Corporate Governance, the Firm and Investor Capitalism: Legal-Political and Economic Views

Alexander Styhre

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Alexander Styhre is a management scholar in the School of Business, Economics and Law at the University of Gothenburg, Sweden. He has written a scholarly work on corporate governance that focuses on how neoclassical economics (in its postwar advocacy of contractarian legal theory) has been irreconcilable with the corpus of legal scholarship (i.e., in corporate law), while also marginalizing management theory, thus ignoring both as competing causal theories that underpin corporate governance of the modern firm. More importantly, Styhre argues that free-market advocates in the United States and Europe, consisting of libertarians (e.g., Austrian School) and conservative US businessmen, have been involved in a decades-old project to undermine managerial capitalism—the postwar legal-political view of corporate governance in America—and successfully replaced it in the 1980s with investor capitalism—representing a narrow focus on shareholder welfare—which predominates in today's global economy.

Styhre approaches his study in four chapters and an epilogue. In chapter 1, he addresses corporate law and the legal system in the United States historically, beginning with private corporation charters dating from the late 1700s. Legal theorists argue that corporate law, whereby directors have a central oversight role in the governance of the publicly traded firm, provides the best form of protection for the greatest number of corporate stakeholders. Styhre further admonishes that, "while economists tend to think of the firm as a vehicle for economic value creation and economic value extraction within the domain of the market economy, legal scholars generally take a wider and more socially embedded view of the firm" (36). Thus, legal scholars "treat the firm as a legal entity being incorporated within the social organization to benefit wider social and political objectives rather than merely providing a more narrow range of benefits including, for example, shareholder value creation" (36).

In chapter 2, Styhre focuses on the influence of free-market advocates, including Nobel laureate Friedrich von Hayek and his adherents, both in academe and in the business community. Hayek and his followers' project fixated on their fears of the coercive, interventionist state and how this institutionalized "collectivism" interferes with efficient, self-regulating markets (described as the "efficient market hypothesis") and "economic freedom" in general. In the 1930s, this collectivism was enshrined in President Roosevelt's National Industrial Recovery Act, which exhibited elements of national economic planning. The post-World War II period, however, was a disappointment for these free-market advocates, as predominantly Keynesian policy prescriptions resulted in strong economic growth in the West (and especially the US). It was not until the 1970s, when the Keynesian welfare state was in decline, that adherents of economic freedom would have the opportunity to be publicly recognized for their detection of the flaws of state collectivism. Moreover, Styhre notes that by the 1970s, advocates of agency theory were

focusing their critiques on post-World War II managerial capitalism's inefficiency in the principal-agent relationship.

Chapter 3 has Styhre focusing his scholarly criticism on the implications of the agency theory of the firm. Starting with the political and economic backdrop of the 1970s, Styhre explains how new theories of the firm began emerging from the academic community (libertarian and conservative economists, financial and legal scholars, and pro-competition think tanks), which purposed to replace managerial capitalism with an investor capitalism favoring the shareholders. Neoclassical economic theorists, influenced by the earlier work of Adolph Berle but adapted to their interests, posited that the firm was a legal fiction that was no more than a "nexus of contracts," and it was the shareholders, or principals, that had a legitimate claim on the firm's net profits.

Styhre criticizes the agency theory perspective as based on a lack of empirical evidence and erroneous relationships, as between corporate law (in this case the contractual view) versus the evidence found in court holdings; an unjustified zealotry concerning the benefits of the market-based control of the firm; and unlike the grounded theory perspectives offered by management theory, an underestimation of market-based production cost factors and resource coordination costs of the firm. According to Styhre, "the contractual view is by and large ignorant of legal theory and turns a blind eye to the historical development of corporate law … and seeks to bypass the state as a legitimate and active agent in corporate governance and corporate law and law enforcement" (158). Even though there is little empirical evidence to support the agency theory and shareholder primacy theory underpinning investor capitalism, Styhre observes that the probusiness political leadership in Washington and London in the 1980s enthusiastically supported the investor capitalism approach to public policy, and managers became indebted (for their jobs) to the financial analysts on Wall Street.

In chapter 4, Styhre brings his study into the new millennium. Not surprisingly, he finds that the investor capitalism model is operating regardless of the fact that the nexus of contracts that forms the foundation of agency theory is basically an ideological belief that does not rest on any foundations in mainstream corporate law or judicial holdings. Styhre ends his study by examining the long-term consequences of investor capitalism and other free-market reforms in the financial sector. Styhre makes some interesting and noteworthy observations in this chapter. For example, he contrasts the post-World War II economic affluence (broadly based on a Keynesian approach to public policy) with the free-market approach of the 1980s and beyond, which has led to lower economic growth and higher unemployment (and underemployment). And Styhre points out that the Great Recession of 2008 had no more than an intermittent impact on the finance industry: "the finance actors quickly dusted off their suits and continued their work as if the music had in fact never stopped" (211). He notes that investors have been reinvesting their returns in the ever-expanding finance industry rather than in actual production capital and human resources as found in the manufacturing sector. Styhre asks a poignant question: "If these are the principal and long-term features of 'economic freedom,' free market protagonists

are facing a challenge in convincing the majority of the population in advanced, (post) industrialized and democratic economies that they should put their faith in the virtues of this regime of economic freedom" (24). In the epilogue, Styhre addresses the ideology of competitive capitalism in neoclassical economic theory. Styhre argues that the economics discipline has created a unified theoretical framework that erects barriers precluding any influence from the research results from other disciplines. Specifically, as it pertains to corporate governance and agency theory, this includes not recognizing some of the most basic legal strictures or empirical research findings in management studies or economic sociology. From Styhre's viewpoint, "it would be helpful if economists committed to the mapping of economic systems would pay attention to a wider set of conditions and theories" (233).

And with those concluding words, I concur with the author. As a management scholar, I tend to adhere to the behavioral theory of the firm. Styhre refers to the behavioral theory in this study but only in passing. He mentions the classics of Simon (1957), Baumol (1959), and Cyret and March (1963) in short passages, but we never really get a sense of the development of the behavioral theory and how it has progressed among management scholars over the last half century, specifically as it pertains to corporate governance. While the book's title does not include "Management" as one of these "Views," Styhre teases the reader at different points in his study by referring to "management studies," but leaves this reader with an intellectual "hole" that I think needs to be filled. Is this his next book?

I also note that Styhre identifies economic freedom and free markets with extreme libertarianism, where any form of government intervention is considered "evil" and inefficient. I think this is an oversimplification of where American capitalism exists in a business world of federal and state government regulation and judicial oversight. Styhre does not address nonmarket failure and the unintended consequences of the regulatory state. For example, in his references to the Great Recession of 2008 and financial derivatives as a major cause of irresponsible risk in the US financial system, Styhre fails to mention a major contributing factor: The Community Reinvestment Act (CRA). The CRA is a US law that is designed to encourage commercial banks and savings associations to help meet the demands of borrowers in all segments of their local communities, including in low-and-moderate income neighborhoods. There is substantial empirical evidence that the CRA (and its associated administrative rules) played a significant role in influencing lax mortgage lending standards that contributed to the US housing bubble.

I believe that Styhre has made a compelling case regarding the dubious foundation (nexus of contracts) on which agency theory (and by extension, investor capitalism) rests. The legal theory behind corporate law (and corporate governance) is based in established legal precedent and actual experiences with corporate governance in practice. The book makes a strong argument for developing a new view of corporate governance based on mainstream legal theory, management study research, and applied microeconomics. I found the book dense reading and it was repetitious at times; its length could have been reduced. Nevertheless, Styhre provides us with much intellectual fodder for the key questions of

the new millennium—most importantly, what role the corporation will play in ensuring a vibrant US economic middle-class in an era of contract employees, underemployment, and ongoing automation.

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Economic Freedom and Human Flourishing: Perspectives from Political Philosophy

Michael R. Strain and Stan A. Veuger (Editors)

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It is rare in economics, where the overall production of goods and services is encouraged and has no natural limit, that less is more. But when it comes to this collection, it certainly is. Surveying the entire tradition of Western political philosophy from Aristotle to Marx on subjects as difficult to define as economic freedom and human flourishing in less than two hundred pages is quite an achievement. Due to its brevity as well as to the clarity of the individual contributions, this volume is an excellent introduction to the complex relationship between economics and political philosophy.

The relationship is complex for a number of reasons. Political philosophy aims at a comprehensive understanding of the city and man and, especially, of justice, whereas economics studies how scarce resources can be allocated most efficiently. Political philosophy often takes an "Olympian" view, looking down on subjects such as economics, but it also begins with the "commonsensical" view of the citizen as a starting point. Socrates was interested in the political opinions of others, especially those who were purported to be wise, in order to arrive at the truth about matters such as justice, love, and friendship; he was executed in the process. The economist, on the other hand, is typically indifferent to questions about "the good life," and the virtues are likely considered exogenous factors in his calculations; modern economics furthers the Lockean end of comfortable self-preservation.

Indeed, the use of the term *human flourishing* rather than virtue and the good or best life is indicative of a change in perspective from political philosophy to economics. To suppose there is a particular way of life that is qualitatively better than others would limit or at least influence our choices drastically. Democratic pluralism is threatened by such questions, whereas a person can "flourish" in any number of ways. Economics is more interested in the "pursuit of happiness," leaving each to define happiness in his own way. Economists do not ask what happiness is. There will be many more economists than political philosophers in a liberal society.

All but one of the contributors favors the perspective of political philosophy. Not surprisingly, Harvey C. Mansfield's treatment of Aristotle, a mere eight pages long, sets the tone:

> Happiness [in the modern commercial world] is regularized by being reduced to something less than the flourishing life of a gentleman or lady, let alone a philosopher—to a more