Corporate Governance:
An Institutionalist Approach

edited by

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Introduction

Robert Cobbaut

The contributions gathered in this collection of papers stem from interdisciplinary research on the question of corporate governance undertaken by: the Centre de philosophie du droit (Centre for the Philosophy of Law) at the Catholic University of Louvain (Belgium); some of the research groups united in FORUM (Fondements des organisations et des régulations de l'univers marchand – Basics in the organizations and regulations of the market world) a National Council for Scientific Research (CNRS) laboratory at the University of Paris X – Nanterre (France); and the Centre for Business Research of Cambridge University (United Kingdom)[1].

The common goal of the authors gathered in this book is to call into question the manner in which the problematic of corporate governance is commonly posed, both in the academic and the managerial literature. The points of view from which the various authors carry out their discussion, if not identical, converge and complement each other enough that we can call them institutionalist without betraying them.

The managerial discourse on corporate governance is probably the most revealing of the manner in which the question is commonly understood. This discourse presents corporate governance as a codified set of normative principles of a universal, at times even immutable, nature, and never as a complex problem in which the elements, as well as the solutions, vary depending on the time, place, and situation. This type of answer to a question that seems so incredibly obvious that it is no longer necessary to formulate it reflects the way in which dominant economic theory has 'stylised'[2] this problematic, one that was initially modelled on the strict framework of a substantive[3] understanding of rationality. To adopt such a posture in economics, understood in this instance as a normative theory of rational choice, has two major implications: the possibility to reduce uncertainty to numerical probabilities and the possibility to optimise, which presupposes an exhaustive knowledge of the events that may potentially influence the results of the

[1] These works would not have been possible without the support of various public research programs, among which we should mention the 14th Program 'Pôles d'attraction interuniversitaires' (PAI), of the Service des affaires scientifiques, techniques et culturelles (SSTC) of the Belgian Federal Government, and the Commissariat Général du Plan de la République Française. Some of the contributions to this book (chapters 2-4 and 6-7) are texts adapted from the report 'Régimes de gouvernement d'entreprise: différences nationales et stratégies d'entreprises', conducted under the responsibility of Professor Michel Aglietta for the Commissariat Général du Plan (Call for projects: "Gouvernement d'entreprise" – Project no. 16).

[2] The demands of manipulability of every formalised representation of the real – even if not with a mathematical model – make it inevitable that we limit the number of the dimensions, often very numerous, that we take into account in a given situation. Consequently, economists' work is based on what they call *stylised facts*.

[3] For further developments, see SIMON H. A. (1978), "Rationality as Process and as Product of Thought", in *American Economic Review*, 68, pp. 1-16.

action taken by a decision maker, a knowledge that in turn implies the ability to draft complete contracts, that is, contracts that establish beforehand an efficacious solution for all possible eventualities.

In this conceptual framework, the nodal point of the approach to corporate governance is, as Jacques Lenoble shows in chapter one, the attribution, justified through the appeal to economic efficiency, of residual rights of control exclusively to the shareholders. The latter, due to their mode of remuneration, are seen as the only stakeholders of the firm who bear the burden of the residual business risks. By pursuing their personal interests, that is, by working all the means permitted by the law and the statutes of the moral entity that they have created by the corporate contract, the shareholders will by the same token maximise the chances that the other stakeholders obtain what is their due by virtue of the - supposedly complete - contracts that link them to the corporation. It is worth noting that the solution proposed to the problem of corporate governance remained exactly the same once rational choice theory moved in the direction of integrating the concept of 'bounded rationality' and was thus led to admitting the impossibility, both at the 'technological' and cognitive levels, to draft 'complete contracts', while continuing, in most cases, to misread the often radical character – that is, as not reducible to probabilistic calculations – of uncertainty. The most interesting aspect of this evolution, which came to be known as the 'Standard Theory Extended'[4], is that it brought about the means to integrate the existence of asymmetries of information into the formalised models, thus bringing into the debate the idea that the relevant information for dealing adequately with a problem is not available to all parties. Even though this obliges us to consider, very unrealistically, that all the other elements of the problem are common knowledge[5] for all the actors, the way in which the theory of incentive mechanisms, and especially agency theory[6], take into account the conflicts of interests engendered by the asymmetry of information is undeniably a significant step in the direction of an institutionalist approach to collective action[7]. As far as private relations are concerned, even if economists have fashioned a highly 'stylised' representation of the contract, the contractarian vision has allowed us, as Williamson says[8], to make the conceptual leap in our understanding of the firm as a 'black box'[9] towards an understanding of it as a 'governance structure'. In matters of public policy, this same approach led us from our understanding of governance as a rigid model of 'command and control' towards a more flexible model of incentive mechanisms.

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[4] Cf. the works of Olivier Favereau, especially FAVEREAU O. (1989), "Marchés Internes, Marchés Externes", in *Revue Economique*, numéro spécial, pp. 273-328.

[5] In its strongest meaning, this expression excludes not only all possibilities of error, but also of doubt.

[6] The conflicts of interest and the opportunistic behaviour engendered by a large number of situations of informational asymmetry bear a somewhat pronounced analogy to those that take place in the execution of a contract of mandate, also called 'agency contract'.

[7] See: BROUSSEAU E. and GLACHANT J. -M. (eds) (2002), *The Economics of Contract, Theories and Applications*, Cambridge University Press, Cambridge.

[8] WILLIAMSON O. E. (2002), "Examining Economic Organization Through the Lens of Contracts", Working Paper, Haas School of Economics, University of California at Berkeley, August.

[9] Invoking the famous critique of the 'institutional void' of the 'standard theory' of the firm formulated in 1937 by the future Nobel laureate in economics Ronald Coase (COASE R. (1937), "The Nature of the Firm", in *Economica*, 4, pp. 386-405).

If the contributors to this book adopt a critical stance towards the approaches we have just described it is because they believe that, from an institutionalist perspective, these approaches present 'insufficiencies' whose common trait is to not have noticed that, like all governance structures, an efficient corporate governance requires the establishment of devices of cooperation between the actors that enable an operation of collective learning. It is in this sense that we should consider this book as an attempt to synthesise the first stage of the contributors' research, which should lead later on to presenting elaborate proposals concerning the conditions of possibility of such devices. This first stage has a double objective, to which correspond respectively the two parts of this book. The first objective is to articulate the need of such operations of organisational learning as an efficiency condition of any governance structure and to show by this means the shortcomings of the 'standard' as well as of the 'extended' approaches. The second objective is to reveal, in the recent transformations that governance practices are undergoing, the trace of the need for such operations.

In order to pinpoint the shortcomings just mentioned, Antoine Rebérioux adopts, in chapter 2, a critical stance internal to the microeconomic discipline that allows him to examine the positions taken by the 'neo-institutionalist' strand of the debate. Oliver Williamson is undoubtedly the leading figure in this strand. Williamson developed his transaction cost theory by elaborating on the works of such pioneers as Ronald Coase[10] and the constructivist approach of authors such as Alchian and Demsetz[11], who propose an understanding of the firm based on the concept of property rights. Williamson's originality rests on the fact that he takes into account, besides the incompleteness of contracts, the multiplicity of the modes of coordinating collective action, notably the exercise of hierarchical authority in the framework of the labour contract, as well as the incompleteness of contracts. It is by opening this perspective that it becomes possible to claim that it is the specific characters of transaction that determine the 'governance structure' adequate to the relationship between the parties.

Rebérioux shows us how Williamson, from within his hypothetical construction, justifies endorsing shareholder sovereignty and he stresses that Williamson would not be able to defend this position without appealing to some rather ambiguous arguments concerning the specificity of the assets offered by them, namely: finance capital in monetary form. By arguing that this resource is the one that can most easily be expropriated, in contrast to, for instance, the inalienable human capital of the workers, Williamson concludes by stressing the need for a governance structure that protects the shareholders. Rebérioux, armed with figures, counters by arguing that markets for common stock are not primarily meant to ensure the financing of corporations but rather the liquidity of investments. Shareholders who feel they have been hurt by the managers always have the 'exit' possibility at their disposal. When exercised on a block of shares by institutional investors acting on behalf of their principal, i.e. the minority shareholders as a group, the 'exit' option amounts to an efficient sanction of the unfair behaviour of managers.

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[10] See footnote 9.

[11] ALCHIAN A. and DEMSETZ H. (1972), "Production, Information Costs, and Economic Organization", in *American Economic Review*, 62, pp. 777-795.

Authors such a Blair and Stout, considered by Rebérioux as epigones of Williamson, hold that other parties, particularly the personnel of the firm, are holders of expropriable assets. This insight leads them to argue that the optimal governance mechanism is one in which the shareholders control a board of directors with fiduciary duties not only to the shareholders, but also to the firm, that is, to the different constituencies to the firm. This solution, however, fails to explain how the (at least partially) antagonistic interests of the various parties involved could be balanced.

Chapters three and four address the 'shortcomings' of the standard version of corporate governance from a very different angle. These authors express the view that the problematic of corporate governance is not confined to the micro level. The different positions in matters of corporate governance essentially reflect a 'convention'[12] of 'financialisation', which is itself the expression of a profound mutation in the dynamics of macro-regulation of the socio-economic system.

In chapter three, Michel Aglietta and Robert Cobbaut characterise this evolution by the gradual establishment of a 'patrimonial regime of growth' meant to overcome the exhaustion of the growth potential of the Fordist model, which had been the regulation regime for the 'Thirty Glorious' (1945-1975). Like every mutation in a regime of growth, this new mode of regulation originated in a mutation in the system of production, propelled, for instance, by telematics, the offspring of the cumulative effects of technological advances in information technology and in telecommunications. The financial system, already highly internationalised, benefited quickly, and massively, from this mutation, which indeed allowed its globalisation. The other essential, and rarely stressed[13], dimension of this evolution is the 'financialisation' of the wage system. The spread of profit-sharing systems and the rapid expansion of stock options plans are the main indicators of this phenomenon, one that raises major questions concerning how we are to articulate the question of corporate governance. In effect, the workers – in very different ways depending on the nature of their contribution to the firm – share, for the first time in a patrimonial manner, the business risks with the financiers, and in particular with the shareholders.

In chapter four, Michel Aglietta and Régis Breton examine the evolution during this same period of the financial system that has become the pivot of global regulation while undergoing itself a major mutation. In fact, while the financial system had a long time been bank-based, today it is based on the market for financial assets. This does not mean that banks have been relegated to playing marginal role in the financial system;[14] indeed, their role has undergone just as dramatic a mutation, which has raised quite significantly the level of risk of their operations.

In a transition phase that corresponds essentially with the 1980s and is characterised by an unprecedented wave of take-over bids, financial markets started to function as markets for corporate control. The violent and unstable character of this regulation, which the authors qualify as a 'predatory system', entailed, in the US, a surge

[12] By this term we mean what 'conventionalist' economists understand by it; in the words of D. K. Lewis: "A solution of a coordination problem that, having succeeded in concentrating on itself the agents' imagination, tends to recur with regularity'. (LEWIS D. K. (1969), *Convention: A Philosophical Study*, Harvard University Press, Cambridge (MA), p. 12.

[13] Only French economists of the 'École française de la régulation' seem to even mention this.

[14] This is particularly true of commercial banks that, by creating money in the act of credit, are the only private actors of the economic system that can anticipate the creation of real wealth.

of anger, providing an incentive for institutional investors, who had become the main holders of financial assets, to practices based on what has come to be called *shareholder activism*. We also notice that, through the 1990s, a mode of corporate control via financial evaluation of performance came to be established, centred on the concept of shareholder value. The corporative capitalism of the Fordist era, in which the centre of decision was the productive pole, under the constraint of solvency vis-à-vis the commercial banks (the so-called debtors' regime), was replaced by a 'patrimonial capitalism' regulated by the financial pole (the so-called creditors' regime), in which the key factor is the power of evaluation. Aglietta and Cobbaut discuss at length the 'conventional' character of this evaluation and conclude their critique through a consideration of what André Orléan[15] calls 'patrimonial individualism': a series of factors, the most pregnant among them being the 'financialisation' of the wage system, leads individuals to perceive their rights as citizens – for example their right to retirement – as being somehow 'incarnated' by financial assets. This move allows us to understand why shareholder value is the cornerstone of a conventional regime that we could call 'shareholding convention', the pivot of which is the defence of the interests of minority shareholders. With the advent of 'patrimonial individualism', as an implicit factor of justification, 'shareholder value', a concept almost impossible to translate adequately into measurement and management tools, came to be a 'convention', that is, a 'reference that polarises all beliefs and stabilises them'. [16] This is how Orléan comes to argue that economic literature on corporate governance is centred on a concept of governance as exercised exclusively by the holders of financial assets[17]. How pregnant this convention is, despite its diffused character, signals the absence of cooperative devices that should prevent, among other things, the problematic dissociation of financial from labour governance.

In the opening chapter, Jacques Lenoble develops in a theoretical and epistemological vein the conditions of possibility of an efficient governance. Lenoble uses, as his starting point, the works of authors who have noticed and highlighted particularly well the shortcomings of the 'standard' approach to corporate governance. Thus, Lenoble discusses the work of Zingales, the works stemming from path-dependency theory (especially works by Coffee and Roe), and also the work of Hodgson, who develops a competence-based theory of the firm centred around the notion of learning. Lenoble shows how all of these works should be expanded if we want to understand, in a critical fashion, the entire process of collective action, that is, the factors that condition the action's effect in the social sphere. Only such an understanding will allow us to stress, above and beyond their undeniable gains, the shortcomings that still plague not only the standard approaches, but also the recent attempts to move beyond them. Moreover, through such a theoretical reconstruction we come to understand why an efficient corporate governance requires the establishment of organised cooperation devices, and to understand also what are the conditions of possibility of these devices. Indeed, the learning process is a central requirement for such cooperation devices. Lenoble argues that this calls for 'procedurally organising the existing perceptions of the

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[15] ORLÉAN A. (1999), *Le pouvoir de la finance*, O. Jacob, Paris, part 4.
[16] *Ibidem*, p. 86.
[17] This tendency is particularly pronounced in Schleifer and Vishny's survey (SHLEIFER A. and VISHNY R. (1997), "A Survey of Corporate Governance", in *Journal of Finance*, 52, pp. 737-783).

actors concerned in light of new constraints and in order to pin down the significance, and the nature, of the shortcomings to be overcome and the problems to be solved'.

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The second goal of the convergent research programs on corporate governance that are presented in this book consists in showing that the recent evolutions in practices bears the mark of the need for cooperation and learning devices, as well as the correlative need for a specific form of procedural organisation. This is what the second part of the book is aimed at illustrating through a collection of texts that are all concerned with identifying situations where the adoption of such a stance of 'proceduralisation' has been 'rough-hewn', or at least at identifying problematic, indeed critical, situations where the problems of coordination confronting the actors reveal beyond any doubt the necessity of such a move. These texts, half of them dealing with the French context and the other half with the context of the United Kingdom, address either some problematics -- the issues revolving around the reform of company law in the United Kingdom and the employee-shareholdership in France, or specific situations – collective layoffs in France and the firms in financial distress in the London financial market. In either case, these discussions call for the establishment, among the various actors concerned, of devices of interaction that give them the reflexive capacity to isolate what the real problem is, to identify the elements of the context that it would be expedient to transform, and to construct collectively the modalities of an effective transformation.

The following paragraphs do not set out to offer a systematic summary of the content of the four contributions of this second half of the book, that is, it does not offer a summary of the examination of the specific normative devices and the theoretical foundations informing each of these discussions. My only goal here is to situate these discussions in relation to the notion of 'proceduralisation' just introduced.

Through a critical rereading of recent theoretical developments, John Paterson examines the process of reform of company law in the United Kingdom (*Company Law Review*). The debate this occasioned brought into focus in a particularly sharp way three problems that are central to the question of proceduralisation: the nature, the extension, and above all the addressees of the directors' duties; the correlative question of the interest of the company; and the matter of the content of annual reports[18]. These three points in a sense encompass the key difficulties issuing from this debate on the question of determining what must be regulated by the law, to what degree of detail, and through what means – all these show to what extent these questions cannot adequately be resolved *ex ante* by regulations of a general and impersonal character, but rather require specific interaction devices of all the parties concerned.

Alexia Autenne examines the question of employee shareholdership in France. This device is embedded in a legislative whole that regulates the 'financial participation of workers', and has been developing through multiple layers. This device highlights, among other things, the question of the self-perception of the employee-shareholders. In fact, it is interesting to note that, even in cases where the 'profit-sharing funds' are

[18] 'This would cover all that is material in the directors' view of users to achieve a proper assessment of the performance and future plans and prospects of the business. It would include, where relevant, its relationships with employees and others and its impact on the community and its environment' [Second stage interim report, called 'Developing Framework' (DF) 2.19].

composed exclusively of shares of their own company, it is very rare that the participants exert fully their rights as shareholders; that is to say, the employee-shareholders rarely demand, even when the fraction of shares held by the fund allows them, one or more seats in the board of directors. In contrast, there is a great deal more attention paid to the exercise of the patrimonial rights linked to the shares, including to the adoption of a proactive attitude of diversification of the investment portfolio when possible. Although it seems clear that the general ambiance, impregnated by 'patrimonial individualism', is at least partly responsible for this phenomenon, the primary reason for it is certainly the absence of all specific interaction devices between the board of directors, the management, and the workers, in order to articulate anew the roles of worker and shareholder.

Tristan Boyer's research focuses on the legitimacy of the 'shareholding convention' as an element in the justifying process of argumentation required by French law for the elaboration of a collective layoff project. The radically unacceptable character of an argument based on the increase of 'shareholder value' as the justification for a layoff project leads to a certain perplexity. As the limit case, a radical prohibition can, for instance, have the undesired effect of favouring a managerial entrenchment despite the most elemental considerations of economic efficiency. The essentially formal[19] character of this legal device, and the manner in which it can consequently be used reveals very clearly the absence of a real collective device that would favour a common construction of the diagnosis of the causes of and the protocol to remedy a problematic situation.

John Armour and Simon Deakin analyse the informal, [20] but strongly structured, device developed on the London financial market with a push from the Bank of England to remedy situations of financial distress in a timely fashion, that is to say, before the situation reaches the point at which judicial liquidation appears as the only possible solution. Such a collective elaboration of a device that encourages companies in difficulties to come out early enough and 'confess' the delicate situation they find themselves in was much more preferable in the context of the United Kingdom since there the bankruptcy legislation is much more favourable to claimants than it is elsewhere[21]. This often makes the rescue of companies in serious, though passing, difficulties impossible. Conceived in a period when the company debts were still almost exclusively bank-based, the 'London approach' to financial distress has not easily found its place in a context of globalisation and, above all, of 'marketisation' of the financial system.

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[19] Though it is not entirely formal, since the process of argumentation cannot be entirely constituted by considerations of a general character. These must be supported by elements that are specific – generally, management indicators such as ratios.
[20] In the sense that it lacks all legal status.
[21] See, for example, the famous 'Chapter eleven' of the U.S. bankruptcy legislation.

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