British Journal of Industrial Relations
41:3 September 2003 0007–1080 pp. 481–509

Models of the Company and the Employment Relationship

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Abstract

How the company is conceptualized has important implications for employees. Divergent theoretical approaches towards the company are synthesized below to form three models: the ownership, nexus of contracts, and social institution models. The first two endorse current UK corporate governance practice, in which companies are run for the ultimate benefit of their shareholders, who have the exclusive right to appoint the board. The third model questions this arrangement and, more generally, the characterization of the company as a wholly private association. The conclusion examines the implications of the third model for reform of company law and governance in the UK.

1. Introduction

There is no single understanding of the company. In the Anglo-American tradition, companies are viewed as property, or more recently as the product of contracting between the various participants in the business. These perspectives share a characterization of companies as 'private' and hold that they should be run exclusively in the interests of their shareholders. In the continental European tradition, on the other hand, companies (that is, economically significant ones) are regarded as partially public bodies, with constituencies that extend beyond the shareholders to include other groups, such as the employees and local communities. The purpose of this article is not to make a comparative assessment of national company law and governance systems, on which there is a substantial literature (Albert 1993; Charkham 1994; Hopt *et al*. 1998), but rather to examine the ways in which the company has been conceptualized in academic and policy debate in the UK. In so doing, particular attention will be paid to the implications of the various rationalizations of the company for the position of employees.

The article will draw selectively on the literature from a number of disciplines in order to construct three distinct theoretical models of the company,

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the third of which is presented in different versions. The principal aim is to make explicit the sometimes unspoken descriptive and normative premises on which policy prescriptions are based, and to subject these premises to critical evaluation. While organizing the material in this way introduces a risk of distortion, since some arguments defy neat categorization and others span more than one model, it is hoped that the analytical benefits will outweigh this disadvantage. The conclusion expresses a preference for the reasoning that underlies the third model, and outlines some of the implications for the reform of company law and governance in the UK.

2. The ownership model

An influential approach to understanding the company has been that of the property analysis, which remains of importance in the contemporary debate. The notion that shareholders are the owners of the company and as such are entitled to insist that it be run exclusively in their interests is regularly relied on in policy arguments in order to defend the fundamentals of the current governance structure. An example is found in the Cadbury Report on corporate governance, which notes that 'the shareholders as owners of the company elect the directors to run the business on their behalf and hold them accountable for its progress' (Committee on the Financial Aspects of Corporate Governance 1992: para 6.1). Similarly, the CBI, as part of its submission to the Hampel Committee, opposed the idea that directors should be responsible to employees and other stakeholders in the business, since this would derogate from the overriding rights of shareholders as the company's owners (CBI 1996: 8).

The property model rests on an analysis of the relationship between the shareholders and the company, which proponents of the model treat as a proprietary one.[1] The ownership rights that shareholders enjoy over their capital contributions are considered to carry through into the enterprise, so that when shareholders invest they become part owners of the company, or at least of its business (Sternberg 2000a: chapter 2). This notion of shareholder ownership then provides a legitimating basis for the shareholders' right to have the company run exclusively in their interests and to exercise ultimate control. Any deviation from these principles is said to undermine respect for the rights of private property, which require that property be used solely in the interests of its owners. A second and related issue concerns the threat to the liberal order if managers expend shareholder funds to pursue objectives that do not maximize profits but instead conform to their own view of what the public interest requires (Hayek 1960). From this standpoint, the public interest is best served by individuals pursuing their private goals in free competitive markets. Furthermore, allowing the public interest to be defined by an unaccountable group may produce irresistible pressure for the invisible hand of the market to be replaced with the visible hand of state intervention (Friedman 1962: 134).

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From the perspective of the ownership model, the company is a purely private association of shareholders or 'members' (as they are referred to in companies legislation). Employees are 'outsiders', with rights strictly delimited by contract. This model is hostile not only to the reform of company law in favour of employee interests — for example giving them a decision-making role in the firm, or imposing an obligation on management to weigh employees' interests alongside those of the shareholders: it is sometimes relied on as well to oppose the extension, via employment law, of employees' rights beyond those for which they have contracted. According to this view, statutory intervention in the employment bargain is an illegitimate intrusion into the private realm constituted by the shareholders' entitlements as owners (Sternberg 2000b: 60–1).

For advocates of the ownership model, the main policy issue has long been how, in practice, the rights of the legal owners of the company can be enforced in a regime of widely dispersed shareholdings. It goes without saying that those managing companies should be obligated solely to maximize shareholder wealth; the concern is the role shareholders should play in securing this outcome. The tension within this position is that it may lead to proposals for a proactive and prescriptive function for the state in defining and extending the appropriate role of shareholders in governance, for example making voting mandatory (Myners 2001: 89–93; Stapledon 2000: 224–31). This contradicts the emphasis on the company as the private property of shareholders, an interpretation associated with resistance to any attempt to introduce regulations that protect the public interest or define the public responsibilities of the company's members.

Criticisms

It is easy to understand why shareholders might be regarded as owners. They enjoy the right to the firm's residual income and to a share in its surplus assets, if any, on its being wound up. These rights, together with their ultimate right of control over management resulting from their power to remove the board, are important badges of ownership. While it is true that the shareholders own their shares, however, it is clear as a matter of law that they do not own the assets used in the business, which belong to the company as a separate legal entity.[2] Nor can it be said that they own the company itself. The company, as a legal person, is incapable of being owned.[3] The idea that shareholders are owners in the legal sense, therefore, rests on a technical error. In so far as they are owners at all, shareholders are owners by analogy rather than in actuality.

In the case of private companies with closely held shares, the analogy is a strong one. While management and shareholding may be formally separated, in practice they are frequently in the same hands. In such cases the interposition of the corporate structure is largely a technicality, and the shareholder–managers can with some justification regard the company as 'theirs'. In companies with publicly traded shares, however, the analogy is

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more problematical. Here incorporation effects a real, and not just a formal, unbundling of ownership rights (Berle and Means 1967: 8). Crucial rights of possession and use lie with the directors and managers, and with them the right to determine the company's business strategy (Kay 1997). The fracturing of ownership rights that takes place in public companies has led some writers to suggest that it is inappropriate to view their shareholders as owners at all (Kay and Silberston 1995). They are providers of a particular input — capital — who, along with other input providers, such as lenders, employees, and suppliers, have financial claims on the company but do not have a unique status as *owners*. From this perspective, the argument that shareholders are owners because the law affords them rights of control adds nothing, since it assumes what it sets out to prove. The proposition that shareholders are owners because they have control rights, and that because they are owners they *should* have control rights, is invincibly circular (Blair 1995: 223–5).

Even if shareholders could properly be described as owners, there are other objections to the ownership model's attempts to legitimate shareholder exclusivity. Thus, it is questionable whether the moral arguments that are usually relied on to justify protecting private property holdings by conferring legal ownership rights apply in the same way when the property in question is a company. A standard justification for granting property rights is that they are needed in order to attain 'human freedom and security'. Yet it is difficult to see how ownership of companies could be necessary for that purpose (Dallas 1995: 37–8). Second, if a company is property, it is property of a very different kind from 'ordinary' property, such as a house or a car. Companies differ in that the way they are operated has wide implications for other groups and the success of the economy as a whole. The company has been described as

> the central productive element of the economies of the United States and the United Kingdom. The health and stability of these economies depends on the ability of corporations to maintain healthy and stable business operations over the long term and to compete in world markets. The corporation affects the destinies of employees, communities, suppliers and customers. (Lipton and Rosenblum 1991: 192)

In other words, the company is more complex and its effects more far-reaching than the usual subjects of property rights. For these reasons, it can be argued that the case for allowing shareholders to insist that companies be operated in their interests exclusively by virtue of their supposed status as owners is not made out.

Given the various objections that can be raised to attempts to justify shareholder exclusivity by reference to inherent property rights, it is not surprising that a different rationalization for that arrangement has been sought. As the next section will show, rather than relying on a rights-based approach, the analysis that now dominates much of the theoretical literature on the company rests on a consequentialist justification for shareholder-centred governance.

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3. The nexus of contracts model

The notion of the company as an entity that is owned by its shareholders and capable in principle of being directed by them has been the subject of a systematic critique by the 'nexus of contracts' school, which has become the dominant legal and economic perspective in North American and British literature and beyond.[4] Though this approach incorporates a range of opinion, the fundamental insight shared by all protagonists is that the firm should be understood as a contracting site at which the parties to a business enterprise agree the terms on which they are prepared to supply the firm's inputs and on which they are to be remunerated for so doing (Fama 1980). The company is conceived as no more than a vehicle for contracting, that is, it acts as the common party for a series of contracts and avoids the need for cross-contracting between the members of the various groups. As such the company is a fiction, and 'ownership of the firm is an irrelevant concept' (Fama 1980: 290).

Re-conceiving the company in this way transforms the terms on which a number of established debates about corporate governance are conducted. First of all, as the firm as a hierarchy is claimed not to exist, nexus of contracts theorists reject the notion that there is within it an authority relationship between managers and employees. Employees perform only the functions that they have accepted within the terms of their contract: 'to speak of managing, directing or assigning workers to various tasks is a deceptive way of noting that the employer is continually involved in renegotiation of contracts on terms that must be acceptable to both parties' (Alchian and Demsetz 1972: 777).[5] The emphasis here on bargaining and employee consent produces a very different characterization of the employment relationship from that drawn on by those who advocate employee participation in decision-making as a means of reducing managerial domination.

Second, the redefinition of the firm as simply a set of contractual relations is also said to expose the argument that companies owe moral or social responsibilities to the workforce, to third parties or to society in general as 'seriously misleading' (Jensen and Meckling 1976: 311), or as resting on a 'fundamental error' (Fischel 1982: 1273). From the nexus of contracts perspective, a company is in reality no different from a market, and to impute moral responsibilities to markets is incoherent. Contract theorists do not deny that the individual participants in a firm might owe such responsibilities, but whether they do or not is a matter of 'ordinary morality', usually equated with market virtues of truthfulness and promise-keeping. There are no additional obligations owed by companies as institutions. This being the case, much of the literature on corporate social responsibility proceeds from a false premise and is accordingly misconceived.

Third, the contract model addresses an issue that has preoccupied economic and legal theorists ever since the appearance of Berle and Means's *The Modern Corporation and Private Property* in 1932 (Berle and Means 1967). This concerns the implications for the integrity of the ownership model of

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the separation of ownership and control (which comes about as a result of incentive and collective action problems when shares are widely dispersed). The practical problems faced by shareholders in monitoring management are seen as posing a threat to the efficiency and legitimacy of the public company, as well as to the ability of the shareholders to protect their own interests. How can those who own the assets of the company be confident that the managers who control how the assets are employed will not waste or abscond with them? The response of contract theorists is that, since companies are not entities to which the term 'ownership' can meaningfully be applied, the 'separation of ownership and control' is a conceptual error and proposals for corrective intervention are unnecessary and potentially damaging. Clearly, this re-conceptualization of the company does nothing in itself to eradicate the problem of agency costs between shareholder and manager. The impossibility of a complete contractual specification of future managerial conduct means that managers must be given discretion, and it must therefore be accepted that they may make decisions that are contrary to the interests of equity-holders. The essence of the nexus of contracts perspective on corporate governance is, however, that shareholders are aware of this agency problem and will adjust the price at which they are willing to supply capital to managers according to their assessment of the severity of the costs to which they are exposed. The governance arrangements by which managers are proposing to operate the enterprise will thus be a factor influencing the price of capital. It follows that managers have an incentive to offer governance safeguards that will minimize agency costs in order that the company receive capital on competitive terms (or, similarly, that will maximize the price obtained at an initial public offering). These market-induced safeguards may take a number of forms, including disclosure and audit, monitoring by independent directors and managerial incentive schemes. Particular confidence is also placed in the market for corporate control, both as a source of pressure on management to introduce appropriate governance safeguards and as a direct form of management discipline. The functioning of the takeover mechanism depends on the shareholders' ability to control the composition of the board, and it is chiefly through the low-cost option of exit that the shareholders are regarded by nexus of contracts theorists as performing a governance role.

Departing from the conventional assumptions of the property model, with its characterization of the shareholders as owners, has a number of advantages. Regarding shareholders as the suppliers of one of the inputs into the production process, rather than elevating them to the status of the firm's proprietors, fits in more closely with the commonplace observation that shareholders are often completely detached from the decision-making process within companies. Indeed, this detachment is the inevitable consequence of the very specialization that makes the modern corporation an efficient organizational construct. By accepting that shareholders merely own their shares as opposed to owning 'the company', the nexus of contracts approach is said to avoid the pitfall of seeking to cajole shareholders into a role (actively

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monitoring management) that they are ill-suited to fulfil. Instead, shareholders should remain 'rationally ignorant' of the details of the firm's operations and should focus on the function for which they have a comparative advantage, namely supplying capital in a manner that enables them to diversify risk.

Fourth, as well as offering some assurances about the effectiveness of market-induced governance arrangements, and in the course of so doing addressing the legitimacy issue, the contract approach provides an alternative rationale for affording the shareholders exclusive residual control rights. Denying the shareholders the status of owners removes the basis on which allocating these rights to them is traditionally justified. Portraying the company as a joint enterprise involving all the contracting parties invites questions about what the rights of the other parties should be: why should management duties run exclusively to shareholders, and why should shareholders alone be represented within the firm? Put another way, why should governance mechanisms be designed to minimize agency costs arising in the management–shareholder relationship, but not those occurring in relationships between management and other interested parties, not least the employees? The answer given to these questions by the nexus of contracts school is an apparently simple and confident one: affording control rights to shareholders is efficient.

The starting point is the proposition that, as the shareholders are the group best able to bear risk, it is appropriate that they should have the right to the firm's residual income. Because of uncertainty in the returns from the firm's projects, there must be at least one party capable of absorbing the losses resulting from under-performance. The providers of the firm's equity can eliminate firm-specific risk by holding a suitably diversified portfolio of shares, and so are in a better position to perform this role than other groups who are liable to be 'over-invested' in the firm. Accordingly, employees and suppliers, for example, settle for fixed and relatively certain returns, while the shareholders contract for a return that is open-ended. It is treated as axiomatic that the reward for accepting variability is an entitlement to the entirety of any excess returns that the firm may generate.

The rest of the argument depends on the efficient consequences of allocating residual control rights to those who enjoy the firm's residual income. First, the group that faces the greatest risk has the most powerful incentive to monitor management. Since the shareholders stand last in line, but enjoy an unlimited right to the surplus, they are regarded as having appropriate incentives to ensure that management conducts the business with vigour and competence. Second, it is contended that the interests of the shareholders alone, as holders of the right to the firm's residual income, are served by policies that maximize the total value of the firm. Consequently, affording control rights to other groups would not be conducive to value-maximizing behaviour on the part of management. For example, lenders and employees, as fixed claimants, would wish the company to enter into only those ventures that increased the security of their claims, and would be opposed to projects

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that were riskier even if they offered potentially higher returns. Therefore, efficiency demands not only that control rights be allocated to shareholders, but that they be allocated to them exclusively. If it were otherwise, 'people who did not receive the marginal gains would be influencing corporate discretion, and the influence would not maximize the wealth of the participants as a group' (Easterbrook and Fischel 1991: 69).

This analysis does not deny the possibility that the interests of non-shareholders might be harmed by post-contractual opportunism. Managers, for instance, acting in the interests of shareholders, might make an uncompensated increase in the riskiness of the company's existing debt, or lay off employees who had contracted with the company on the assumption that their jobs would be secure. It is argued, however, that it is feasible for these groups to negotiate appropriate contractual safeguards *ex ante*. Thus, it is asserted that 'workers, bondholders, even local communities can protect their interests by contracting for the right to veto future proposed actions by management' (Macey and Miller 1993: 417).[6] Only the shareholders, because their interest in the maximization of the surplus is open-ended, need protection by means of the company's governance mechanisms. As well as their right to control the composition of the board, this reasoning provides a justification for making shareholders the exclusive beneficiaries of fiduciary duties. Because of the problem of contractual incompleteness, to which they are uniquely subject, shareholders require the protection of *ex post* judicial scrutiny of managerial conduct. In addition, there is said to be another cost to conferring discretionary powers on more than one constituency. The well rehearsed problems of aggregating the voting preferences of agents who have different preference rankings is invoked on the basis that restricting access to voting rights to one constituency group is more likely to lead to a consistent ranking of choices (Hansmann 1996: 34–40).

A final consequence of re-conceptualizing the company along the lines proposed by the nexus of contracts literature is that it transforms the role of and perceived need for corporate law. The emphasis put on the optimality of free contracting has meant that statutory requirements which constrain the set of contracting outcomes (each assumed to be welfare-enhancing if voluntarily entered into) are viewed sceptically. Provided markets are allowed to operate without encumbrance, a series of spontaneous market pressures will lead the involved parties to select the optimal set of governance arrangements. Market competition rather than regulation is thus perceived to be the mechanism that upgrades the standards of governance structures used by firms, though it is conceded that company law can enhance efficiency by reducing transaction costs through the provision of standard, 'off-the-peg' terms.

This strand of nexus of contracts theorizing clearly assumes a highly normative bent. Rather than merely seeking to explain the shape of a particular configuration of corporate laws, it is concerned with advocating a particular (non-) system of corporate law. From its perspective, political interventions designed to achieve favoured social outcomes are inevitably welfare-reducing. For example, this is the characteristic response to mandated structures for

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employee participation in enterprise decision-making. That such arrangements are 'rarely seen unless compelled' (Easterbrook and Fischel 1991: 69) is taken as evidence of their sub-optimality. The intended beneficiaries, as well as the shareholders, will be made worse off by regulatory interference, since shareholders will demand compensation for the decline in returns that results when employees have a decision-making role — a lowering of wages or other benefits, or a reduction in employment levels.

There is, however, one fundamental caveat to this anti-interventionist view of company law. On a crucial aspect of the law, and one that is integral to contemporary public policy debates, all proponents of the normative nexus of contracts thesis concur. This concerns the pivotal role that the market for corporate control plays in disciplining management and ensuring that agency problems are minimized. Without a freely functioning market, the pronouncements on the evolutionary-efficient properties of the market system (with regard to governance systems) do not hold. Consequently, nexus of contracts theorists need to support the imposition of a highly elaborate system of company and securities laws which facilitate the 'free' functioning of this market. Under these circumstances, the capital market disciplines management by monitoring its performance (about which information is embodied in share price) and ultimately provides the mechanism through which assets can be transferred to more productive management teams (takeover bids). Similarly, by 'pricing' governance structures, the market creates incentives for management to adopt features attractive to shareholders.

Criticisms

The nexus of contracts perspective provides a powerful means of conceptualizing the company. In its more limited guise it is relatively uncontroversial; it draws on the intuitively attractive idea that a company consists of a bundle of consensual relationships between the various parties that play a role in the enterprise. The wider claims made by nexus of contracts theorists are, however, more problematic. A number of the shortcomings of this approach are picked up in the next section, and indeed form the basis for some of the perspectives examined there. But a few initial objections will be considered in this section in their own right.

First, a cluster of problems centre on the severely reductionist character of the nexus of contracts model, in which the company as an organization is effectively eliminated. Thus, it has been argued that regarding the company as no more than the sum of its contractual components involves a misdescription of the social reality of workplace relations. Employees are not merely participants in a process of continuous contractual renegotiation. The financial and personal costs associated with the termination of the employment relationship mean that managerial authority is a powerful force in their lives (Archer 1995: 44–7; Dahl 1985: 113–16). A rather different point is that the contract model leaves no room for non-contractable, 'organizational'

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elements that many business theorists regard as providing an explanation of an important source of competitive advantage. These include employee and customer–supplier co-operativeness, which tends to evolve over time and depends on trust, and the development of firm-specific and team-based competencies (Blair 1995, 1999; Kay 1993; Lazonick 1997). There is also little reason to be persuaded by the contract theorists' argument that it is incoherent to view companies as bearers of moral and social responsibilities, rather than to treat such responsibilities as reducible to the obligations of the individuals that make them up. Without any need to ascribe moral personality to artificial entities or group actors, the notion of a corporate 'conscience' is a helpful analogue for the processes necessary in complex organizations to ensure that they comply with social regulation and the broader values that underlie it (Gunningham and Rees 1997: 380–2; Selznick 1992: 345–54). It would, for example, be a perfectly rational objective of public policy to seek to 'moralize' the company by mandating the collection by it of information about the societal effects of its operations and the implementation of management systems designed to ensure that company policies are enforced down the line of command. Further, the nature of the issues that companies must address and the potential scale of the impacts of their activities mean that moral precepts that have evolved to guide individual behaviour are of limited assistance in determining what is appropriate corporate behaviour. With these points in mind, the portrayal of the company as a 'market' seems little more than a rhetorical device that obscures the existence of private power and resists the questioning of the terms on which its possession should be regarded as legitimate.

A second set of problems is associated with contract theorists' reliance on the theory of efficient evolution. Although they treat the theory as axiomatic, it is more an article of faith than a necessary truth. As noted, the contract model is not merely an analytical device, a way of thinking about the efficient allocation of risk, returns and control rights in a company. It also purports to provide a descriptively accurate account of how governance arrangements are adopted, which in turn is used to support a normative stance on how such arrangements *should* be adopted. No doubt competitive forces are at work in shaping governance structures, but institutional path-dependency, entrenched self-interest and weak competitive pressure in the relevant markets give grounds for scepticism about the evolutionary theory on which claims about optimality rest. Survival indicates that some threshold of efficiency has been crossed, but not that existing arrangements are necessarily the most efficient ones that are practically realizable, nor that other arrangements with different distributive outcomes might not also have good survival properties. Insistence that a company *is* a nexus of contracts narrows the scope for debate about the role of regulation in these areas by raising strong, but dubious, presumptions about the efficiency of the status quo. The evidence suggests, for example, that mandatory systems of employee participation do not necessarily have the adverse efficiency effects predicted by contract theory (Gerum and Wagner 1998; Streeck 1992: chapter 5). Their failure

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to 'evolve' is as easily attributable to the power of entrenched interests to retain the private benefits of control as to their overall wealth-reducing effects (Freeman and Lazear 1995). Nor does the history of the development of governance mechanisms to protect shareholder interests in the absence of regulatory intervention provide strong support for evolutionary theory (Parkinson 2000).

Relatedly, the normative project of the contractarian theorists supports the notion of a single 'ideal type' of corporate law which emerges as the end-product of an evolutionary process that inevitably and 'naturally' converges on a US-style pattern of corporate ownership and control, a system dominated by liquid capital markets (cf. Roe 1994, but see also La Porta *et al.* 1999; Coffee 2001). Exponents do not see this as a US-centric view of the company. Countries that deviate from the Anglo-American model, i.e. much of the rest of the world, are assumed to do so because of institutional and legal obstacles to the operation of free markets. If these restrictions were removed, such countries would converge on more efficient, Anglo-American practices (Easterbrook 1997). However, this view of the superiority of the Anglo-American system has little empirical support (Carlin and Mayer 2000; Mayer 1997). A more plausible conclusion based on the evidence so far is that systems have different comparative advantages but none is demonstrably more efficient overall (Hall and Soskice 2001: 21). For example, the highly liquid capital market of the Anglo-American system, and the ease of entry and exit from markets and associated restructuring, are strengths in high-tech and other sectors undergoing fundamental change. Sophisticated manufacturing industries that depend on a highly skilled workforce and access to the technological expertise of suppliers, on the other hand, are likely to fare better in more stakeholder-oriented systems. Further, the superior profit performance of the Anglo-American system does not necessarily demonstrate, as is sometimes assumed, its greater economic efficiency in general. There is evidence, for example, that, while UK companies are on average more profitable than their continental European counterparts, they create less value overall and have a lower rate of growth (de Jong 1996; see also Gospel and Pendleton in this issue).

4. The company as a social institution

The major alternative to the approaches discussed so far is the idea that the company is a complex social institution which cannot adequately be characterized through the language of ownership or contract. Instead, this perspective introduces concepts such as citizenship, participation and legitimacy, which depart from the concerns of both private property rights and conventional economic analysis. The suggestion is that these values, which have more usually been applied to non-commercial, social and political organizations, are appropriate too in evaluating the governance of firms and in making recommendations for their reform.

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A number of positions unite the disparate views that fall under the broad 'social institution' heading. The first is a rejection of the relevance of traditional concepts of private ownership to the analysis of the modern corporation. The economic and legal changes that led to the separation of the management of the company from its shareholders are interpreted as being transformative developments, which converted the company from the simple owner–manager enterprise into an altogether different form of organization, which is, and should be, operated according to different rules (see Kay and Silberston 1995: 88). Second, the role of the state in granting the legal privileges that companies enjoy, or, more neutrally, in sustaining the relationships of which companies are made up, is held to introduce a public interest dimension to the operations and internal organization of companies (Parkinson 1993: 25–32). They should be thought of not as purely private associations, but as 'social enterprises', which the state is entitled to shape to secure the public good (Dahl 1972). Third, supporters of the model are preoccupied with the legitimacy of the business corporation. While many advocates of the social institution approach would maintain that it is fully consistent with promoting efficiency (Allen 1992: 272), it is also the case that adherents wish to balance efficiency considerations with a concern for the legitimacy of the company both among its insiders and in the wider social environment. A fourth and closely related point concerns the communitarian origins of some versions of the social entity model. These have evolved as a response to the sense of insecurity and flux that is said to flow from the property and contract models of the company. They reflect the academic and political pressures for an alternative notion of the enterprise to be developed which recognizes values of membership and inclusion.

Legal scholarship has long been aware of the important changes in the conceptualization of the corporate form that occurred in the nineteenth century. From viewing 'the company' as the collective personality of its shareholder-members, the company became an entity in its own right, distinct from its shareholders (Ireland 1996a: 45–8). Similarly, as the size and complexity of the organization grew, the notion that the directors were the agents of the shareholders was abandoned. The board of directors became an independent organ of the company, with the shareholders enjoying rights of intervention only as prescribed by statute or the company's constitution. Recognizing the company's separateness from its shareholders does not necessarily entail any departure from the principle that it should be the shareholders' interests alone that management should advance. In English law no such consequence has followed. It does, however, create the conceptual space for a movement away from shareholder exclusivity. This space has been utilized by a number of writers in the social institution tradition. In the light of similar legal developments in the United States, Dodd (1932), for example, argued that management was entitled to fulfil the company's obligations as a 'good citizen', notwithstanding that this might reduce profits, on the basis that management duties ran to the company as a distinct entity, and not to the shareholders.

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While they have much in common, there are also significant differences in the positions adopted by advocates of the social institution perspective. Three variants are distinguished here: the benign managerial model, the stakeholder model, and the political model.

The Benign Managerial Model

The most widely cited strand of the social institution literature has focused on the role that managers play as trustees of the company's assets for the various groups affected by its activities. As control of the company is held to have been ceded to management, the board of directors is in a position to play a role that is radically different from that envisaged in the classical conception of the firm. Rather than acting exclusively for the benefit of the shareholders, the directors have the discretion to safeguard and balance the various interests that have a legitimate claim on the business (Dodd 1932; Kaysen 1957; Mason 1958). As with other models of the company, the managerial thesis contains both descriptive and normative elements. Some exponents seek to describe the empirical reality of the modern company, while others propose legal and institutional changes that would assist managers in implementing what they hold to be a socially desirable reinterpretation of the management function. Important to both the descriptive and normative aspects of the model is the proposition that, not only have internal constraints on managers become attenuated, but also external competitive conditions are not so restrictive as to eliminate their freedom to adopt non-profit-maximizing courses of action (cf. Ireland 1996b: 304).

The benign managerial model places particular emphasis on the expertise of management in identifying and reconciling the different interests that are bound up with the company (cf. MacIntyre 1985: 74–8). Some supporters of this model view the role of management as being to balance the interests of the parties that are directly involved in the business, including employees, suppliers and customers as well as shareholders. Others stress a more wide-ranging obligation to further the interests of society at large. A less ambitious version of the latter approach refers to the duty of management to ensure that the company act as a 'good citizen' or in a way that is 'socially responsible'. Two themes recur in statements of the normative underpinnings of these positions. One points to the significant impact of corporate decision-making, for good or ill, on affected interests. In markets characterized by limited competition, managers enjoy a real discretion. Exercising that discretion in order to further the interests of shareholders alone is unlikely to be optimal, in terms of either efficiency or social justice.

The second theme disputes the capacity of the state to steer corporate behaviour in socially favoured directions by altering the background legal rules within which business is required to operate. It is tempting to assume that the interests of affected parties and society in general can be protected by changing the external regulatory framework, leaving managers with the relatively straightforward obligation of maximizing profits, subject to

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complying with the relevant legal constraints. While regulation can achieve a great deal, it is argued that bringing about a satisfactory re-balancing of interests is, however, too complex a task for intervention by way of general rules, and requires in addition a 'company-centred' approach (Stone 1975; Teubner 1985).

For several decades prior to the 1980s, the benign managerial position took on something of the status of orthodoxy, at least at a rhetorical level. For example, in the USA the chairman of Standard Oil in 1950 proclaimed that companies should be run 'in such a way as to maintain an equitable and working balance among the claims of the various directly interested groups — stockholders, employees, customers and the public at large' (quoted in Craig Smith 1990: 65). Similarly, in the UK in 1973, in its statement of *The Responsibilities of the British Public Company*, the Confederation of British Industries maintained that companies owed a duty to 'behave like a good citizen in business' (CBI 1973: para. 61). They had 'moral obligations that go beyond the pursuit of profit and the specific requirements of legislation'. Boards should recognize obligations 'arising from the company's relationships with creditors, suppliers, customers, employees and society at large' and strike a balance between them and their obligations to the shareholders (CBI 1973: paras. 22 and 23). Even sections of the political left adopted a favourable view of the motives of managers, accepting that professional management could largely be trusted to pursue the public interest, and that interference in the internal constitution of the company was unnecessary (Crosland 1956, 1962).

To an extent, conflict between the obligation of management to maximize returns to shareholders, still enshrined in law, and the apparently contradictory acceptance of obligations to a broader range of groups can be avoided by invoking the concept of the long-term interests of the shareholders. That is, actions prompted by considerations of social responsibility that are harmful to the shareholders in the short term might be justified by their positive effect on profits over the long term, say because they enhance the company's reputation for fair dealing. It has been pointed out that the short-term/long-term distinction preserves the form of the shareholder-centred model, while permitting 'a considerable degree of behaviour consistent with a view that sees public corporations as owing social responsibilities to all affected by their operation' (Allen 1992: 273). The extent to which managements have been prepared in practice to override shareholder interests under the cover of the long-term shareholder formula is unclear (Fidler 1981). In any event, the rise of the hostile takeover and increased institutional activism, which have the effect of putting managers under greater pressure to maximize 'shareholder value', plus remuneration schemes that link management pay to shareholder returns and heightened competition resulting from the trend towards globalization, together seem to have restored shareholder interests to a pre-eminent position in management thinking (see Armour *et al.* in this issue). Evidence of this can be seen in the willingness to engage in major restructuring exercises from the 1980s onwards, involving, for example,

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acquisitions, share repurchases and downsizing through closures and spin-offs, designed to boost stock market valuations (Froud *et al*. 2000b).

The Stakeholder Model

A different strand of the social entity perspective supports the notion that company decision-making ought to involve a balancing of interests, but questions whether management itself can be an efficient or impartial arbitrator between them. As managers will have their own interests and will pursue the private benefits of control, or may be too committed to the pursuit of shareholder goals, it is necessary that significant stakeholder groups have some opportunity to ensure that their interests are adequately considered. Belief in the benign stewardship of management will not suffice (see Williamson in this issue). Consequently this stakeholder line of argument emphasizes the need for institutions, organizational norms or laws that will ensure that the interests of the various constituencies are reflected in the firm's decision-making. There are a number of different mechanisms or governance arrangements that could be adopted which are consistent with this approach. They include formal representation on company boards, the use of two-tier boards, the explicit incorporation of stakeholder interests in directors' fiduciary duties, mandatory consultation procedures and the use of stakeholder audits as a means of gauging company performance.

One difficulty with the stakeholder approach is identifying the conceptual grounds on which each stakeholder group can claim to have a legitimate interest in the firm. No single allocation of governance rights can be said to follow from the analyses that underpin stakeholder conceptions of the company. Instead, a range of literatures advance a variety of judgements concerning the governance role of different groups. Some approaches reject, in general terms, the moral acceptability of the subordination of the interests of non-shareholders inherent in traditional perspectives on the company. Evan and Freeman (1988), for example, invoking Kant, insist that the various groups in and affected by the enterprise (employees, customers, suppliers and members of the local community) should be treated as ends and not means. Their interests should be regarded as being of equal worth to those of shareholders, and they should have the institutional means (board representation) to ensure that they are protected. Particular attention has been paid to the position of employees. A variety of approaches, many of them eschewing a broader stakeholder analysis, argue that the stake of employees in the firm is at least as great as that of shareholders, and similarly worthy of protection (see Williamson in this issue). Unlike the often well-diversified shareholders, the financial security of employees is dependent on the continuation of their relationship with one particular company, their employer. Dissatisfaction with the traditional means of securing employees' interests, i.e. through collective bargaining, and especially its inability to influence investment decisions and other aspects of business strategy on which employee welfare depends, have prompted calls for internal representation. Recognition of the

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limitations of collective bargaining was an important factor, for example, in the trade unions' acceptance of the case for board-level participation, which led to the recommendations in the Bullock Report (Committee on Industrial Democracy 1977; Clift *et al.* 2000).

It might be noted that some writers, sharing the socially progressive aims of proponents of the social institution model, have sought to define an employee 'stake' and to justify protecting it through the corporate governance structure, by reference to the contractual analysis of the company, but emphasizing deficiencies in the conventional version of that analysis. Thus, it is argued that it is common for companies to give implicit, but not legally binding, promises of continuity of employment. These are of benefit to the company because they encourage the acquisition of firm-specific skills. As they are intended to be, and are, relied on by employees, means should be provided for giving effect to them (O'Connor 1991; Singer 1988; Stone 1993). A different approach points to various transactional problems, such as inadequate information, that lead a company and its employees to enter into sub-optimal explicit bargains. It is argued that employees should be afforded mechanisms that enable them to enforce the contractual arrangements they would have made in the absence of transactional imperfections (Daniels 1993; Howse and Trebilcock 1993). Yet another perspective questions the efficiency argument on which the case for affording primacy to shareholder interests rests, by challenging the view that it is the shareholders alone who are the recipients of the firm's residual income and are exposed to its residual risk. Where employees make firm-specific investments, they are likely to share in the economic surplus generated by the firm, since their bargaining relationship is no longer such that pay will be determined solely by the external market for labour. In this sense their position is not as different from that of shareholders as the conventional economic analysis has it, and they should enjoy corresponding governance protection (Blair 1995, 1999; Kelly and Parkinson 2000). A development of this approach, the team production theory of the company, celebrates the role of an independent board of directors in 'neutrally' allocating rents among shareholders, employees and other stakeholders, as a way of overcoming the incentive problems associated with the non-separability of the outcomes of joint production (Blair and Stout 1999).

The Political Model: The Firm as Private Government

A variant of the stakeholder position contends that stakeholder groups who are particularly affected by corporate decisions should receive the equivalent of political rights which ensure that their views are represented. This approach differs from the previous one in that its bias is participationist; because the firm has power over various groups affected by it, they have a right to be represented. Underpinning this view is the notion that the firm is in some sense a political (as well as social) entity to which the basic notions of democratic theory can be applied (Dahl 1972). Dahl, for example, argues

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that, 'in a certain kind of human association, the process of government should as far as possible meet democratic criteria, because people involved in this kind of association possess a *right*, an inalienable right to govern themselves by the democratic process' (Dahl 1985: 56–7; emphasis in original; see also Waltzer 1983: 291–303). The contention is that companies are a relevant form of 'human association' for this purpose. While it is agreed that the governance of the company is inevitably concerned with balancing the interests of different constituency groups, this view sees no reason why the terms on which this balancing exercise is conducted should be determined solely by managers. Rather, the norms of a liberal democracy should be applied to the internal structure of the firm, ensuring that decisions (which might otherwise have led to conflict between the company and affected interests) can be resolved within the company through political channels. According to this view, the company might then become 'a version of . . . the Republic in miniature' (Chayes 1959). Hence issues of representation, citizenship and the separation of powers become integral to the analysis of, and prescriptions for, the constitution of the firm.

Some writers in this tradition distinguish the position of employees from that of other groups whose interests are bound up with the company. It is argued that employees are uniquely subject to the authority of the organization and therefore should have a right of democratic participation in the firm's decision-making (see Armour *et al*. and Williamson, both in this issue). Other groups, such as customers and suppliers, are affected by the organization's decisions but are not in an authority relationship with it. For them, modes of influence falling short of direct democratic control are appropriate, for example ordinary market mechanisms or consultation (Archer 1995: chapters 1, 2). It may be noted that other advocates of worker democracy deny that proper democratic participation by employees within the capitalist enterprise is attainable. Thus, it has been suggested that 'the essence of a democracy is precisely that all its members should be on the same footing in crucial matters such as the choice of leadership. If an enterprise is necessary binary and two-sided that condition cannot strictly be met' (Oakeshott 1990). On this view, co-determination, for instance, does not satisfy the requirements of democracy, especially since providers of capital, who are not subject to the authority of the firm, have rights of control in it. For such writers the solution is not the reform of the company, but its replacement by fully democratic enterprises subject to the ultimate control of those who work in them.

Criticisms

A familiar criticism of social institution models in their various forms is that within them the objectives to be pursued by management are rendered indeterminate. It is argued that, instead of a single goal of maximizing shareholder wealth, the company has multiple goals of maximizing the well-being of the potentially unlimited groups that are affected by its activities. The interests of these groups will sometimes inevitably clash; and, especially if

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they are to be regarded as being of equal standing, managers can be given no more useful indication of how they should respond than that they should 'balance' the relevant interests, an inherently subjective process. It is conceded that in shareholder-centred models a complex balancing act is also required, but here the organization has a clear substantive goal — shareholder wealth maximization — that can be used to resolve conflicts (Sternberg 2000a: 9). It is argued that the problems are at least as great in versions of the model that involve direct stakeholder participation. Commentators have, for example, pointed to the difficulties of operating collective choice mechanisms where actors have non-homogeneous interests (Hansmann 1993). This is an issue because of conflicts of interest both between constituencies and within them. There are, for instance, divergences of interest between employees based on such factors as age, skills and location. The danger with the model in its various forms is, then, that increased complexity and likely delay in decision-making, together with confusion over corporate objectives, would seriously detract from the wealth-creating capacity of the company. Not only that, but doubts have been expressed about the ability of revised corporate governance mechanisms to safeguard the interests of the intended beneficiaries. Ideally, all groups on whom the company has a significant impact should have some sort of representation in the firm if a defensible balancing of interests is to be achieved, but identifying and facilitating representation for all affected interests would be likely to prove impossible. There is in addition a danger that policy outcomes would be either arbitrary, being dependent on the bargaining strength of particular constituencies and the shifting composition of coalitions between them, or else little different from current ones, given managements' superior access to information, the ability of managerial insiders to set the company's agenda, and their greater expertise in the practicalities of running the business.

A second and related criticism is that the social institution model is incompatible with effective managerial accountability. The argument is that, since the organization's objectives would to a greater or lesser extent be indeterminate if the model were implemented, it would be impossible to devise clear standards against which management performance could be judged. Even though evidence about financial outcomes would still be available, financial performance would no longer be the sole relevant criterion. Management might thus seek to excuse inadequacies in that or any other area by reference to the company's success in fulfilling some other goal. Since there is no demonstrably optimal way of balancing relevant interests, it might prove impossible to establish that management performance overall was sub-standard. This being the case, managers are in a position to exploit their relative freedom from control at the expense of shareholders and other stakeholders. Concern about the accountability problems associated with the social institution model has long been expressed. It is reflected in Berle's often cited comment that 'you cannot abandon emphasis on "the view that business corporations exist for the sole purpose of making profits for their stockholders" until such time as you are prepared to offer a clear and reasonably

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enforceable scheme of responsibilities to someone else' (Berle 1932: 1397, quoting Dodd 1932). It may be noted in this connection that policies that are presented as having the objective of protecting the interests of stakeholders have in some contexts been interpreted as a cloak for entrenching managerial autonomy. The adoption of non-shareholder constituency statutes by American state legislatures, which sanction the implementation of takeover defences that may have the effect of insulating companies and their managements from the market for corporate control, have attracted a 'public choice' type analysis of the role of management in using political channels to obtain these measures (Macey and Miller 1993: 419–21; Roe 1994: 160–8; cf. Orts 1992).

While identifying genuine problems, these criticisms can be overstated. The indeterminacy point is well made on both practical and conceptual grounds in relation to general injunctions to managers to serve 'the public interest'. An acceptance that there should be constraints on profit maximization additional to those imposed by external regulation in order to protect the interests of non-shareholders does not, however, give rise to the same radical indeterminacy as a requirement to replace profit-making with an open-ended commitment to secure the welfare of relevant constituencies. While stakeholder theories that regard all affected groups as having equal claims to participation in the organization seem incapable of providing a blueprint for a workable form of business enterprise, a recognition that stakeholders have different types of interest that it is appropriate to protect may make it possible to avoid intractable problems of institutional design. With regard to accountability, there seems no reason in principle why management performance cannot be effectively evaluated by reference to multiple standards. What is required is an independent process of review that is capable of discriminating between management actions that result from incompetence or the pursuit of self-interest on the one hand, and those motivated by attempts to accommodate the legitimate interests of affected parties on the other (Kay and Silberston 1995: 93–5). A suitably constituted supervisory board, or a single-tier board with an independent and appropriately diverse non-executive element, might be one way of providing this function.

5. Conclusion

Despite the many conceptual and practical criticisms that can be made of the social institution model of the company, it derives its strength from its challenge to the notion, present in both the property and the nexus of contracts models, that the company is mainly, or even wholly, a private association with which the state ought to have very little to do. The social institution model turns that view on its head by arguing that the company is at least partly a public association created by the state. This position takes the company out of the realm of purely private property and contract and requires the state, on behalf of the community, to make a series of moral decisions as to what

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the appropriate rights and obligations of different constituencies within the firm should be, and to ensure that company law reflects those judgements. Framing the company in these terms opens up the parameters of the debate on corporate governance, corporate responsibility and the place of employees within the firm, and invites greater contestation of the appropriate norms by which companies are constituted and regulated.

As discussed in the previous section, those who invoke the social institution model often do so in support of a radical reform agenda. Acceptance of the general theoretical assumptions on which the model rests does not however necessarily lead to the conclusion that in practice a fundamental recasting of the company would be desirable. Whatever the attractions in principle of extending governance rights to employees, or more broadly of adopting a stakeholder-oriented system, there would be severe practical difficulties in making such arrangements work in the UK context. The effective incorporation of non-shareholder interests into the governance function would require a major redesign of corporate decision-making structures to permit participation by the relevant stakeholder groups. Less radical changes, such as modifying directors' duties to allow, or even require, management to serve a wider range of interests than those of the shareholders, would probably not have a significant impact in practice, given difficulties over enforceability and the realities of shareholder power (Parkinson 1993: 369–72). Yet the bolder course of adopting participative mechanisms would not be a straightforward matter. Functioning systems of stakeholder governance are embedded in a wider set of supporting institutional arrangements (Hall and Soskice 2001). In Germany, for example, there is a tradition of pay determination at industry level, thus reducing the scope for conflict at enterprise and plant levels that could undermine effective employee involvement in decision-making. There are also complex networks of trade associations that help secure the integrity of long-term customer–supplier relationships, as well as a close monitoring of company performance by banks and industrial shareholders with large percentage holdings, thereby ameliorating management accountability problems. Without equivalent agencies for these institutional features, there is a danger that a move away from a shareholder-exclusive model would be ineffective, and/or would be achieved at a high price in terms of reduced economic efficiency. This is problematic, because it is not obvious how background support structures necessary to facilitate the operation of companies with a stakeholder orientation could be created through public policy interventions. The difficulties may not be insuperable, but they point to the advantages of first seeking to strengthen mechanisms for stakeholder protection that operate outside company law. As far as employees are concerned, the implementation of the 2002 European Directive on informing and consulting employees will be an important step in this direction (DTI 2002a; see also Armour *et al.* in this issue).

Although a radical transformation of corporate governance structures may be inappropriate, the social institution model nevertheless has important implications for how the UK's shareholder-centred system should be

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evaluated and, if necessary, reformed. If the company is viewed as a form of public body, albeit under private control, it is legitimate for the state to insist that directors and managers be subject to a level of accountability commensurate with the power that they possess. This has implications both for internal control mechanisms serving conventional governance objectives, and for a broader social responsibility agenda.

As to the first of these, ensuring that appropriate mechanisms of internal accountability are in place should not simply be left to shareholder–manager 'contracting'. There is, for example, a clear public interest in questions such as the role, powers and standards of independence of non-executive directors, given the importance of these issues to ensuring that companies are being honestly and efficiently managed and that conflicts of interest, particularly over pay, are effectively being controlled. Until comparatively recently, board structure and composition were left entirely for companies themselves to determine. Since 1992 and the report of the Cadbury Committee (Committee on the Financial Aspects of Corporate Governance 1992), these matters have been subject to a form of regulation, in the sense that (for listed companies) there is an obligation to disclose the extent to which the company observes the guidelines, now contained in the Combined Code on Corporate Governance (Parkinson 2000). Aside from questions about the effectiveness of this form of enforcement, the rules were drawn up by private-sector bodies with strong business representation, and whether or not they have created a sufficiently rigorous governance framework is open to serious doubt. For example, notwithstanding the requirement for a nomination committee, non-executives are often selected by executive management, and responsibility for appointments rests with what is usually a management-dominated board. It is unlikely that directors chosen in this way would be sufficiently independent to exercise an effective monitoring role (Franks and Mayer 2000). The recent proposals for a series of amendments to the Code by the government-sponsored Higgs review — in particular the expectation that boards have a majority of independent non-executive directors — and the strengthening of the roles of the audit and nomination committees give some cause for optimism (Higgs 2003). Should more prescriptive intervention prove to be necessary, however, then, from the social institution perspective, the state has a clear entitlement, and indeed obligation, to act.

With regard to issues of social responsibility, the contractual analysis of the company causes the adverse social and environmental impacts of corporate behaviour to be seen simply as externalities to be addressed by the regulatory framework to which all businesses are subject, but without implications for the objectives of the company itself or the design of corporate governance mechanisms. The social institution model, in contrast, takes more seriously the organizational reality of the company, its power and the magnitude of its impacts; correspondingly, it supports a public policy agenda that focuses on the company's own decision-making processes, in addition to the external regulatory controls to which it is subject. In addition to a recognition of the problems of securing compliance with regulation by complex

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organizations (including issues of corporate culture and the time-scale according to which decisions are made), there is an awareness of the limitations of regulation (be it 'command and control' or fiscal or economic instruments) in achieving policy objectives, and the need for self-regulatory responses that go beyond mere compliance with externally mandated controls. One approach sees an important role for market and civil society actors in applying pressure on companies to improve their social and environmental performance, and invites consideration of the ways in which government intervention might stimulate or increase the effectiveness of these pressures, for example through mandated social and environmental disclosure (Parkinson 2003).

The social institution model also offers a more subtle challenge to shareholder-centred company law. From the model's perspective, making profits for shareholders is not an end in itself. Rather, in so far as a requirement to afford priority to shareholder interests is justified, it is as a means of serving the public interest (on the assumption that acting for the long-term benefit of the shareholders is the best way of maximizing the wealth of society as a whole). There are signs, however, that a gap has opened up between contemporary perceptions of what shareholder interests are and how they should be advanced on the one hand, and the wider public interest on the other. The rise of the takeover market and increased reliance on executive share options and other forms of performance-related pay have sharpened the incentives for directors to focus directly on maximizing current share prices, rather than to manage with a view to building a strong business over the long term, with good returns for shareholders viewed as a consequence of that strength (Kay and Silberston 1995). This change in emphasis has been rationalized by reference to the philosophy of 'shareholder value', as refined via a range of proprietary metrics supplied by consultancy firms (Froud *et al.* 2000a). Maximizing shareholder value affords priority to the demands of the capital market, and thus, according to its supporters, promotes the efficiency of the corporate system as a whole by ensuring that capital is directed to its most efficient uses. The resulting 'financialization' of management goals has undoubtedly prompted a major, and seemingly continuous, restructuring of the corporate sector, involving financial restructuring (e.g. share buy-backs and increased reliance on debt), takeovers, spin-offs, downsizing and general cost reduction (Froud *et al.* 2000b). The extent to which these measures are successful in their own narrowly financial terms is debatable. The evidence on the effects of takeovers, especially for bidders, suggests that many of them are ill conceived (Gugler 2001: chapter 4). On the other hand, the social dislocation that restructuring involves, and the costs borne by employees and other stakeholders, are obvious. A number of commentators have drawn attention, furthermore, to the danger that a preoccupation with short-term share price will undermine the conditions for innovation and human capital development, and with it the long-term competitive strength of the enterprise and the economy as a whole (Hutton 2002: chapter 7; O'Sullivan 2000).

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There is some recognition of the unwelcome consequences of this shift in emphasis in managerial objectives, and the broader social responsibility agenda, in the proposals contained in the Government White Paper, *Modernising Company Law* (DTI 2002b), which largely follow the recommendations of the DTI-sponsored Company Law Review. The proposed statement of directors' duties (to be contained in a new Companies Act), while retaining the principle of shareholder priority, refers to an obligation to *promote the success of the company* for the benefit of the shareholders, giving support to the idea that shareholder returns should be viewed as the result of running a successful business, rather than an end to be maximized directly. The statement also stresses the need for directors to have regard to the long-term consequences of their actions, to foster the company's relationships with employees and others, to have regard for the company's environmental and community impacts and to protect its reputation (DTI 2002b: 26–27; Company Law Review Steering Group 2000a: 22–37; 2000b: chapter 3; 2001: Annex C). In addition to the statement of duties, the White Paper also proposes a regime of wider company reporting, by way of a mandatory operating and financial review ('OFR') (DTI 2002b: 38–40; Company Law Review Steering Group, 2000a: 180–91; 2000b: chapter 3; 2001: 48–55, 180–93). The objective is to enable shareholders to make an informed assessment of the company's operations, financial position, future strategy and prospects. The OFR should also make more transparent the extent to which directors are complying with the obligations in the statement of duties — facilitating, for example, an evaluation of the company's performance in dealing with the social and environmental challenges that it faces. It is intended that increasing the accessibility of information of this kind will encourage institutional investors to factor social and environmental considerations (where they have financial implications) into their investment decisions, and in appropriate cases to engage with managements to improve performance in these areas. This follows on from attempts to stimulate investor interest in social responsibility issues via amendments to the Pensions Act in 1999, which require pension fund trustees to disclose the extent to which they take social, environmental and ethical considerations into account in their investment policy and decisions about engagement (see Pensions Act 1995, s. 11A, added by the Occupational Pension Schemes (Investment, Assignment, Forfeiture, Bankruptcy etc.) Amendment Regulations 1999, SI 199 No. 1849). While OFR disclosures are aimed primarily at shareholders, they will also provide an opportunity for all stakeholders to assess company policies and performance, potentially increasing the market and civil society pressures that companies face.

How effective these reforms are likely to be in refocusing managerial attention on the long-term needs of the enterprise, its relationships with employees and its broader impacts remains to be seen. It may be that wider structural changes to reduce short-termist pressures, for example reigning in the market for corporate control and more robust action against remuneration schemes that set perverse, near-term incentives, may also be needed. It may also be

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that the proposed wider disclosure requirements will need to be supplemented, by provisions that address more directly the information needs of non-shareholders. In the meantime, it is suggested that the contract metaphor, which has been used to depict the company as nothing more than a sequence of market transactions and to legitimate the maximization of shareholder value as an end in itself, does not provide the conceptual underpinning for the kind of debate on the future of the company that is required. The social institution model, which emphasizes the role of public policy in shaping corporate governance and recognizes the character of the company as a complex organization, offers a more fruitful way forward in both analytical and policy terms.

Final version accepted 14 April 2003.

Acknowledgements

I am grateful to Andrew Gamble and Gavin Kelly for their assistance with an earlier draft of this paper and for the comments on an earlier draft of the paper from an anonymous referee and the editors of this symposium. The usual exclusions apply.

Notes

1. The model examined here is a rights-based model. That is, it takes the shareholders to be morally entitled to be treated as owners of the company by virtue of their ownership rights in their capital contributions. This position should be distinguished from that adopted by exponents of the economic property rights theory of the firm, which analyses the firm in terms of the efficient allocation of property rights (e.g. Hansmann 1996: especially 11–16; Hart 1989; Hart and Moore 1990). From this perspective there is no necessary connection between the ownership of the company and the contribution of capital. While defending an exclusive governance role for shareholders, it does not therefore regard them as possessing an antecedent right to be treated as owners.
2. It was established in *Bligh* v. *Brent* (1837), 2 Y & C Ex 268, that shareholders have no proprietary interest in the company. See also *Short* v. *Treasury Commissioners* [1948], 1 KB 116, at 122, per Evershed LJ: '[s]hareholders are not, in the eye of the law, part owners of the undertaking. The undertaking is something different from the totality of the shareholdings'. The earlier position had been that in an incorporated company, while legal title to the assets was in the company, beneficial ownership was vested in the shareholders (Ireland 1996a).
3. It has been noted that at law the 'company itself is treated not merely as a person, the subject of rights and duties, but also as a *res*, the object of rights and duties' (Davies 1997: 301). Once it is accepted, however, that the shareholders do not own the company's assets, and that the company itself has the status of legal person, the idea that the company is a *res* as well seems either empty or a contradiction.

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4. Some care should be taken to disentangle the undiluted nexus of contracts perspective that is the focus of this section from the approach taken by transaction costs theorists, who accept that the firm is a bundle of contracts between different actors, but supplement this with the view that the firm exists as a hierarchical entity with an institutional content above and beyond the terms of the contracts agreed by its constituents. See Coase (1973) and Williamson (1985, 1996).
5. This is not, however, the position in the transaction costs version of contract theory. Here, the position of authority in which the company stands towards employees is a defining characteristic of the firm.
6. Their argument is that such protection is technologically feasible, not that it is necessarily obtained in practice. Non-shareholder groups may be deterred from contracting for protection because they are unwilling to pay the price demanded: Macey and Miller (1993: 417–18). It should be noted however that, in what might be labelled the *institutional* nexus of contracts literature (i.e. that which recognizes that the firm exists as an substantive entity with an internal hierarchy), it is sometimes stressed that non-shareholder groups will utilize collective action in order to ensure that it is rational to enter into (implicit) contracts with firms. Thus, Williamson (1985: chapter 10) suggests that employees can police their implicit contracts by unionizing.

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