many commentators list social factors (and not strictly calculative and information-processing difficulties) as explanations for ratings failures. The “issuer pays” model (Partnoy, 1999) used in the credit rating industry incentivizes the CRAs to overrate the value of the assets issued by paying clients, providing companies with the opportunity to shop around for a credit rating agency willing to tolerate lower rating quality (Alp, 2013, p. 2455). Clark and Newell (2013, p. 20) suggest that what they refer to as *complicit decoupling* is another social mechanism whereby two or more firms develop trustful relations that lead to a gradual decline in the integrity stipulated on behalf of the CRA and the client – a process similar to what Vaughan (1996) refers to as the “normalization of deviance.”

In response to the critique regarding inadequate ratings, the CRAs have shifted strategy from claiming that they do, in fact, control professional expertise that is superior to other comparable mechanisms for guiding finance investment decisions, to claiming that they are “members of the media” and the “publishers” of market information, making them similar to “journalists” whose ratings are “opinions” about “matters of public concern” (Hunt, 2009, p. 183. See also Biondi, 2011). As a consequence, the CRAs have asserted that the First Amendment thus “[b]ars all manner of efforts to regulate them or hold them liable for the quality of their ratings” (Hunt, 2009, p. 183). Leo C. O’Neill, President of Standard & Poor’s, relied on this line of reasoning in response to the critique ensuing from the notorious Enron bankruptcy:

My view is that [Enron case’s Senate Governmental Affairs Committee’s] report ascribed a watchdog role to S&P that no one, including us, ever intended S&P to have. That’s not our job. We are recipients of the information that is generated by the companies, approved by their auditors, and sanctioned by their legal counsel. (Leo C. O’Neill, President of Standard & Poor’s, cited in Rebérioux, 2007, p. 518)

While the CRAs may be fashioning a journalistic role for themselves when it suits their interests and shielding off critique regarding their prediction skills and integrity, the CRAs remain a major economic power in the regime of investor capitalism, not shying away from dictating even political decisions when they

think they can do so without exposing themselves to risk or critique: “The Big 3 [Standard & Poor, Moody’s and Fitch] are able to kneel governments.” Naciri (2015: xvi) writes: “The S&P [Standard & Poor’s] warning made in the middle of the last turmoil in Tunisia to neighboring governments that if they tried to calm social unrest with ‘populist’ tax cuts or spending increases, they may face a downgrade.” That is, as Partnoy (1999, p. 713–714) stresses, the CRAs are neither journalists nor the providers of informational services that are of vital importance to the functioning of the global financial market; instead, their role is institutional and political, and serves to provide what Portnoy calls “regulatory licenses”:

[Credit rating agencies] have not maintained good reputations based on the informational content of their credit ratings. Instead, the credit rating agencies have thrived, profited, and become exceedingly powerful because they have begun selling regulatory licenses, *i.e.*, the right to be in compliance with regulation. (Partnoy, 1999, p. 713–714)

Putting all the implications aside, with regard to the monopolistic power of the “Big Three” (Standard & Poor’s, Fitch and Moody’s), what they do on an everyday basis has little to do with efficient market pricing. If that had been the case, we would not have been able to see the rating quality deteriorating over time (as demonstrated by, for example, Alp, 2013), and there would have been fewer downgrades *ex post facto* (indicating that the CRAs tend to systematically underrate risk in their original assessments). In other words, if the market-based control of relatively easily-valued financial assets proves to be only modestly efficient, how would firm-specific and internal resources, including, for example, the quality of managerial decision-making, be monitored by market actors?

Thirdly and finally, a host of studies has been provided by management scholars indicating that social factors strongly influence, or even determine, what information is issued to finance industry actors, including the CRAs, further complicating the neat but simplistic argument that finance market valuations accurately measure the quality of managerial decision-making. Most neoclassical economists and law and economics scholars would reject such a view out of hand since such factors are not included in their theoretical framework, and nor do they match the model for the utilitarian calculation of individual benefits; however, the literature provides a strong case in favour of the social embedding of finance market interaction. Westphal and Clement (2008) show that CEOs can prevent or reduce the effects of negative finance market evaluations by threatening finance analysts with exclusion from what Westphal and Clement (2008) refer to as “executive favor rendering,” *e.g.*, gaining access to insiders at the firm who can provide these finance analysts with information that can enhance their capacity to make accurate

stock market price predictions. As such “executive favor rendering” is vital to the professional credibility of the finance analyst, CEO and market intermediaries such as finance analysts forge intimate relations that benefit their interests. This leads to a situation whereby finance analysts demonstrate a “significantly reduced” propensity to downgrade a firm’s stock in response to their announcement regarding “relatively low earnings or diversifying acquisitions” (Westphal & Clement, 2008, p. 888). In other words, CEOs and directors may jointly or individually initiate activities which, in various ways, undermine the free circulation of information that would be of interest to *all* finance traders. That is, for management scholars and students of financial trading, “[e]conomic action is inherently social action” (Davis, 1991, p. 611). In order to understand “how issues of corporate control are resolved,” continues Davis (1991, p. 611), the researcher must “attend to both the incentive structures and monitoring mechanisms within the firm as well as the social system in which corporate action is embedded.” For instance, corporate governance practices are inherently social and thus cannot be accurately captured using some metrics, regardless of the sophistication of the algorithms being devised, propose Bhagat et al. (2008). When examining initiatives to measure the quality of corporate governance in order to benefit the market for corporate control, Bhagat et al. (2008) reject both the underlying propositions of such a pursuit since the relationship between governance and performance is plausibly “bidirectional” rather than “unidirectional,” as stipulated by the model, and because it is technically difficult to define a solid econometric model measuring governance and performance as independent variables. Therefore, Bhagat et al. (2008, p. 1808) conclude, “there is no one ‘best’ measure of corporate governance: The most effective governance institution depends on context and on firms’ specific circumstances.”

Taken together, the belief that finance market actors are able to effectively control the quality of managerial decision-making in order to reduce allegedly substantial agency costs, through the use of the available market information, translated into metrics, is unsustainable. Finance traders do not rely on such figures, but actively seek to decode what lies “behind the numbers”; the credit rating agencies, entrusted with the role of the centrally-located evaluator of the “investment-worthiness” of financial assets issued by market actors, fail to show a high level of precision in their predictions; the work of directors and executives internal to the firm actively shapes and structures what information is released, and to whom, on the basis of social interest. Attempts to code such processes into robust metrics, which separate governance quality and performance into independent variables, have been reported to fail. Therefore the intellectually intriguing thesis that the market (the widespread use of this

anthropomorphism can be overlooked for the time being) *knows more* than the insiders is a corollary from the utilitarian framework and the methodological reductionism of price theory, and its accompanying attempt to undermine the extant corporate legislation for being inefficient and inducing unnecessary costs (the most noteworthy being agency costs) in a predictable way. This thesis is untenable: the price theory and the law and economics proposal to modify corporate law, so that it better complies with the theoretical propositions of price theory, or even to eliminate corporate law entirely (with the exception of rules for incorporation, see Manne, 1967), is unsubstantiated by evidence of the efficacy of finance market control of the quality of managerial decision-making (i. e., the quality of corporate governance). The price theory propositions are simply mistaken and do not justify any retrenchment of existing corporate law.

Discussion

Agency theory has been enormously influential in its advocacy of shareholder welfare governance. While numerous scholars have remarked that agency theory is theoretically inconsistent, unsubstantiated by empirical evidence, and counter-intuitive (Daily, Dalton, & Cannella, 2003; Davis & Stout, 1992; Dobbin & Jung, 2010; Kaufman & Englander, 2005; Lubatkin, 2005; Weinstein, 2013), the governance model proposed appears to have performative qualities (Esposito, 2013; Mackenzie, 2004): “Agency theory must be regarded as a ‘performative’ theory ... rather than a positive one,” suggests Weinstein (2013, p. 46). On the basis of such performativity, agency theorists have constructed an image of the world as its spokespersons would wish it to be, independently of the scientific qualifications and empirical accuracy of the underlying theories invoked in order to justify favoured policies and practices. Agency theory is in turn a branch or a special formulation of price theory and law and economic theorizing, sharing a firm belief in the efficacy of market pricing and, as its principal corollary, the market for corporate control. Critics of the methodological reductionism and orthodoxy of rational choice theories stress that propositions derived from such a theoretical model are “either trivial or false” (Bennet & Friedman, 2008, p. 199), tracing this failure to mistaken assumptions or misconceptions regarding what Bennet and Friedman (2008, p. 199) call the “knowability” and “weightability” of costs and benefits. That is, in the case of the price theorist marching under different banners, the world is all too transparent and its complexity is no larger than can be accommodated by metrics, lending itself to information processing and price

setting, in turn making rational (i. e., rule-based. See Stiglitz, 2010, p. 249) calculative practices the very essence of human behavior. Failure to comply with such calculative practices is dismissed as a deplorable case of irrationality (Bennet & Friedman, 2008, p. 199).

What Campbell and Lindberg (1990, p. 636) name *governance regimes* is key to understanding how corporations are governed. In the regime of managerial capitalism, Marris, 1964,) emphasized the role of the board of directors and their assigned executives, while price theorists and law and economics scholars introduced the concept of transaction costs in order to assess the costs generated by governance activities, including, for example, the legal system. Only by making efficiency the primary objective of the governance regime, and introducing the concept of the transaction cost, can governance practice optimize the use of the available resources. At the same time, the intellectual program aimed at understanding, for example, legislation and law enforcement in strictly economic terms, adhering to the efficiency criteria, was well aligned with the Chicago economic theory tradition of discrediting institutions and agencies that do not primarily rely on market pricing mechanisms (including, for instance, legislative bodies, courts, and regulatory agencies). Unfortunately, this governance regime, based on the price mechanism and calculative practices, is narrowly formulated and excludes most social and cultural explanations regarding expressed preferences and aspirations. Price theory and the law and economics literature render preference concepts such as norms, ideologies, etc., as either irrelevant complications unfit for theorizing or treat them as exogenously given (i. e., they simply exist as some innate quality of the individual, independently of social, cultural, and economic conditions – per se a complicated proposition, see Tversky & Kahneman, 1981) (Ellickson, 1989, 1998). As a consequence, *ex hypothesis*, the shareholder welfare model, derived from price theory and the law and economics program, is justified on the basis of the efficiency criteria and nothing else. That is, the under-socialized price theory is so sparsely formulated that it, as an auxiliary benefit, insulates itself from criticism regarding the very methodological orthodoxy upon which it rests; as social and cultural conditions are excluded right from the outset in terms of being meaningful theoretical categories; such factors cannot be invoked in order to undermine the inherited analytical model.

The institutionalization of the shareholder welfare governance model coincides with a series of worrying tendencies in the capitalist economy, examined in detail in the existing literature: Stagnating economic growth after 1980 (Tomaskovic-Devey, Lin, & Meyers, 2015), stagnating or declining real wages outside of the top 10 percent income strata (and the top 1 percent in particular) (Weil, 2014, p. 16; Zalewski & Whalen, 2010, p. 766; Wolff, 2003, p. 451), substantial growth in economic instability (Calomiris & Haber, 2014), and economic

inequality (Davidson, 2014; Jacobs & Myers, 2014; Lin & Tomaskovic-Devey, 2013; Stockhammer, 2015; Van Arnum & Naples Michele, 2013; Wisman, 2013), with the unprecedented expansion of the finance industry and various exotic financial assets (Abdelal, 2007; Greenwood & Scharfstein, 2013; Krippner, 2011) today being widely-documented features of contemporary competitive capitalism.

One of the most salient implications from the entrenchment of shareholder welfare governance over the last three decades, at the firm level, is the fact that the corporate welfare system built up in the US, as a form of market-based, patriarchal welfare model, a central component of the managerial capitalism regime (Davis, 2010), has been decomposing over time. In terms of health insurance benefits, the proportion receiving health benefits from their employers “fell from almost 42% to just over 26 % between 1979 and 1998” (Hacker, 2004, p. 253). Also, what Hacker (2004, p. 253) calls “retirement security” has been harmed by the new doctrine aimed at benefitting shareholders at the expense of other stakeholders, leading to “a basic decline in employers’ support for retirement benefits”: “Between the early 1980s and the mid-1990s, the value of pension benefits to current workers dropped in every income group, but by far most rapidly among the lowest paid workers, who already had the lowest coverage levels” (Hacker, 2004, p. 255). This policy and corporate decision-making have systemic implications since risks are essentially being “privatized,” but without an accompanying safety net, offering large groups, which not only include the unemployed and “the working poor” (Brady, Baker, & Finnigan, 2013, p. 873) but also growing segments of the middle-class, little option than to have recourse to “debt-fare” – the expansion of private debt to pay for even basic needs (Hyman, 2011; Montgomerie, 2009; Peñaloza & Barnhart, 2011; Zinman, 2015). In addition to increased household debt, poor families are eking out an existence on the basis of whatever means they can access: “[T]he number of pawn shops has grown 50 % since the start of the Great Recession, with over 10,000 outlets in the United States currently,” reports Zinman (2015, p. 258). It is against this evidence that statements such as, “[m]aximizing profits for equity investors assists other ‘constituencies’ automatically” (Easterbrook & Fischel, 1996, p. 38) should be assessed. As Clifford Geertz (1975, p. 22) once noted, at times “some of the most crucial properties of the world are not regarded as concealed beneath a mask of deceptive appearances, things inferred from pale suggestions or riddled out of equivocal signs.” In such cases, when the world can be read like an open book, “the really important facts of life” remain “invisible only to the clever” (Geertz, 1975, p. 22). Indian author and staunch critic of the capitalist economic system, Arundhati Roy (2014), shares this concern – how ideology-turned-into-

orthodoxies conceals “important facts”: “Capitalism’s real ‘gravediggers’ may end up being its own delusional cardinals, who have turned ideology into faith. Despite their strategic brilliance, they seem to have trouble grasping a simple fact.”

Conclusion

When summarizing the contributions made by the Chicago law and economics research work, led by Aaron Director in the 1950s and 1960s, that gradually penetrated law schools and business schools (Ellickson, 1989, 1998), the scholar best epitomizing the authority of this research program, i. e. judge and legal scholar Richard A. Posner (1979, p. 931), sneers that “in some quarters the Chicago school was regarded as little better than a lunatic fringe.” The ideas brought forward in these margins of the legal discipline gradually served as the blueprint for substantial changes to the American and global economies in the decades after 1980. In 2009, Posner (2009, p. 234) was himself able to examine the long-term consequences of new policies, stating ominously that “[c]apitalism may survive only in a compromised form.” Moreover, the 2008 finance industry collapse was “systemic.” (Posner, 2009, p. 236), and the entrenched *lasses-faire* economic regime that had been instituted over time provided the federal government with few alternatives than to delegate the authority Wall Street to repair the crisis it had created (Posner, 2009, p. 239), in turn leading to few systemic changes (Pontusson & Raess, 2012, p. 27). Ultimately, thundered Posner (2009, p. 240), “[t]he financial crisis is indeed a crisis of capitalism rather than a failure of government.” In this debacle, shareholder welfare governance is a key component to consider:

[T]he shareholder value movement produced a perverse set of incentives to reduce total production and perhaps in the long-run total profit, while boosting stock prices and dividend payments on the remaining equity. Our results suggest that financial investment strategies, in concert with the shareholder value movement and CEO compensation strategies reduced the long-term value of the non-finance corporate sector and transferred income to financial service firms and rentier capital in general. (Tomaskovic-Devey et al., 2015, p. 542)

Given the outcomes of the shareholder welfare governance deriving from the price theory and agency theory literature, we should perhaps be thankful that legislative bodies and court rulings have maintained the notion that the rule of law and the courts, granting managers and directors discretion, provides a more robust model for the corporate system than do market-based forms of control

(Eisenberg, 1989, p. 1499; Clark, 1989, p. 1706–1707; Gordon, 1989, p. 1597; Lan & Heracleous, 2010, p. 302). Legislators and courts have thus rejected Manne's (1967), Roe's (1994), and Hansmann and Kraakman's (2000) recommendation to modify corporate legislation so as to grant the market for corporate control further authority (Lan & Heracleous, 2010, p. 302; Clark, 1989, p. 1706–1707; Elzinga, 1977, p. 1204). In hindsight, the notion that shareholder welfare would be beneficial to all constituencies, and to the entire economy, brought forward by price theory and agency theory arguments and accompanied by the claim that the existing corporate legislation and the allegedly overtly “emotional” and “moralist” court rulings (i. e., being prone to consider, economically speaking, irrelevant issues) counteracted the stated goal of maximized economic efficiency (Coase, 1960) and did not create the outcomes its protagonists had anticipated. Quite the contrary, with faltering economic growth, soaring economic instability, and a vastly unequal distribution of the economic value generated in the regime of investor capitalism, even hard-core rationalists and law and economics scholars, such as Richard A. Posner (2009), may lose their faith in the economic system they have legitimized and enforced. One thing that can be learnt from this history of the present economic condition is that under-socialized economic and legal theories are not to be trusted blindly unless these are accompanied by substantial empirical evidence and adequate robustness checks. At the end of the day, armchair theorizing is one thing, while responsible governance conducive to economic growth and stability is quite another.

Funding: This research work has been funded by Bank of Sweden's Tercentenary Foundation, grant number P15-0643:1.

References

- Abdelal, R. (2007). *Capital rules: The construction of the global finance*. Cambridge: Harvard University Press.
- Ailon, G. (2014). Financial risk-taking as a sociological gamble: Notes on the development of a new social perspective. *Sociology*, 48(3), 606–621.
- Akerlof, G. A., & Shiller, Robert J. (2009). *Animal spirits: How human psychology drives the economy, and why it matters for global capitalism*. Princeton & London: Princeton University Press.
- Akerlof, G. A., & Shiller, Robert J. (2015). *Phishing for phools: The economics of manipulation and deception*. Princeton: Princeton University Press.
- Alp, A. (2013). Structural shifts in credit rating standards. *The Journal of Finance*, 68(6), 2435–2470.
- Amihud, Y. (2002). Illiquidity and stock returns: Cross-section and time-series effects. *Journal of Financial Markets*, 5(1), 31–56.

- Becker, G. S., & Stigler, G. J. (1974). Law enforcement, malfeasance, and compensation of enforcers. *Journal of Legal Studies*, 3(1), 1–18.
- Bennet, S. E., & Friedman, J. (2008). The irrelevance of economic theory to understanding economic ignorance. *Critical Review*, 20(3), 195–258.
- Berle, Adolf A. Jr (1932). For whom corporate managers are trustees: A note. *Harvard Law Review*, 45(8), 1365–1372.
- Berle, A. A., & Means, G. (1934/1991). *The modern corporation & private property*. New Brunswick: Transaction Publishers.
- Bhagat, S., Bolton, B., & Romano, R. (2008). The promise and peril of corporate governance indices. *Columbia Law Review*, 108(8), 1803–1882.
- Biondi, Y. (2011). The enterprise entity and the constitution of the American economic republic. *Accounting, Economics, and Law*, 1(3), 2152–2820.
- Biondi, Y. (2013). The governance and disclosure of the firm as an enterprise entity. *Seattle University Law Review*, 36(2), 391–416.
- Blair, M. M., & Stout, L. A. (1999). A team production theory of corporate law. *Virginia Law Review*, 85(2), 247–328.
- Blinder, A. S. (2013). *When the music stopped: The financial crisis, the response, and the work ahead*. New York: Penguin.
- Bolton, P., Freixas, X., & Shapiro, J. (2012). The credit ratings game. *Journal of Finance*, 67(1), 85–112.
- Brady, D., Baker, Regina S., & Finnigan, R. (2013). When unionization disappears: State-level unionization and working poverty in the United States. *American Sociological Review*, 78(5), 872–896.
- Brudney, V. (1997). Contract and fiduciary duty in corporate law. *Boston College Law Review*, 38(4), 595–666.
- Bryer, R. A. (1997). The mercantile laws commission of 1854 and the political economy of limited liability. *Economic History Review*, 50(1), 37–56.
- Calomiris, C. W., & Haber, S. H. (2014). *Fragile by design: The political origins of banking crises and scarce credit*. Princeton & Oxford: Princeton University Press.
- Campbell, J. L., & Lindberg, L. N. (1990). Property rights and the organization of economic activity by the state. *American Sociological Review*, 55(5), 634–647.
- Carosso, V. (1970). Washington and Wall Street: The new deal and investment bankers, 1933–1940. *Business History Review*, 44(4), 425–445.
- Chong, K., & Tuckett, D. (2015). Constructing conviction through action and narrative: How money managers manage uncertainty and the consequence for financial market functioning. *Socio-Economic Review*, 13(2), 309–330.
- Clark, R. C. (1989). Contracts, elites, and traditions in the making of corporate law. *Columbia Law Review*, 89(7), 1703–1747.
- Clark, C. E., & Newell, S. (2013). Institutional work and complicit decoupling across the U.S. capital markets: The work of rating agencies. *Business Ethics Quarterly*, 23(1), 1–30.
- Coase, R. H. (1960). The problem of social cost. *Journal of Law & Economics*, 3(1), 1–44.
- Coffee, J. C. (1984). Regulating the market for corporate control: A critical assessment of the tender offer's role in corporate governance. *Columbia Law Review*, 84(5), 1145–1296.
- Daily, C. M., Dalton, D. R., & Cannella Jr, A. A. (2003). Corporate governance: Decades of dialogue and data. *The Academy of Management Review*, 28(3), 371–382.

- Davidson, P. (2014). Income inequality and hollowing out the middle class. *Journal of Post Keynesian Economics*, 36(2), 381–384.
- Davies, W. (2010). Economics and the ‘nonsense’ of law: The case of the Chicago antitrust revolution. *Economy and Society*, 39(1), 64–83.
- Davis, G. F. (1991). Agents without principles? The spread of the poison pill through the intercorporate network. *Administrative Science Quarterly*, 36(4), 583–613. doi:10.2307/2393275.
- Davis, G. F. (2010). After the ownership society: Another world is possible. *Research in the Sociology of Organizations*, 30B, 331–356.
- Davis, G. F., & Stout, S. K. (1992). Organization theory and the market for corporate control: A dynamic analysis of the characteristics of large takeover targets, 1980–1990. *Administrative Science Quarterly*, 37(4), 605–633.
- De Goede, M. (2005). *Virtue, fortune, and faith: A genealogy of finance*. Minneapolis & London: Minnesota University Press.
- DeMott, D. A. (1988). Beyond metaphor: An analysis of fiduciary obligation. *Duke Law Journal*, 1988(5), 879–924.
- Djelic, M. -L. (2013). When limited liability was (still) an issue: Mobilization and politics of signification in 19th-century England. *Organization Studies*, 34(5–6), 595–621.
- Dobbin, F., & Jung, J. (2010). The misapplication of Mr. Michael Jensen: How agency theory brought down the economy and why it might again. *Research in the Sociology of Organizations*, 30B, 29–64.
- Easterbrook, F. H., & Fischel, D. R. (1993). Contract and fiduciary duty. *Journal of Law and Economics*, 36(1), 425–446.
- Easterbrook, F. H., & Fischel, D. R. (1996). *The economic structure of corporate law*. Harvard University Press.
- Eisenberg, M. A. (1989). The structures of corporate law. *Columbia Law Review*, 89, 1461–1526.
- Ellickson, R. C. (1989). Bringing culture and human frailty to rational actors: A critique of classical law and economics. *Chicago-Kent Law Review*, 65, 23–55.
- Ellickson, R. C. (1998). Law and economics discovers social norms. *The Journal of Legal Studies*, 27(S2), 537–552.
- Elzinga, K. G. (1977). The goals of antitrust: Other than competition and efficiency, What else counts? *University of Pennsylvania Law Review*, 125(6), 1191–1213.
- Esposito, E. (2013). The structures of uncertainty: Performativity and unpredictability in economic operations. *Economy and Society*, 42(1), 102–129.
- Fama, E. F. (1970). Efficient capital markets: A review of theory and empirical work. *Journal of Finance*, 25(2), 383–417.
- Fama, E. F., & Jensen, M. (1983). Separation of ownership and control. *Journal of Law and Economics*, 26(2), 301–325.
- Frankel, T. (1983). Fiduciary law. *California Law Review*, 71(3), 795–836.
- Fraser, S. and Gerstle, G., eds (1989). *The rise and fall of the new deal order, 1930–1980*. Princeton: Princeton University Press.
- French, E. A. (1990). The origin of general limited liability in the United Kingdom. *Accounting and Business Research*, 21(81), 15–34.
- Froot, K. A., Scharfstein, D. S., & Stein, J. C. (1992). Herd on the street: Informational inefficiencies in a market with short-term speculation. *The Journal of Finance*, 47(4), 1461–1484.
- Galbraith, J. K. (1958). *The affluent society*. Boston: Houghton Mifflin.

- Geertz, C. (1975). Common sense as a cultural system. *The Antioch Review*, 33(1), 5–25.
- Gordon, J. N. (1989). The mandatory structure of corporate law. *Columbia Law Review*, 89(7), 1549–1598.
- Gordon, J. N. (2007). The rise of independent directors in the United States, 1950–2005: Of shareholder value and stock market prices. *Stanford Law Review*, 59(6), 1465–1568.
- Greenwood, R., & Scharfstein, D. (2013). The growth of finance. *Journal of Economic Perspectives*, 27(2), 3–28.
- Hacker, J. S. (2004). Privatizing risk without privatizing the welfare state: The hidden politics of social policy retrenchment in the United States. *American Political Science Review*, 98(2), 243–260.
- Hansmann, H., & Kraakman, R. (2000). End of history for corporate law. *Georgetown Law Journal*, 89, 439–468.
- Hawley, E. (1966). *The new deal and the problem of monopoly*. Princeton: Princeton University Press.
- Hayward, M. L. A., & Boeker, W. (1998). Power and conflict of interest in professional firms: Evidence from investment banking. *Administrative Science Quarterly*, 43, 1–22.
- Howard, J. L. (1991). Fiduciary relations in corporate law. *Canadian Business Law Journal*, 19(1), 1–27.
- Hunt, J. P. (2009). Credit rating agencies and the worldwide credit crisis: The limits of reputation, the insufficiency of reform, and a proposal for improvement. *Columbia Business Law Review*, 109(1), 109–209.
- Hyman, L. (2011). *Debtor nation: The history of America in red ink*. Princeton University Press.
- Jacobs, D., & Myers, L. (2014). Union strength, neoliberalism, and inequality: Contingent political analyses of U.S. income differences since 1950. *American Sociological Review*, 79(4), 752–774.
- Jensen, M. C. (1986). Agency costs of free cash flow, corporate finance, and takeovers. *American Economics Review*, 76(2), 323–329.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.
- Jones, D. S. (2012). *Masters of the universe: Hayek, Friedman, and the birth of neoliberal politics*. Princeton & Oxford: Princeton University Press.
- Kaldor, N. (1972). The irrelevance of equilibrium economics. *The Economic Journal*, 82(328), 1237–1255.
- Kaufman, A., & Englander, E. (2005). A team production model of corporate governance. *The Academy of Management Executive*, 19(3), 9–22.
- Kaufman, J. (2008). Corporate law and the sovereignty of states. *American Sociological Review*, 73(3), 402–425.
- Kaufman, A., & Zacharias, L. (1992). From trust to contract: The legal language of managerial ideology, 1920–1980. *Business History Review*, 66(3), 523–572.
- Krippner, G. R. (2011). *Capitalizing on crisis: The political origins of the rise of finance*. Cambridge & London: Harvard University Press.
- Krome, F. (1987). From liberal philosophy to conservative ideology? Walter Lippmann's opposition to the new deal. *Journal of American Culture*, 10(1), 57–64.
- Lamoreaux, N. R. (1998). Partnerships, corporations, and the theory of the firm. *American Economic Review*, 88(2), 66–71.
- Lan, L. L., & Heracleous, L. (2010). Rethinking agency theory: The view from law. *Academy of Management Review*, 35(2), 294–314.

- La Porta, R., Lopez-de-Silanes, F., Shleifer, A. & Vishny, R. (2000). Investor protection and corporate governance. *Journal of Financial Economics* 58(1–2), 327.
- Lin, K. -H., & Tomaskovic-Devey, D. (2013). Financialization and U.S. income inequality, 1970–2008. *American Journal of Sociology*, 118(5), 1284–1329.
- Lipton, M. (1987). Corporate governance in the age of finance corporatism. *University of Pennsylvania Law Review*, 136(1), 1–72.
- Lubatkin, M. H. (2005). A theory of the firm only a microeconomist could love. *Journal of Management Inquiry*, 14(2), 213–216.
- MacKenzie, D., & Millo, Y. (2003). Constructing a market. Performing a theory: A historical sociology of a financial market derivatives exchange. *American Journal of Sociology*, 109(1), 107–145.
- Mackenzie, D. (2004). The big, bad wolf and the rational market: Portfolio investment, the 1987 crash and the performativity of economics. *Economy and Society*, 33(3), 303–334.
- Manne, H. G. (1965). Mergers and the market for corporate control. *Journal of Political Economy*, 73(2), 110–120.
- Manne, H. G. (1967). Our two corporation systems: Law and economics. *Virginia Law Review*, 259–284.
- Mizruchi, M. S., & Brewster, L. S. (2005). Banking and financial markets. In N. J. Smelser & R. Swedberg (Eds.), *The handbook of economic sociology* (2nd ed, pp. 284–306). Princeton & London: Princeton University Press.
- Montgomerie, J. (2009). The pursuit of (past) happiness? Middle-class indebtedness and American financialisation. *New Political Economy*, 14(1), 1–24.
- Moore, M. T., & Rebérioux, A. (2011). Revitalizing the institutional roots of Anglo-American corporate governance. *Economy and Society*, 40(1), 84–111.
- Morrison, A. D. (2005). Credit derivatives, disintermediation, and investment decisions. *Journal of Business*, 78(2), 621–648.
- Naciri, A. (2015). *Credit rating governance: Global credit gatekeepers*. Abingdon & New York: Routledge.
- Partnoy, F. (1999). The Siskel and Ebert of financial markets? Two thumbs down for the credit rating agencies. *Washington University Law Quarterly*, 77(3), 619–714.
- Peñaloza, L., & Barnhart, M. (2011). Living U.S. Capitalism: The normalization of credit/debt. *Journal of Consumer Research*, 38(4), S111–S130.
- Philips-Fein, K. (2009). *Invisible hands: The making of the conservative movement from the new deal to reagan*. New York: W. W. Norton & Co.
- Pierson, P. (1996). The new politics of the welfare state. *World Politics*, 48(02), 143–179.
- Pitluck, A. Z. (2011). Distributed execution in illiquid times: An alternative explanation of trading in stock markets. *Economy and Society*, 40(1), 26–55.
- Pontusson, J., & Raess, D. (2012). How (and why) is this time different? The politics of economic crisis in Western Europe and the United States. *Annual Review of Political Science*, 15, 13–33.
- Posner, R. A. (1973). An economic approach to legal procedure and judicial administration. *The Journal of Legal Studies*, 2(2), 399–458.
- Posner, R. A. (1979). The Chicago School of antitrust analysis. *University of Pennsylvania Law Review*, 127(4), 925–948.
- Posner, R. A. (2009). *A failure of capitalism: The crisis of '08 and the descent into depression*. Cambridge & London: Harvard University Press.

- Rajan, R. G. (2006). Has finance made the world riskier? *European Financial Management*, 12(4), 499–533.
- Rebérioux, A. (2007). Does shareholder primacy lead to a decline in managerial accountability? *Cambridge Journal of Economics*, 31(4), 507–524.
- Rizzo, M. J. (1980). The mirage of efficiency. *Hofstra Law Review*, 8(3), 641–658.
- Roe, M. J. (1994). *Strong managers, weak owners: The political roots of American corporate finance*. Princeton: Princeton University Press.
- Roe, M. J. (2000). Political preconditions to separating ownership from corporate control. *Stanford Law Review*, 53(3), 539–606.
- Rom, C. (2009). The credit rating agencies and the subprime mess: Greedy, ignorant, and stressed? *Public Administration Review*, 69(4), 640–650.
- Roy, A. (2014). *Capitalism: A Ghost Story*. London: Haymarket Books.
- Shiller, R. J. (2003). *The new financial order: Risk in the 21st century*. Princeton: Princeton University Press.
- Stiglitz, J. E. (2010). *Freefall: America, free markets, and the sinking of the world economy*. New York & London: WW. Norton.
- Stockhammer, E. (2015). Rising inequality as a cause of the present crisis. *Cambridge Journal of Economics*, 39, 935–958.
- Stout, L. A. (2012). New thinking on “shareholder primacy,”. *Accounting, Economics, and Law*, 2(2), 1–22.
- Stout, L. A. (2013). Toxic side effects of shareholder primacy. *University Pennsylvania Law Review*, 161(7), 2003–2023.
- Tomaskovic-Devey, D., Lin, K. -H., & Meyers, N. (2015). Did financialization reduce economic growth? *Socio-Economic Review*, 13(3), 525–548.
- Tversky, A., & Kahneman, D. (1981). The framing of decisions and the psychology of choice. *Science*, 211(4481), 453–458.
- Van Arnum, B. M., & Naples Michele, I. (2013). Financialization and Income Inequality in the United States, 1967–2010. *American Journal of Economics and Sociology*, 72(5), 1158–1182.
- Van Horn, R., & Emmett, R. B. (2015). Two trajectories of democratic capitalism in the post-war Chicago school: Frank Knight versus Aaron Director. *Cambridge Journal of Economics*, 39(5), 1443–1455.
- Vaughan, D. (1996). *The Challenger launch disaster: Risky technologies, culture, and deviance at NASA*. Chicago & London: The University of Chicago Press.
- Weil, D. (2014). *The fissured workplace: Why work became so bad for so many and what can be done about it*. Cambridge & London: Harvard University Press.
- Weinstein, O. (2012). Firm, property and governance: From Berle and Means to the agency theory, and beyond. *Accounting, Economics and Law*, 2(2), 1–55.
- Weinstein, O. (2013). The shareholder model of the corporation, between mythology and reality. *Accounting, Economics and Law*, 3(1), 43–60.
- Weiss, H. R., & Huault, I. (2016). Business as usual in financial markets? The creation of incommensurables as institutional maintenance work. *Organization Studies*, 37(7), 991–1015.
- Westphal, J. D., & Clement, M. (2008). Sociopolitical dynamics in relations between top managers and security analysts: Favor rendering, reciprocity and analyst stock recommendations. *Academy of Management Journal*, 51(5), 873–897.
- Williamson, O. E. (1981). The modern corporation: Origins, evaluations, attributions. *Journal of Economic Literature*, 19, 1537–1568.

- Wisman, J. D. (2013). Wage stagnation, rising inequality and the financial crisis of 2008. *Cambridge Journal of Economics*, 37(4), 921–945.
- Wolff, E. N. (2003). What's behind the rise in profitability in the US in the 1980s and 1990s? *Cambridge Journal of Economics*, 27(4), 479–499.
- Zalewski, D. A., & Whalen, C. J. (2010). Financialization and income inequality: A post Keynesian institutionalist analysis. *Journal of Economic Perspectives*, 44(3), 757–777.
- Zaloom, C. (2003). Ambiguous numbers: Trading technologies and interpretation in financial markets. *American Ethnologist*, 30, 258–272.
- Zaloom, C. (2006). *Out of the pits: Trading and technology from Chicago to London*. Durham & London: Duke University Press.
- Zinman, J. (2015). Household debt: Facts, puzzles, theories, and policies. *Annual Review of Economics*, 7, 251–276. doi: 10.1146/annurev-economics-080614-115640.
- Zuckerman, E. W. (1999). The categorical imperative: Securities analysts and the illegitimacy discount. *American Journal of Sociology*, 104, 1398–1438.