INSTITUTIONAL THEORY FOR CORPORATE LAW: AN INVITATION

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Abstract: Reliance on agency-theoretic reasoning has led to substantial theoretical and empirical advances in company law scholarship, but the narrow focus on board-level actors and phenomena has disconnected the analysis of the company from the reality of the economic organization it is meant to enable and support. We follow Oliver Williamson's call for a 'law, economics, and organization' approach, and build on Elinor Ostrom's 'institutional analysis and development' framework to propose a narrative model of the company in terms of nested levels of governance. We argue that our model works as a positive description of the law as it is, and puts us in a stronger position to evaluate the likely consequences of certain normative interventions, which we illustrate with some observations about ongoing debates in corporate governance.

Keywords: Company law theory; agency theory; institutional theory; law, economics, and organization; Elinor Ostrom

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1 INTRODUCTION

Over the past few decades, company law scholarship[1] has greatly benefited from insights derived from applied microeconomics: the nexus-of-contracts theory of the firm,[2] agency-theoretic reasoning in corporate finance,[3] and the economic analysis of law more generally,[4] have provided the social science foundations company law scholars have largely relied upon. An impressive research programme has evolved to work out the ramifications of the idea that the rules governing conflicts of interest among directors, shareholders, and creditors that minimize agency costs and therefore maximize shareholder returns tend to prevail.[5] This agenda, and a general commitment to the method of comparative investigation,[6] have shaped the current understanding of the connections between company law, securities regulation, accounting and reporting practices, and corporate governance, producing a number of important offshoots (including law and finance[7]), such that students of company law today benefit from a wealth of theoretical and empirical knowledge that was unavailable to their predecessors.

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[1] In this paper the terms 'company' and 'corporation' are used interchangeably, as are the expressions 'company law' and 'corporate law'.

[2] Ronald H Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386; Armen A Alchian and Harold Demsetz, 'Production, Information Costs and Economic Organization' (1972) 62 *American Economic Review* 777; Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure' (1976) 3 *Journal of Financial Economics* 305.

[3] Jensen and Meckling (n2); Eugene F Fama and Michael C Jensen, 'Agency Problems and Residual Claims' (1983) 26 *Journal of Law and Economics* 327. Michael C Jensen and Clifford W Smith, *The Modern Theory of Corporate Finance* (McGRaw-Hill 1984).

[4] Richard A Posner, *The Economic Analysis of Law* (Little, Brown & Co 1973); Werner Z Hirsch, *Law and Economics: An Introductory Analysis* (Academic Press 1979); Mitchell A Polinsky, *An Introduction to Law and Economics* (Little, Brown & Co 1983).

[5] Richard A Posner and Robert E Scott, *Economics of Corporation Law and Securities Regulation* (Little, Brown & Co 1980); Frank H Easterbrook and Daniel D Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991); Stephen Bainbridge, *Corporate Law and Economics* (Foundation Press 2002); Reinier H Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-Georg Ringe and Edward B Rock, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd ed 2017 Oxford University Press).

[6] Kraakman et al (n5); Andreas Fleckner and Klaus Hopt, *Comparative Corporate Governance: A Functional and International Analysis* (Cambridge 2013); Mathias Siems and David Cabrelli *Comparative Company Law: A Case-Based Approach* (2nd ed Hart 2018).

[7] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W Vishny, 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1131; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113; Ronald J Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 *Harvard Law Review* 1641; Matthias Siems and Amedeo De Cesari, 'The Law and Finance of Share Repurchases' (2012) 12 *Journal of Corporate Law Studies* 1; Ronald J Gilson and Allan Schwartz, 'Corporate Control and Credible Commitment' (2015) 43 *International Review of Law and Economics* 119; Luca Enriques and Tobias Tröger, *The Law and Finance of Related Party Transactions* (Cambridge University Press 2019).

Agency theory is the dominant 'reference point' among company law scholars today.[8] Leading textbooks are written from this perspective.[9] Nevertheless, there is a robust and established body of work that is critical of the foundations and implications of this approach to company law.[10] The concerns this critical literature raises are important. But while we agree that agency theory has its shortcomings, we would not want to leave behind the advances this framework has generated. Hence instead of rejecting it outright, we wish to show that agency theory is but one component of a larger social science edifice that can be brought to bear on issues of company law – much of which is not well-known in company law circles. This broader perspective acknowledges the importance of rules and practices that help align the incentives of board-level actors,[11] but also draws attention to phenomena that the reliance on agency theory leads us to miss. We argue that this is notably the case of the business organization that company law is meant to enable and support.

Typically, a company is set up by an entrepreneur or a group of entrepreneurs with a view to producing and selling goods or services valued by customers in the market. This involves acquiring, specializing, combining, and deploying various kinds of resources, while addressing a range of collective action, coordination, and commitment problems among managers and employees operating at various levels within the boundaries of the organization. A surplus is generated when the market value of the output exceeds the costs of producing it. Given that conflicts of interest among claimants to this surplus will inevitably arise, not necessarily only at the board level, analyses of rules and practices that align the parties' incentives are without question valuable. But there is more to understanding how organizations, and therefore companies, operate. Conflicts of interest are not the only relevant

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[8] Marc T Moore and Martin Petrin, *Corporate Governance: Law, Regulation and Theory* (Palgrave 2017) 46.

[9] Kraakman et al (n5) 29-47; Paul Davies, *Introduction to Company Law* (3nd ed 2020 Oxford University Press) 10-25; David Kershaw, *Company Law in Context* (2nd ed 2012 Oxford University Press) 171-188.

[10] Paddy Ireland, 'Shareholder Primacy and the Distribution of Wealth' (2005) 68 *Modern Law Review* 49; Charlotte Villiers, 'Controlling Executive Pay: Institutional Investors and Distributive Justice' (2010) 10 *Journal of Corporate Law Studies* 309; Jean-Philippe Robé, 'The Legal Structure of the Firm' (2011) 1 *Accounting, Law and Economics* 1; Lynn A Stout, 'The Toxic Side Effects of Shareholder Primacy' (2013) 161 *University of Pennsylvania Law Review* 2003; Beate Sjåfjell, Andrew Johnston, Linn Anker-Sørensen and David Millon, 'Shareholder Primacy: The Main Barrier to Sustainable Companies' in Beate Sjåfjell and Benjamin J Richardson, *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press 2015); Simon Deakin, 'Reversing Financialization: Shareholder Value and the Legal Reform of Corporate Governance' in C. Driver and G. Thompson, *Corporate Governance in Contention* (Oxford University Press 2018); Michael Galanis, 'Growth and the Lost Legitimacy of Business Organizations: Time to Abandon Corporate Law Reform' (2019) 20 *Journal of Corporate Law Studies* 291; Lorraine Talbot, 'Shareholders and Directors: Entitlement, Duties and the Expansion of Shareholder Wealth' in Andrew Johnston and Lorraine Talbot, *Great Debates in Commercial and Corporate Law* (Bloomsbury 2020).

[11] Kraakman et al (n4) 31-47.

ones in the organizational, and therefore corporate governance, context: conflicts can also arise when people use different criteria to evaluate decisions, procedures, and outcomes. We submit that a deeper understanding of the formal and informal organizational rules that govern such conflicts is important for company law research.

Company law scholars can profitably emulate the stance of the New Private Law literature, which appeals to a broad range of social science ideas and methodologies to rethink the nature of contract, property, or tort.[12] We can similarly draw on insights from several rich traditions of institutional theory to be found across the social sciences to understand the links between human behavior, organizations, the legal forms they take, and their societal environment. The aim of the article is conceptualize the company in a manner that captures these connections. Our discussion builds on the work of Oliver Williamson and Elinor Ostrom, who in 2009 shared the Nobel Prize in Economic Sciences for their path-breaking work on economic governance. We follow Williamson's theoretical pluralism in calling for the integration into company law scholarship of organization theory alongside law and economics,[13] and rely on Ostrom to propose a narrative model – or what Ronald Gilson refers to as an 'informal analytic narrative'[14] – of the company in terms of nested levels of governance.[15]

We begin by presenting mainstream company law theory (section 2), before showing how the reliance on agency-theoretic thinking directs attention away from the economic organization that company law is meant to support (section 3). We make a case for broadening company law scholarship to include this organization, and note that, recently, a modern real entity approach has used insights from institutional theory to that end.[16] We then characterize various strands of institutional theorizing available to company law scholars (section 4). This is followed by a statement of institutional theory for company law that builds on Williamson and Ostrom (section 5). We show that our approach allows us to benefit

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[12] Andrew S Gold, John CP Goldberg, Daniel B Kelly, Emily Sherwin and Henry E Smith, *The Oxford Handbook of The New Private Law* (Oxford University Press 2021); Hanoch Dagan and Benjamin Zipursky, *Research Handbook on Private Law Theory* (Edward Elgar 2020); Stefan Grundmann, Hans-W. Micklitz and Moritz Renner, *New Private Law Theory: A Pluralist Approach* (Cambridge University Press 2021).

[13] Oliver E Williamson, 'Why Law, Economics and Organization?' (2005) 1 *Annual Review of Law and Social Science* 369.

[14] Ronald J Gilson, 'From Corporate Law to Corporate Governance' in Jeffrey N Gordon and Georg Ringe *The Oxford Handbook of Corporate Law and Governance* (Oxford University Press 2015) 16.

[15] Elinor Ostrom, *Understanding Institutional Diversity* (Princeton University Press 2005).

[16] Eva Micheler, *Company Law: A Real Entity Theory* (Oxford University Press 2021) 84-88.

from knowledge generated by agency theory while integrating insights into how humans behave in organizational settings developed elsewhere. In the process, we place company law within its broader institutional setting, gain a better understanding of the law as it stands, and put ourselves in a stronger position to evaluate the likely consequences of certain normative interventions, which we illustrate with some observations about ongoing corporate governance debates (section 6).

2 MAINSTREAM COMPANY LAW THEORY

It is widely recognized that modern company law scholarship originated in the United States, from where it spread to the United Kingdom and elsewhere. And it is often said that, in the United States, company law, as 'a field of intellectual effort', was 'dead' in the 1960s,[17] before experiencing a genuine 'revolution' in the 1980s.[18] It was only when, the story goes, the nexus-of-contracts theory of the firm[19] and the associated agency-theoretic models in corporate finance[20] were combined with Henry Manne's earlier ideas about the market for corporate control,[21] reinforced by new thinking about the virtues of jurisdictional competition for corporate charters,[22] that modern company law scholarship really took off.[23] This rise coincided with, and helped explain (and justify), new business practices, including most notably the takeover boom of the 1980s.[24] Within a few years, critics and advocates could

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[17] Bayless Manning, 'The Shareholder's Appraisal Remedy: An Essay for Frank Coker' (1962) 72 *Yale Law Journal* 223, 245 n37.

[18] Robert Romano, 'After the Revolution in Corporate Law' (2005) 55 *Journal of Legal Education* 342; Brian R Cheffins, 'Trajectories of (Corporate Law) Scholarship' (2004) 64 *Cambridge Law Journal* 456.

[19] n2 above.

[20] n3 above.

[21] Henry G Manne, 'Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A Berle' (1964) 64 *Columbia Law Review* 1428; Henry G Manne, 'The Market for corporate Control' (1965) 73 *Journal of Political Economy* 110; Henry G Manne, 'Our Two Corporate Systems: Law and Economics' (1967) 53 *Virginia Law Review* 259. For an overview of Manne's contributions, see William J Carney, 'The Legacy of "The Market for Corporate Control" and the Origins of the Theory of the Firm"' (1999) 50 *Case Western Reserve Law* Review 2015; Larry E Ribstein, 'Henry Manne: Intellectual Entrepreneur' in LR Cohen and JD Wright, *Pioneers of Law and Economics* (Edward Elgar 2009).

[22] Ralph K Winter, 'State Law, Shareholder Protection and the Theory of the Corporation' 6 *Journal of Legal Studies* 251; Peter Dodd and Richard Leftwich, 'The Market for Corporate Charters: "Unhealthy Competition" versus Federal Regulation' (1980) 53 *Journal of Business* 259.

[23] Romano (n18) 348; Cheffins (n18) 481-484. For a critique of this narrative, see Harwell Wells, '"Corporate Law Is Dead": Heroic Managerialism, the Cold War, and the Puzzle of Corporation Law at the Height of the American Century' (2013) 15 *University of Pennsylvania Journal of Business Law* 305.

[24] Romano (n18) 347.

only agree that 'a revolution, under the banner "nexus of contracts," ha[d] … swept the legal theory of the corporation'.[25]

The nexus-of-contracts theory of the firm stems from Ronald Coase's suggestion that firms emerge to economize on transaction costs.[26] Transaction costs (incurred by parties in the process of negotiating, drafting, and policing agreements) are reduced when the complex set of multilateral contracts between resource owners that would be required to coordinate production through market exchange is replaced by a simpler set of bilateral contracts between each resource owner and a sole common central party.[27] The central agent directing production, and designing and policing contracts, is the entrepreneur in a sole proprietorship, and the owner, or residual claimant, in the 'capitalist firm' with employees.[28] In an incorporated association of resource owners, such as the company, the central agent is the 'legal fiction that serves as a nexus for contractual relationships' among individuals, as Michael Jensen and William Meckling famously put it.[29] Managers (comprising directors and officers) enter into contracts with employees, suppliers, creditors, and other parties on the central agent's behalf.

But managers must be incentivized to act in the interests of the company's owners, whose delegated powers they exercise. The agency problem arises because managers do not bear the wealth effects resulting from their decisions, and information asymmetries make it costly for principals to police their opportunistic agents. Where monitoring costs are high and the adverse impact of managerial discretion on the owners' wealth severe, optimal incentive-aligning contracts will tend to include some sort of profit-sharing scheme (such as stock-options).[30] Making managers bear some of the residual risk reduces the conflict of interest, and improves the firm's performance, but agency costs are never quite zero, and some of the venture's value will necessarily be foregone. To mitigate high agency costs, the company's

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[25] Lewis A Kornhauser, 'The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel' (1989) 89 *Columbia Law Review*, 1449. See also William W Bratton, 'The "Nexus of Contracts" Corporation: A Critical Appraisal' (1989) 74 *Cornell Law Review* 407.

[26] Coase (n2).

[27] Coase (n2) 391. See also Ronald H Coase, 'The Problem of Social Cost' (1960) 3 *Journal of Law and Economics* 1, 16.

[28] Alchian and Demsetz (n2) 783.

[29] Jensen and Meckling (n2) 311.

[30] Fama and Jensen (n3); Michael C Jensen and Jerold B Warner, 'The Distribution of Power among Corporate Managers, Shareholders and Directors' (1988) 20 *Journal of Financial Economics* 3; Michael C Jensen and Kevin J Murphy, 'Performance Pay and Top-Management Incentives' (1990) 98 *Journal of Political Economy* 225.

investor-owners may rely on their residual control rights and terminate the managers' contracts. Underperforming managers can also be replaced in the market for corporate control.[31] Whether effected through a proxy fight, a direct purchase of shares, or a merger, takeovers, and indeed their very threat, can be powerful checks on managerial discretion.

A key message of the contractual theory of the firm and the modern theory of corporate finance is that agency problems arising between owners and managers, and the attendant need to align their incentives, are central to what corporate governance is about.[32] But contrary to the midcentury view associated with Adolf Berle and Gardiner Means,[33] namely that the separation of ownership and control leads to illegitimate and unchecked managerial power, the new thinking was that the separation of ownership from control is an efficiency-enhancing feature of the corporate form: separating management and risk-bearing functions is a way of reaping the gains of specialization.[34] Since the presence of agency costs erodes the value of these gains, minimizing these costs is essential, and this is what disclosure, auditing, and various new forms of external finance seek to achieve.[35] These ideas spread into accounting[36] and came to define the new thinking in company law.[37]

The new scholarship, summarized in Frank Easterbrook and Daniel Fischel's *The Economic Structure of Corporate Law*,[38] framed every topic of company law – control

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[31] Sanford Grossman and Oliver D Hart, 'Takeover Bids, the Free-Rider Problem and the Theory of the Corporation' (1980) 11 *Bell Journal of Economics* 42; Michael C Jensen and Richard S Ruback, 'The Market for Corporate Control: The Scientific Evidence' (1983) 11 *Journal of Financial Economics* 5; Michael C Jensen and Jerold L Zimmerman, 'Management Compensation and the Managerial Labor Market' (1985) 7 *Journal of Accounting and Economics* 3.

[32] Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) 52 *Journal of Finance* 737, 773.

[33] Adolf A Berle and Gardiner C Means, *The Modern Corporation and Private Property* (Harcourt, Brace & World 1932); Adolf A Berle, *Power Without Property: A New Development in American Political Economy* (Harcourt, Brace & World 1959); Gardiner C Means, *The Corporate Revolution in America: Economic Reality vs. Economic Theory* (Crowell-Collier 1962).

[34] Eugene F Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288, 290-292; Harold Demsetz, 'The Structure of Ownership and the Theory of the Firm' (1983) 26 *Journal of Law and Economics* 375, 381-383.

[35] Robert A Haugen and Lemma W Senbet, 'Resolving the Agency Problem of External Capital through Options' (1981) 36 *Journal of Finance* 629; Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301; Ross L Watts and Jerold L Zimmerman, 'Agency Problems, Auditing and the Theory of the Firm: Some Evidence' (1983) 26 *Journal of Law and Economics* 613.

[36] Ross L Watts and Jerold L Zimmerman, *Positive Accounting Theory* (Pearson 1985).

[37] For a historical account of how the nexus-of-contracts theory of the firm and the accompanying agency-theoretic reasoning made their way into company law scholarship, see David Gindis, 'On the Origins, Meaning and Influence of Jensen and Meckling's Definition of the Firm' (2020) 72 *Oxford Economic Papers* 966.

[38] Easterbrook and Fischel (n5). An overview of Easterbrook and Fischel's impact can be found in Katherine V Litvak, 'Easterbrook and Fischel' in LR Cohen and JD Wright, *Pioneers of Law and Economics* (Edward Elgar 2009).

transactions, takeovers, defensive tactics, insider trading, disclosure, dividend policy, shareholder voting, appraisal remedies, limited liability, or the corporate contract – in terms of the imperative to minimize agency costs.[39] Building on Richard Posner's suggestions that a corporation was a 'standard contract'[40] and that an important function of company law was 'to economize on transaction costs by supplying the standard contract terms that the parties would otherwise have to adopt by express agreement',[41] Easterbrook and Fischel popularized the view that 'corporate law is a set of terms available off-the-rack'.[42] Corporate law, from this perspective, 'anticipates the desires of the contracting parties'[43] by providing default terms, and its effects on how business ventures operate are 'probably rather marginal'[44] – perhaps even 'trivial'.[45]

More recent discussions have taken issue with this claim, casting doubt on the argument that company law rules could have been achieved by contractual arrangement, but

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[39] Representative works include: Daniel R Fischel, 'The Law and Economics of Dividend Policy' (1981) 67 *Virginia Law Review* 699; Frank H Easterbrook and Daniel R Fischel, 'Takeover Bids, Defensive Tactics and Shareholders' Welfare' (1981) 36 *Business Lawyer* 1733; Ronald J Gilson, 'A Structural Approach to Corporations: The Case against Defensive Tactics in Tender Offers' (1981) 34 *Stanford Law Review* 775; Frank H Easterbrook and Daniel R Fischel, 'Corporate Control Transactions' (1982) 91 *Yale Law Journal* 698; William A Klein, 'The Modern Business Organization: Bargaining under Constraints' (1982) 91 *Yale Law Journal* 1521; Daniel R Fischel, 'The Appraisal Remedy in Corporate Law' (1983) 1983 *American Bar Foundation Research Journal* 875; Frank H Easterbrook, 'Managers' Discretion and Investors' Welfare: Theories and Evidence' (1984) 9 *Delaware Journal of Corporate Law* 540; Barry D Baysinger and Henry N Butler, 'The Role of Corporate Law in the Theory of the Firm' (1985) 28 *Journal of Law and Economics* 179; Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 52 *University of Chicago Law Review* 89; Frank H Easterbrook, 'Insider Trading as an Agency Problem' in JW Pratt and RJ Zeckhauser, *Principals and Agents: The Structure of Business* (Harvard Business School Press); Frank H Easterbrook and Daniel R Fischel, 'Close Corporations and Agency Costs' (1986) 38 *Stanford Law Review* 271; David D Haddock, Jonathan R Macey and Fred S McChesney, 'Property Rights in Assets and Resistance to Tender Offers' (1987) 73 *Virginia Law Review* 701; John C Coffee, 'Shareholders versus Managers: The Strain in the Corporate Web' in JC Coffee, L Lowenstein and S Rose-Ackerman, *Knights, Raiders and Targets: The Impact of the Hostile Takeover* (Oxford University Press 1988).

[40] Richard A Posner, *Economic Analysis of Law* (2nd ed 1977) 292.

[41] Richard A Posner, *Economic Analysis of Law* (3rd ed 1986) 372.

[42] Frank H Easterbrook and Daniel R Fischel, 'The Corporate Contract' (1989) 89 *Columbia Law* Review 1416, 1444; Easterbrook and Fischel (n5) 34. Frank H Easterbrook and Daniel R Fischel, 'Contract and Fiduciary Duty' (1993) 36 *Journal of Law and Economics* 425, 427. The idea that efficient solutions would have been negotiated had the transaction costs been low enough is a variation on Coase's famous argument that efficiency-enhancing arrangements of rights would always take place if transaction costs were zero. See Coase (n26) 15. An exhaustive discussion of the 'Coase theorem' and its numerous applications can be found in Steven G Medema, 'The Coase Theorem at Sixty' (2020) 58 *Journal of Economic Literature* 1045.

[43] Frank H Easterbrook and Daniel R Fischel, 'Voting in Corporate Law' (1983) 26 *Journal of Law and Economics* 395, 401.

[44] Posner (n40) 295.

[45] Bernard S Black, 'Is Corporate Law Trivial? A Political and Economic Analysis' (1990) 84 *Northwestern University Law Review* 542.

only a greater cost.[46] Company law, from this revised perspective, has 'proprietary foundations'.[47] Its essential role, as Henry Hansmann and Reinier Kraakman explained, is that it partitions assets and liabilities in a manner that enables firms and other kinds of organizations to operate.[48] An organization can only function effectively if its central agent has not just the authority to design and police contracts with employees, suppliers, creditors, and other parties, but also the ability to credibly 'bond its obligations'.[49] This implies that the central agent has control over a pool of assets that is distinct from the personal assets of the firm's owners or managers, and that this capital is 'locked-in', in the sense that investors cannot partly or wholly withdraw it at will.[50] This crucially ensures the firm's continuity through changes in its membership.

While company law scholarship has thus moved away from Easterbrook and Fischel's view that arrangements among parties in the company context 'depend on contract' and 'not on corporate law or the status of the corporation as an entity',[51] the new consensus has not displaced the focus on agency problems. As *The Anatomy of Corporate Law* clarifies, in addition to its role of providing organizations with a basic structure, company law addresses conflicts of interest between shareholders and directors, controlling and non-controlling shareholders, and shareholders and other parties (such as creditors and employees) with whom the firm contracts.[52] Indeed, corporate laws everywhere share the same core features'[53]

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[46] A concise overview of how company law scholarship has evolved can be found in David Gindis and Martin Petrin, 'The Economic Analysis of Corporate Law', in A Marciano and GB Ramello *Encyclopedia of Law and Economics* (Springer 2020).

[47] John Armour and Michael J Whincop, 'The Proprietary Foundations of Corporate Law' (2007) 27 *Oxford Journal of Legal Studies* 429.

[48] Henry Hansmann and Reinier R Kraakman, 'The Essential Role of Organizational Law' (2000) 110 *Yale Law Journal* 387; Henry Hansmann and Reinier R Kraakman, 'Organizational Law as Asset Partitioning' (2000) 44 *European Economic Review* 807; Kraakman et al (n5).

[49] Henry Hansmann, Reinier R Kraakman and Richard Squire, 'Law and the Rise of the Firm' (2006) 119 *Harvard Law Review* 1333, 1337; Kraakman et al (n5) 6.

[50] Margaret M Blair, 'Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century' (2003) 52 *UCLA Law Review* 387; Margaret M Blair, 'The Neglected Benefits of the Corporate Form: Entity Status and the Separation of Asset Ownership from Control' in A Grandori *Corporate Governance and Firm Organization: Microfoundations and Structural Forms* (Oxford University Press 2004); Richard Squire, 'Why the Corporation Locks in Financial Capital but the Partnership Does Not' (2022) 74 *Vanderbilt Law Review* 1787; Giuseppe Dari-Mattiacci, 'The Theory of Business Organizations' in A Badawi *Corporate Law and Economics* (*Encyclopedia of Law and Economics* 2nd ed, Vol 11 2023).

[51] Easterbrook and Fischel (n5) 12.

[52] Kraakman et al (n5) 2, 29-30.

[53] Ibid 267. See also David Cabrelli and Irene-Marie Esser, 'A Rule-Based Comparison and Analysis of the Case Studies' in M Siems and D Cabrelli *Comparative Company Law: A Case-Based Approach* (2nd ed Hart 2018).

because they 'respond to the similar economic problems'[54] Therefore, company law rules can and should be assessed in terms of their agency cost-reducing effects—the only evaluative criterion that really matters. This thinking extends to soft law instruments, such as the UK Corporate Governance Code,[55] the Stewardship Code,[56] the Wates Corporate Governance Principles for Large Private Companies,[57] and similar codes elsewhere. It pervades almost any discussion of corporate governance reform. The narrative is powerful, but it is not without limitations.

3 TENSIONS AND LIMITATIONS

It is inevitable that theories and models underscore some features of the reality they wish to portray and understand, to the detriment of others: this process of 'theoretical isolation' is essential to the enterprise of theorizing, and economic theorizing is no exception to this rule.[58] For example, supply-and-demand models taught in introductory economics courses[59] isolate the effects of price variations on the quantities exchanged, suppressing and directing attention away from the effects of transaction costs or the roles of legal institutions, which are considered given (or hidden behind *ceteris paribus* clauses).[60] While this seems to make them unrealistic, because they capture basic principles such as the 'law of demand' (namely, the observable phenomenon that people demand less of something when its price increases, all else being equal), such parsimonious models provide important insights into the nature of economic reality, if only a particular part of that reality.

If we want a thicker picture of the market, we need to include something that was previously excluded or engage with additional theoretical models, perhaps attempting some form of theoretical unification.[61] But we would be wrong to reject the understanding gained

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[54] Ibid 4.

[55] https://www.frc.org.uk/directors/corporate-governance/uk-corporate-governance-code.

[56] https://www.frc.org.uk/investors/uk-stewardship-code.

[57] https://www.frc.org.uk/directors/corporate-governance/governance-of-large-private-companies.

[58] Ekkehart Schlicht, *Isolation and Aggregation in Economics* (Springer 1985); Uskali Mäki, 'On the Method of Isolation in Economics' (1992) 26 *Poznan Studies in the Philosophy of the Sciences and the Humanities* 316.

[59] Eg John Sloman and Dean Garrett, *Essentials of Economics* (9th ed 2023 Pearson).

[60] Uskali Mäki, 'Economics with Institutions: Agenda for Methodological Enquiry' in U Mäki, B Gustafsson and C Knudsen, *Rationality, Institutions and Economic Methodology* (Routledge 1993) 27.

[61] Uskali Mäki, 'Theoretical Isolation and Explanatory Progress: Transaction Cost Economics and the Dynamics of Dispute' (2004) 28 *Cambridge Journal of Economics* 319, 320.

from the basic supply-and-demand model. By the same token, although models of the firm developed to study the make-or-buy decision isolate the effects of asset specificity on the level of transaction costs,[62] thereby suppressing or directing attention away from entrepreneurship,[63] among other things, such parsimonious models shine an useful light on the determinants of firm boundaries and the distinction between firms and markets. A more realistic picture of the firm can be obtained by including broader strategic considerations or engaging with alternative paradigms, possibly with a view to unifying them,[64] but it would be a mistake to reject the knowledge gained from basic make-or-buy models.

Agency-theoretic models that isolate the effects of incentive-aligning remedies on conflicts of interests are no different in this respect. Placing conflicts of interest and incentive-aligning solutions under the microscope focuses attention on a key part of what company law and corporate governance are about, but the isolations involved in such 'single-factor governance models', to use Gilson's expression,[65] suppress or direct attention away from other important parts of the story. While we should appreciate that agency theory provides a heuristic 'common language'[66] for framing many developments around the world,[67] and retain what 'a straightforward agency perspective'[68] can teach us, we also need to be aware of what the lens of agency theory obscures. This then opens up the possibilities for including things that were previously excluded from the analysis, and may provide a justification for engaging with additional theoretical perspectives. Both avenues may lead to explanatory progress.

3.1 The company

Agency models involve isolations that suppress or direct attention away from some of the most basic features of company law. Indeed, one problem with viewing companies

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[62] Sanford Grossman and Oliver D Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' (1986) 94 *Journal of Political Economy* 691; Oliver D Hart, *Firms, Contracts and Financial Structure* (Oxford University Press 1995).

[63] Kirsten Foss and Nicolai J Foss, 'Theoretical Isolation in Contract Theory: Suppressing Margins and Entrepreneurship' (2000) 7 *Journal of Economic Methodology* 313, 319.

[64] As, for example, in Nicholas Argyres and Todd Zenger, 'Capabilities, Transaction Costs, and Firm Boundaries' (2012) 23 *Organization Science* 1643.

[65] Gilson (n14) 15.

[66] Kraakman et al (n5) 3.

[67] Curtis J Mulhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press 2008) 52.

[68] Shleifer and Vishny (n32) 738.

exclusively through the lens of conflicts of interests among individuals, or classes of individuals, is that the legal structure of the company is relegated to the background. This is particularly clear in Easterbrook and Fischel's suggestion that contractual arrangements among parties in the company do not depend on the status of the company as a separate entity.[69] What matters, for them, are the 'real contracts'[70] between the 'real people' involved in the company – not the 'unreal' contracts that each participant formally enters into with the company, which, given that the company itself is merely a legal fiction, are more 'a matter of convenience than reality.'[71]

Although it is now widely recognized that the separate legal entity supplied by company law is more than mere convenience, commitment to the idea that a key function of company law is to mitigate conflicts between shareholders and managers makes it almost inevitable to look through and ultimately ignore the corporate entity.[72] It also makes it almost inevitable to assume the existence of real contracts where there are none. There are no direct, actual, or even implied contracts among corporate officers, directors, and shareholders,[73] and descriptions of the company constitution as a contract, albeit a 'statutory' one,[74] are misleading. Directors owe fiduciary duties to the company, not the shareholders, with the implication that the conflict of interest arises not been directors and shareholders, but between the directors and the company.[75] The only way to reinterpret this as a conflict between directors and shareholders is to assume that the body of shareholders and the company are one and the same, which not only contradicts the *Salomon* principle[76] but also leads to the paradoxical view that the shareholders both are and own the company.[77]

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[69] Easterbrook and Fischel (n5) 12.

[70] Ibid 15-16.

[71] Ibid 12. See also Klein (n39); Henry N Butler, 'The Contractual Theory of the Corporation' (1989) 11 *George Mason University Law Review* 4; Jonathan R Macey, 'Corporate Law and Corporate Governance: A Contractual Perspective' (1993) 18 *Journal of Corporation Law* 185.

[72] Micheler (n16) 4.

[73] Robert C Clark, 'Agency Costs Versus Fiduciary Duties' in JW Pratt and RJ Zeckhauser, *Principals and Agents: The Structure of Business* (Harvard Business School Press 1985) 60.

[74] Companies Act 2006, s 33; Micheler (n16) 112-122. See also David Gibbs-Kneller and Arad Reisberg, 'The Thick End of the Wedge: Good Faith in the Corporate Constitution" (Society of Legal Scholars Conference on Rethinking Company Law, University of Newcastle, 2024).

[75] Micheler (n16) 31.

[76] *Salomon v A Salomon & Co Ltd* [1897] AC 22.

[77] Viewing shareholders as the 'owners' of the company is itself an anachronistic remnant of partnership law. On this, see: Paddy Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 52 *Modern Law Review* 32; David Ciepley, 'The Anglo-American Misconception of Stockholders as "Owners" and "Members": Its Origins and Consequences' (2020) 16 *Journal of Institutional Economics* 623.

These tensions can be seen in the shifting language *The Anatomy* uses to describe the third conflict of interest, variously portrayed as a conflict 'between shareholders and the corporation's other contractual counterparties'[78], a conflict 'between the firm itself – including, particularly, its owners – and the other parties with whom the first contracts',[79] and a conflict 'between non-shareholder constituencies and shareholders as a class'.[80] There are no direct, actual, or even implied contracts among shareholders and any of company's other constituencies. Instead, constituencies have a legal relationship with the company. It is a curious state of affairs when an approach that so carefully established that the essential role of company law is to provide organizations with a separate legal entity proceeds to ignore it.[81] Overall, although agency-theoretic thinking has generated considerable advances for company law scholars, the isolations agency theory imposes invertedly direct attention away from the central object of company law scholarship – the company itself.

3.2 Management and remuneration

The prevailing paradigm focuses attention primarily on directors and shareholders, to the detriment of other constituencies. Specifically, what is suppressed is the role of senior and lower-ranking managers, whose impact on information flows, corporate decision-making, and outcomes more generally is significant, especially in large firms. The focus on conflicts of interest among board-level players means that the approach has little to say about the day-to-day managing of the company: the analysis of the company is decoupled from the reality of the organization it is meant to enable. Thus, Coase's critique of his fellow economists' tendency 'to neglect the main activity of a firm, running a business',[82] can be directed at company law scholars as well, whose discussions rarely consider what anyone below the board level actually does.[83] Even less is said of entrepreneurship, despite the fact that

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[78] Kraakman et al (n5) 2.

[79] Ibid 30.

[80] Ibid 267.

[81] Paddy Ireland refers to the tendency to take the separate existence of the company very seriously in some contexts but to completely ignore it in others as 'corporate schizophrenia'. See Paddy Ireland, 'Corporate Schizophrenia: The Institutional Origins of Corporate Social Irresponsibility' in Nina Boeger and Charlotte Villiers, *Shaping the Corporate Landscape: Towards Corporate Reform and Enterprise Diversity* (Hart 2018).

[82] Ronald H Coase, 'The Nature of the Firm: Influence' (1988) 4 *Journal of Law, Economics and Organization* 33, 38. Coase attributed this defect to an 'undue emphasis … on the choice of contractual arrangements' that his approach had encouraged; he understood the limits imposed by his theoretical isolations.

[83] A historical account of how we got here can be found in: Andrew Johnston, Blanche Segrestin and Armand Hatchuel, 'From Balanced Enterprise to Hostile Takeover: How the Law Forgot about Management' (2018) 39

entrepreneurs typically require company law to set up and operate their businesses. As a result, company law scholarship today falls short of 'capturing the empirical phenomena company law is designed to support'.[84]

The disconnection between agency theory and the realities of how companies are run is thrown into sharp relief by the lack of consistent empirical support for the prediction that incentive-aligning compensation packages enhance corporate performance.[85] This may be an matter of poor compensation design.[86] It may also be down to faulty governance structures, which enable executives to influence remuneration committees and therefore their own pay.[87] But there is arguably a deeper issue here. Prior to the latter part of the twentieth century, when there were no remuneration committees or reporting requirements, when markets for corporate control did not exert disciplinary pressures, and when directors typically determined their own remuneration, executive pay was restrained, even when adjusted for taxation.[88] Agency theory would have predicted quite the opposite. We are not suggesting that the emphasis on agency costs and incentive-aligning solutions is wrong. Our point is merely that there seems to be more than just incentives involved.

3.3 Behavior and organization

The typical agency theory model assumes that humans are self-interested utility maximizers who respond to extrinsic incentives. This suppresses or directs attention away from alternative behavioral assumptions. While leading agency theorists, including Jensen, have at

Legal Studies 75; Andrew Johnston and Blanche Segrestin, 'Lost from View: The Legal Invisibility of Managers in the UK' in Knut Sogner and Andrea Colli, *The Emergence of Corporate Governance: People, Power and Performance* (Routledge 2021).

[84] Micheler (n16) 29.

[85] Cynthia E Devers, Albert A Cannella, Gregory P Reilly and Michele E Yoder, 'Executive Compensation: A Multidisciplinary Review of Recent Developments' (2007) 33 *Journal of Management* 1016; Herman Aguinis, Luis R. Gomez-Mejia, Geoffrey P Martin and Harry Joo, 'CEO Pay Is Indeed Decoupled from CEO Performance: Charting a Path for the Future' (2018) 16 *Management Research* 117; Carola Frydman and Raven E Saks, 'Executive Compensation: A New View from a Long-Term Perspective, 1936-2005' (2010) 23 *Review of Financial Studies* 2099; Alex Edmans and Xavier Gabais, 'Executive Compensation: A Modern Primer' (2016) 54 *Journal of Economic Literature* 1232.

[86] Increasingly complex compensation packages seem to have a negative impact on corporate performance: Ana M Albuquerque, Mary E Carter, Zhe Guo and Luann J Lynch, 'Complexity of CEO Compensation Packages' (2023) ECGI Working Paper No. 885/2023, https://ssrn.com/abstract=4066889.

[87] Lucian A Bebchuk and Jesse M Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard University Press 2004); Alexander Pepper, *Agency Theory and Executive Pay: The Remuneration Committee's Dilemma* (Palgrave 2019).

[88] Lorraine Talbot and Andreas Kokkinis, *Great Debates in Company Law* (Hart 2024).

times proposed a more nuanced view,[89] the basic model underpinning company law and corporate governance scholarship (most notably *The Anatomy*) remains expressed in traditional terms. But efforts to expand the analysis are underway. Some have incorporated intrinsic motivation and other insights from behavioral economics (micro) into agency-theoretic explanations of executive pay,[90] while others have appealed to cultural explanations (macro).[91] Both approaches may help explain the restraints in pay mentioned above. There has also been a more general interest in how considerations of human cognitive fallability might help scholars construct an alternative understanding of company law and corporate governance.[92] We welcome these avenues of research: insofar as they deal with understanding and regulating human interactions, legal scholars need to appreciate and address the full spectrum of human motivation and cognition.

But behavioral approaches that remain focused on board-level phenomena do not accomplish enough. The new conceptual model we believe is needed requires not just richer behavioral assumptions but also a broadening of what company law scholarship views as the empirical phenomena company law is designed to support. Here, institutional theory, much of which is already built on alternative behavioral foundations, can make a vital contribution. For example, Eva Micheler's recent *Company Law: A Real Entity Theory*[93] combined insights

[89] Michael C Jensen and William H Meckling, 'The Nature of Man' (1994) *Journal of Applied Corporate Finance* 4; Michael C Jensen, 'Self-Interest, Altruism, Incentives and Agency Theory' (1994) *Journal of Applied Corporate Finance* 40.

[90] Alexander Pepper and Julie Gore, 'Behavioral Agency Theory: New Foundations for Theorizing about Executive Compensation' (2015) 41 *Journal of Management* 1045; Alexander Pepper, *The Economic Psychology of Incentives: New Design Principles for Executive Pay* (Palgrave-Macmillan 2015).

[91] Amir N Licht, 'Culture and Law in Corporate Governance' in Jeffrey N Gordon and Wolf-Georg Ringe, *The Oxford Handbook of Corporate Law and Governance* (Oxford University Press 2015). For a cultural reinterpretation of the main results of the law and finance literature, see Amir N Licht, Chanan Goldschmidt and Shalom H Schwartz, 'Culture, Law and Corporate Governance' (2005) 25 *International Review of Law and Economics* 229.

[92] Kent Greenfield, 'The End of Contractarianism? Behavioral Economics and the Law of Corporations' in E Zamir & D Teichman *The Oxford Handbook of Behavioral Economics and the Law* (Oxford University Press 2014). See also Donald C. Langevoort, 'Behavioral Approaches to Corporate Law' in Claire A Hill and Brett H McDonnell *Research Handbook on the Economics of Corporate Law* (Edward Elgar 2012); Julia Redenius-Hövermann, 'Behavioural Economics, Neuroeconomics and Corporate Law' in HK Anheier and T Baums *Advances in Corporate Governance: Comparative Perspectives* (Oxford University Press 2020).

[93] Micheler (n16).

from institutional theory[94] with an updated version of real entity theory[95] to argue that organizations are autonomous and 'real in their consequences',[96] before showing how this idea sits with company law. Organizations affect their members' beliefs and actions, giving rise to practices that otherwise would not come about, and are sustained by these practices. Company law formalizes, legitimizes, and enhances autonomous organizational actions by ensuring that their consequences exist not just socially but also legally. It supplies a procedural framework for corporate decision-making and mechanisms for holding organizational actors to account. Our aim in what follows is to push further in this direction.

4 A BRIEF INTRODUCTION TO INSTITUTIONAL THEORY

We propose that corporate law scholars draw inspiration from proponents of New Private Law,[97] whose openness to new methodologies, ideas, and subject areas, and attendant efforts to embed legal doctrine within wider theoretical thinking, is commendable. For the purpose of setting out a conceptual framework linking human behavior, economic organization, company law, and the broader environment, a 'wealth of new avenues for exploration' are available throughout the social sciences.[98] The value of seeking these lies in the novel theoretical framings they invite us to consider. Since each framing will involve its own isolations, we may find that some degree of unification will be required to advance our agenda. And since we do not wish to reject agency theory, we will also need to find 'ways to synthesize it with [these] complementary perspectives'.[99] But let us first provide an overview of what we consider to be the most fruitful avenues for exploration. There is more to say

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[94] Especially: *Herbert A Simon, Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations* (Macmillan 1947); Richard R Nelson and Sydney G Winter, *An Evolutionary Theory of Economic Change* (Harvard University Press 1982); W Richard Scott, *Institutions and Organizations: Ideas, Interests and Identities* (4th ed 2014 Sage).

[95] David Gindis, 'From Fictions and Aggregates to Real Entities in the Theory of the Firm' (2009) 5 *Journal of Institutional Economics* 25; Richard Adelstein, 'Firms as Social Actors' (2010) 6 *Journal of Institutional Economics* 329; Christian List and Philip Pettit, *Group Agency: The Possibility, Design and Status of Corporate Agents* (Oxford University Press 2011). See also Eric W Orts, *Business Persons: A Legal Theory of the Firm* (Oxford University Press 2013).

[96] Micheler (n16) 21.

[97] See n12 above.

[98] Matthew T Bodie, 'The Post-Revolutionary Period in Corporate Law: Returning to the Theory of the Firm' (2012) 35 *Seattle university Law Review* 1033, 1057.

[99] Barak Richman, 'New Institutional Economics' in Gold et al (n12) 120.

about each of the approaches discussed, but for our present purpose these summary statements will suffice.

The variety of institutional paradigms to be found in political science, sociology, and economics are particularly relevant.[100] Different types of 'institutionalisms' are available in each of these disciplines, often with distinctions between 'new' and 'old' versions.[101] To corporate lawyers, the most familiar of these is the 'new institutional economics', which comprises, among other prominent subfields, the contractual theory of the firm and agency theory.[102] Williamson suggests that agency models focus on phenomena (incentive alignment and efficient risk-bearing) that are nested within those the theory of the firm is concerned with (governance structures), which are themselves set within the broader institutional environment (legal system) studied by other subfields of the new institutional economics.[103] In principle, company law theory spans all three levels of analysis, though in its current version explanations of and justifications for specific legal rules and governance arrangements boil down to their effects on individual incentives.

What unites all institutionalisms is, broadly speaking, a common interest in understanding how shared (social) rules affect behavior, outcomes, and their evaluation. If we think of institutions as established and durable social rules – including norms, conventions, customs, laws, or regulations – we need to explain how such rules (a) emerge, are made, expressed, enacted, enforced, legitimized, compared, contested, function, change, or evolve, (b) to guide, govern, constrain, enable, expand, or disrupt (c) individual, interpersonal, or collective (d) cognition, beliefs, valuations, identity, morality, interests, strategies, incentives, communication, action, coordination, and organization. While some approaches focus on formal rules (laws, regulations), others look at informal ones (norms, conventions, customs) or their interplay. But the key differences between institutional theories lie in the choice of level of analysis (individual, organization, industry, society), the relative explanatory weight

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[100] Licht's (n91) discussion of culture and law in corporate governance likewise points to the relevance of a broad range of institutionalist paradigms.

[101] See for example: Malcolm Rutherford, *Institutions in Economics: The Old and New Institutionalism* (Cambridge University Press 1994); Mary C Brinton and Victor Nee, *The New Institutionalism in Sociology* (Russell Sage Foundation 1998); B Guy Peters, *Institutional Theory in Political Science: The New Institutionalism* (4th ed 2019 Edward Elgar).

[102] Comprehensive overviews can be found in: Claude Ménard and Mary M Shirley, *Handbook of New Institutional Economics* (Springer 2005); Eric Brousseau and Jean-Michel Glachant, *New Institutional Economics: A Guidebook* (Cambridge: Cambridge University Press 2008).

[103] Oliver E Williamson, 'The New Institutional Economics: Taking Stock, Looking Ahead' (2000) 38 *Journal of Economic Literature* 595, 597.

given to individual action as opposed to social structures or social forces, and combinations of elements in the (a)-(d) sequence that are highlighted.

In political science, it is customary to distinguish three institutionalisms.[104] The first is 'rational choice institutionalism', which leans heavily on microeconomics and game theory to explain how individual strategic cost-benefit calculations, bargaining, and rent-seeking behavior depend on transaction and agency costs, and determine the formal organization of the polity and the dynamics of political change.[105] A second approach, 'sociological institutionalism', revives ideas from classical sociology by holding that human behavior is shaped and legitimated by cultural symbols, moral templates, and the need to maintain a repertoire of social roles and shared identities.[106] Political change, from this perspective, is driven not by efficiency or cost-benefit considerations but by social forces and the spread of novel conceptions of legitimate action.[107] Finally, 'historical institutionalism' stands somewhere between,[108] in that it considers humans as both norm-abiding rule-followers and self-interested rational actors capable of opportunistic behavior, depending on the context, with the implication that macro-level change, which it sees as embedded in concrete path-depedent processes, can be explained in multiple ways.[109]

Scholars in sociology and management studies have developed an approach known as 'organizational institutionalism' to examine connections between individual and group behavior, managerial structures that determine chains of command and assign roles and

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[104] Peter A Hall and Rosemay CR Taylor, 'Political Science and the Three New Institutionalisms' (1996) *Political Studies* 936. See also Edward A Koning, 'The Three Institutionalisms and Institutional Dynamics: Understanding Endogenous and Exogenous Change' (2015) 36 *Journal of Public Policy* 639; Henry Farrell, 'The Shared Challenges of Institutional Theories: Rational Choice, Historical Institutionalism and Sociological Institutionalism' in J Cluckler, R Suddaby and R Lenz *Knowledge and Institutions* (Springer 2018).

[105] Kenneth A Shepsle, 'Rational Choice Institutionalism' in SA Binder, RAW Rhodes and BA Rockman *The Oxford Handbook of Political Institutions* (Oxford University Press 2008). See also Terry Moe, 'The New Economics of Organization' (1984) 28 *American Journal of Political Science* 739; Jack Knight, *Institutions and Social Conflict* (Cambridge University Press 1992).

[106] Sociological institutionalism, which sometimes goes by other labels, is usually associated with James G March and John P Olsen, *Rediscovering Institutions: The Organizational Basis of Politics* (Free Press 1984). See also Mark Blyth, *Great Transformations: Economic Ideas and Institutional Change* (Cambridge University Press 2002).

[107] 'Discursive institutionalism' is an offshoot of this approach that revolves around the idea that the public communication of ideas, and the institutional context in which and through which ideas are communicated, produces their legitimation. See Vivien A Schmidt, 'Discursive Institutionalism: The Explanatory Power of Ideas and Discourse' (2008) 11 *Annual Review of Political Science* 303.

[108] Sven Steinmo, 'Historical Institutionalism' in D Della Porta and M Keating, *Approaches and Methodologies in the Social Sciences* (Cambridge University Press 2008) 126.

[109] Kathleen Thelen, 'Historical Institutionalism in Comparative Politics' (1999) 2 *Annual Review of Political Science* 369; Orfeo Fioretos, Tulia G Falleti and Adam Sheingate, *The Oxford Handbook of Historical Institutionalism* (Oxford University Press 2016).

responsibilities, and the normative pressures specific to an industry or emanating from society at large.[110] A distinctive feature of this approach is that it identifies and focuses on 'fields', which comprise 'key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products',[111] and are governed by 'institutional logics',[112] namely by shared conceptions of value and common understandings of the rules of legitimate action. This explains why organizations tend to share more similarities than differences, and why such similarities tend to persist over time.[113] But while widespread adherence to the prevailing logics tend to provide stability to a given field, strategic action by institutional entrepreneurs, seeking to change the balance of power in their favor by using discursive, political, or legal means, is to be expected.[114] Such dynamics can be observed both inside and outside organizational boundaries.

Indeed, individual organizations are actors in higher-level (industry) fields but also themselves contain fields, given that any organization is a coalition of diverse professional interests that contest which of several possible governance models should be adopted.[115] Any settlement must strike a balance between various internal and external valuations or orders of worth.[116] Understanding corporate governance thus requires not simply an invocation of alternative behavioral assumptions but the recognition that the social reality of the organization to be governed is constructed in overlapping fields.[117] In other words, as James

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[110] Paul J DiMaggio and Walter W Powell, *The New Institutionalism in Organizational Analysis* (University of Chicago Press, 1991); Royston Greenwood, Christine Oliver, Kerstin Sahlin and Roy Suddaby, *The SAGE Handbook of Organizational Institutionalism* (Sage 2008); Linda Rouleau, *Organization Theories in the Making: Exploring the Leading-Edge Perspectives* (Oxford University Press 2022).

[111] Paul J DiMaggio and Walter W Powell, 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields' (1983) 48 *American Sociological Review* 147, 148. For an overview, see Melissa Wooten and Andrew J Hoffman, 'Organizational Fields: Past, Present and Future' in Greenwood et al (n109).

[112] Patricia H Thornton, William Ocasio and Michael Lounsbury, *The Institutional Logics Perspective: A New Approach to Culture, Structure and Process* (Oxford University Press 2012).

[113] DiMaggio and Powell (n109); Ronald L Jepperson and John W Meyer, *Institutional Theory: The Cultural Construction of Organizations, States and Identities* (Cambridge University Press 2021).

[114] Cynthia Hardy and Steve Maguire, 'Institutional Entrepreneurship' in Greenwood et al (n109).

[115] Royston Greenwood and CR Hinings, 'Understanding Strategic Change: The Contribution of Archetypes' (1993) 36 *Academy of Manageement Journal* 1052.

[116] Luc Boltanski and Laurent Thévenot, *On Justification: Economies of Worth* (trans C Porter, Princeton University Press 1991). See also David Stark, *The Sense of Dissonance: Accounts of Worth in Economic Life* (Princeton University Press 2009).

[117] Neil Fligstein and Doug McAdam, *A Theory of Fields* (Oxford University Press 2012) 9, 59-64. Organizational institutionalism shares with systems theory the idea that there are distinct social arenas of interactions, which have specific boundaries but are also embedded within wider systems. See W Richard Scott, *Organizations: Rational, Natural and Open Systems* (4th ed 1998 Sage).

Westphal and Edward Zajac put it, a 'multi-level alternative to the simple theories used by governance researchers, such as agency theory',[118] is needed. Among other things, a multi-level view of governance can help explain differences in managerial discretion across industries or countries.[119]

Although law does not play an explicit role in organizational institutionalism,[120] it is clear that the organizations operating within fields, and indeed fields themselves, are to an important degree legally constructed. The constitutive power of law has been highlighted in 'legal institutionalism', an approach which recently emerged in economics in response to the tendency among economists to downplay the legal determinants of economic institutions.[121] The legal constitution of organizational actors involves decisions concerning who or what counts as a legal actor, as well as decisions about the nature and scope of the rights and duties thus assigned. Such decisions are not merely a matter of company law because, as Simon Deakin has argued, legal actors are constructed simultaneously in employment law, commercial law, insolvency law, and tax law.[122] Nor are such decisions merely legal, as they also depend on the changing social, political, and normative evaluations of the community.[123]

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[118] James D Westphal and Edward J Zajac, 'A Behavioral Theory of Corporate Governance: Explicating the Mechanisms of Socially Situated and Social Constituted Agency' (2013) 7 *Academy of Management Annals* 607, 651.

[119] Craig Crossland and Donald C Hambrick, 'Differences in Managerial Discretion Across Countries: How Nation-Level Institutions Affect the Degree to Which CEOs Matter' (2011) 32 *Strategic Management Journal* 797. Futher arguments for the adoption of a multi-level view of governance can be found in Ruth V Aguilera, Deborah E Rupp, Cynthia A Williams and Jyoti Ganapathi, 'Putting the S Back in Corporate Social Responsibility: A Multilevel Theory of Social Change in Organizations' (2007) 32 *Academy of Management Review* 836; See also Licht (n91).

[120] Frank Partnoy, 'Law and the Theory of Fields' (2016) 39 *Seattle University Law Review* 579, 583.

[121] Simon Deakin, David Gindis, Geoffrey M Hodgson, Kainan Huang and Katharina Pistor, 'Legal Institutionalism: Capitalism and the Constitutive Role of Law' (2017) 45 *Journal of Comparative Economics* 188; Geoffrey M Hodgson, *Conceptualizing Capitalism: Institutions, Evolution, Future* (University of Chicago Press 2015). See also Katharina Pistor, 'Legal Theory of Finance' (2013) 41 *Journal of Comparative Economics* 315. Given its aim of developing a legally-grounded understanding of key economic institutions of capitalism (such as money, property, finance, markets, and firms), this approach is distinct from the body of legal theory that goes by the same label (which we do not explore here), the aim of which is to understand law as an institutional normative order. See: Neil MacCormick and Ota Weinberger, *An Institutional Theory of Law: New Approaches to Legal Positivism* (Kluwer 1986); Neil MacCormick, *Institutions of Law: An Essay in Legal Theory* (Oxford University Press 2007).

[122] Simon Deakin, 'The Juridical Nature of the Firm' in T Clarke and D Branson *The SAGE Handbook of Corporate Governance* (Sage 2012) 119; Simon Deakin, 'The Corporation in Legal Studies' in In G Baars and A Spicer *The Corporation: A Critical, Multi-Disciplinary Handbook* (Cambridge University Press 2017) 55. The entire range of legal instruments that construct and regulate the firm is sometimes called 'enterprise law'. See Ewan McGaughey, *Principles of Enterprise Law: The Economic Constitutional and Human Rights* (Cambridge University Press 2022).

[123] David Gindis, 'Legal Personhood and the Firm: Avoiding Anthropomorphism and Equivocation' (2016) 12 *Journal of Institutional Economics* 499, 507; Susana K Ripken, *Corporate Personhood* (Cambridge University Press 2019) 50.

But while changes in such evaluations accompany the emergence of new categories of organizational actors, new kinds of markets, or new types of commodities, it is often their 'legal codification' that cements their place in the relevant fields.[124]

None of the institutionalist paradigms discussed here were developed with a legal audience explicitly in mind, so it is hardly surprising that they are little known in legal circles,[125] or that company law scholars seem largely unaware of what various institutionalisms might bring to the table. The aim of our inevitably selective overview was to highlight ideas that are thus largely absent in company law theory, but which we believe may be tremendously helpful in moving company law scholarship forward. We are now in a position to outline an analytical framework that links company law with the economic organization it enables and supports, and places it within a broader institutional setting, thereby allowing us to gain a better understanding of the law as it stands.

5 INSTITUTIONAL THEORY FOR COMPANY LAW

Mainstream company law theory can be viewed as the company law version of rational choice institutionalism, as more or less the same economic concepts and frameworks are used to explain the formal organization of company law and the dynamics of legal change. Progress is therefore unlikely to come from this body of work,[126] unless it is combined with relevant insights from the sociological, historical, organizational, and legal institutionalisms. The question, in this case, is how to bring these disparate elements together. Here, we propose to follow Williamson and Ostrom. What we take from Williamson is not the

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[124] Katharina Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* (Princeton University Press 2019). See also:Ana Lourenço and Simon Turner, 'The Role of Regulation in Constituting Markets: A Co-Evolutionary Perspective on the UK Television Production Sector (2019) 15 *Journal of Institutional Economics* 615; Brian Callaci, 'Control Without Responsibility: The Legal Creation of Franchising, 1960-1980' (2021) 22 *Enterprise and Society* 156; Michael G Jacobides and Ioannis Lianos, 'Regulating Platforms and Ecosystems: An Introduction' (2021) 30 *Industrial and Corporate Change* 1131; Simon Deakin, 'The Legal Construction of Management: A Neo-Realist Framing and Genealogical Case Study' (2023) 23 *Journal of Corporate Law Studies* 375.

[125] An exception is legal institutionalism, which is now part of the conversation in renewed efforts to connect law with political economy: Jedediah Britton-Purdy, David S Grewal, Amy Kapczynski and K Sabeel Rahman, 'Building a Law-and-Political Economy Framework: Beyond the Twentieth Century Synthesis' (2020) 129 *Yale Law Journal* 1785; Ioannis Kampourakis, 'Legal Theory in Search of Social Transformation' (2023) 1 *European Law Open* 808.

[126] There is still no doubt something to learn from the agency models with multiple principals used more in political science than in economics, and therefore in company law scholarship. See Edgar Kisser, 'Comparing Varieties of Agency Theory in Economics, Political Science and Sociology: An Illustration from State Policy Implementation' (1999) 17 *Sociological Theory* 147.

transaction cost economics he is famous for,[127] but rather his call for a 'law, economics, and organization' approach.[128] And what we take from Ostrom is not her most celebrated work on the management of natural common-pool resources,[129] but rather her specific approach to doing institutional analysis.

Williamson's general idea is that our analysis of the firm must not rest solely on economics, or even solely on law and economics; instead, in addition to making economic sense and being fully cognisant of the legal framework within which firms operate, it must draw on research in organization theory.[130] In a famous exchange with Williamson, Posner forcefully rejected this view, on the grounds that organization theory had nothing useful to add to law and economics.[131] It seems that company law scholars have mostly, albeit implicitly, agreed. Yet this is where company law theory stands to gain the most. Indeed, even Posner changed his mind about the value of organization theory for the study of legal institutions and corporate governance.[132] In subscribing to Williamson's approach, we do not need to accept his idiosyncratic view of what exactly ought to be retained from each of the three fields of study. But we do think that an approach that rests on the 'three interdisciplinary legs' of law, economics, and organization[133] – that is willing to the take account of all the relevant legal framework, and that is open to considering the range of insights from organization theory – is an important step in the right direction.

This is the approach that will help us integrate the key ideas from the institutional approaches outlined in the previous section, and capture the empirical phenomena company law is designed to support. We propose to build the relevant framework from the bottom up,

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[127] For an overview, see Oliver E Williamson, 'Transaction Cost Economics: The Natural Progression' (2010) 100 *American Economic Review* 673.

[128] Williamson (n13); Oliver E Williamson, 'Revisiting Legal Realism: The Law, Economics and Organization Perspective' (1996) 5 *Industrial and Corporate Change* 383.

[129] See most notably Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge University Press 1990).

[130] Williamson had in mind not organizational institutionalism but older works, such as: Simon (n94); Chester I Barnard, *The Functions of the Executive* (Harvard University Press 1938); James G March and Herbert A Simon, *Organizations* (Wiley 1958); Richard M Cyert and James G March, *A Behavioral Theory of the Firm* (Basil Blackwell 1963); Richard H Hall, *Organizations: Structure and Process* (Prentice-Hall 1972); Howard E Aldrich, *Organizations and Environments* (Prentice-Hall 1979).

[131] Richard A Posner, 'The New Institutional Economics Meets Law and Economics' (1993) 149 *Journal of Institutional and Theoretical Economics* 73, 84.

[132] Richard A Posner, 'From the New Institutional Economics to Organization Economics: With Applications to Corporate Governance, Government Agencies and Legal Institutions' (2010) 6 *Journal of Institutional Economics* 1.

[133] Oliver E Williamson, 'Reflections on the New Institutional Economics' (1985) 141 *Journal of Institutional and Theoretical Economics* 187, 190.

identifying and exploring the phenomenon we are examining through an interdisciplinary lens and with a methodologically open mind, without commitment to particular theoretical priors. In this, we also follow Williamson, whose approach not only engaged in conversations across disciplinary boundaries but also borrowed liberally from traditions in economics that did not fit into orthodox boxes.[134] Williamson advocated an exploratory 'pragmatic methodology' that eschewed the self-confidence of orthodox thinking and unpretentiously attempted to understand some class of phenomena by simply asking: 'What is going on here?'[135] Methodological openness, theoretical pluralism, and interdisciplinarity were likewise the hallmarks of Ostrom's work,[136] which is particularly useful for the task at hand.

On our reading, Ostrom's approach to institutional analysis combines key elements of rational choice, sociological, historical, organizational, and legal institutionalisms. Like rational choice institutionalism, the 'Bloomington school' associated with Ostrom and her colleagues[137] views human behavior in terms of strategic individual interactions and has relied extensively on game theory to analyze the structure and outcomes of conflicts of interest over resource uses.[138] But like sociological institutionalism, 'Ostromian institutionalism'[139] recognizes that behavior is also driven by internalized social norms and shared moral templates, which inevitably intervene when people evaluate outcomes and

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[134] Oliver E Williamson, *Organization Theory: From Chester Barnard to the Present and Beyond* (Oxford University Press 1990); Oliver E Williamson, 'The Sociology and Economics of Organization: One View of the Dialogue' in U Bindseil, J Haucap and C Wey *Institutions in Perspective* (Nohr Siebeck 2006). For an overview, see Esther-Mirjam Sent and Annelie LJ Kroese, 'Commemorating Oliver Williamson, A Founding Father of Transaction Cost Economics' (2022) 18 *Journal of Institutional Economics* 181.

[135] Oliver E Williamson, 'A Comparison of Alternative Approaches to Economic Organization' (1990) 146 *Journal of Institutional and Theoretical Economics* 149; Oliver E Williamson, 'What Is Going On Here? – Pragmatic Methodology and Economic Organization' (2003), unpublished (https://www.researchgate.net/publication/242074798); Oliver E Williamson, 'Pragmatic Methodology: A Sketch, with Applications to Transaction Cost Economics' (2009) 16 *Journal of Economic Methodology* 145; Williamson (n126). See also Barak Richman, '"Just What is Going Here?" An Homage' (2023) 86 *Law and Contemporary Problems* 131.

[136] Elinor Ostrom and James Walker, *Trust and Reciprocity: Interdisciplinary Lessons for Experimental Research* (Russell Sage 2003); Amy R Poteete, Marco A Janssen and Elinor Ostrom, *Working Together: Collective Action, the Commons, and Multiple Methods in Practice* (Princeton University Press 2010). For an overview and an example of how Ostrom's approach can be usefuly extended beyond the natural resource context, see Brett Frischmann, 'Two Enduring Lessons from Elinor Ostrom' (2013) 9 *Journal of Institutional Economics* 387.

[137] Paul D Aligica and Peter J Boettke, *Challenging Institutional Analysis and Development: The Bloomington School* (Routledge 2009); Dan H Cole and Michael McGinnis, *Elinor Ostrom and the Bloomington School of Political Economy, Vol 3: A Framework for Policy Analysis* (Lexington 2018).

[138] Elinor Ostrom, Roy Gardner and James Walker, *Rules, Games and Common-Pool Resources* (University of Michigan Press 1994).

[139] Paul D Aligica, *Institutional Diversity and Political Economy: The Ostroms and Beyond* (Oxford University Press 2014) 166.

procedures.[140] Like historical institutionalism, the Bloomington school focuses on incremental and path-dependent institutional change, which it analyzes by focusing on nested 'action situations',[141] similar to the action fields discussed by organizational institutionalists. Finally, like legal institutionalists, it places great emphasis on the constitutive power of formal and informal rules that assign rights to positions, govern access to and uses of resources, and define structures of authority and responsibility.[142]

All these elements come together in what Ostrom and her colleagues referred to as the 'Institutional Analysis and Development' (IAD) framework, which is a 'multitier conceptual map'[143] developed to 'allow social scientists from various disciplinary backgrounds to organise their thinking' about governance arrangements.[144] It is therefore exactly what we need. Before we adapt it to the analysis of the company, let us briefly examine how mainstream company law scholarship represents the company. Hansmann[145] proposed the following visualization:

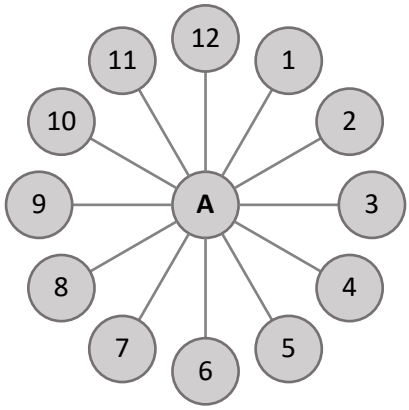

Figure 1. The nexus-of-contracts visualization of the company

Figure 1 represents actors (circles) and their bilateral relationships (lines) with the company (A), the sole common central party, represented by its directors. The actors, who can be

[140] Ostrom (n15n15).

[141] Ostrom (n15) 32-68.

[142] Ostrom (n15) 188-200.

[143] Elinor Ostrom, 'Doing Institutional Analysis: Digging Deeper than Markets and Hierarchies' in Ménard and Shirley (n102) 828.

[144] Dan H Cole, 'Laws, Norms and the Institutional Analysis and Development Framework' (2017) 13 *Journal of Institutional Economics* 829, 833.

[145] Henry Hansmann, 'Ownership and Organizational Form' in Robert Gibbons and John Roberts, *The Handbook of Organizational Economics* (Princeton University Press 2013) 893.

natural or legal persons, include investors (actors 1 and 2, for example), employees (actors 3 to 7), suppliers (actors 8 and 9), and customers (actors 10 to 12). No distinction is made between investors, employees, suppliers, or customers, all of whom are represented as just having a contractual relationship with the company. Figure 1 is a static representation that says nothing about the allocation of power, influence, or governance rights between shareholders and other participants. It does not capture the central point of agency-theoretic thinking that shareholders have governance rights because they are residual claimants.[146] Nor does it show how different actors interact with each other over time, understand their positions and situations, or evaluate outcomes.[147]

The IAD framework, by contrast, enables a far more granular and dynamic analysis. It focuses not on bilateral relationships but on action situations,[148] which it characterizes in terms of a set of formal and informal rules defining the participants' positions and governing access to and uses of resources, the attributes of the community (ranging from group size and heterogeneity to shared values and mental models), and relevant material conditions.[149] These 'structural variables'[150] can be found in action situations in any social setting – markets, courtrooms, corporate boardrooms, faculty meetings, and even the family dinner table[151] – though their values will of course differ. The IAD framework furthermore connects action situations across multiple levels of governance: the 'operational level' of frequent interactions among participants, where everyday decisions are made; the 'policy level' (or 'collective choice level'), where strategic orientations are formulated and rules affecting the operational level are set; the 'constitutional level', where the rules of the game, including who can make policy decisions and how they must be made, are defined; and finally the 'meta-constitutional level', which establishes how constitutional-level decisions are made and by whom.[152]

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[146] Micheler (n16) 4-5.

[147] To be fair, the nexus-of-contracts model was never meant to do any of these other things. Its purpose was to shift attention from firms (or corporations) to the individuals voluntarily contributing to the surplus. See Gindis (n37).

[148] Ostrom (n15) 32-35.

[149] Ostrom (n15) 15-27.

[150] Ostrom (n142) 827; Elinor Ostrom, 'Background on the Institutional Analysis and Development Framework' (2011) 39 *Policy Studies Journal* 7, 9.

[151] Cole (n144) 831.

[152] Ostrom (n15) 58-64; Cole (n144) 831; Michael D McGinnis, 'An Introduction to IAD and the Language of the Ostrom Workshop: A Simple Guide to a Complex Framework' (2011) 39 *Policy Studies Journal* 169.

This setup scales up and down, applying to organizations, the industry, or society itself. At this macro level of analysis, the meta-constitutional encompasses 'long-lasting and often subtle constraints' on the forms of constitutional, policy, and operational processes that are 'considered legitimate within an existing culture',[153] the policy or collective choice level comprises for example the legislature and various regulatory bodies, while firms and similar organizations are actors at the operational level. This bears some resemblance to Williamson's presentation of the new institutional economics noted above,[154] but the resemblance stops there. Williamson matches different kinds of institutional economics to different levels of analysis, whereas Ostrom develops a multi-level framework within the same institutional analysis. Moreover, Ostrom, but not Williamson, considers that firms and similar organizations contain nested levels of governance.[155] In fact, a detailed Ostromian analysis of how organizations function concretely reveals many action situations within each nested level of governance.[156]

In any action situation, interactions are framed by formal law and informal rules but are driven by the participants' interests and the incentive structure they face, their perceptions of and beliefs concerning the material and social environment, and their evaluation of the outcomes. To avoid over-complicating the presentation, Figure 2[157] visualizes only the key interdependent nested action situations in a company:

[153] McGinnis (n152) 173.

[154] What Ostromians refer to as the meta-constitutional level, Williamson calls the 'social embeddedness level'. See Williamson (n103) 596

[155] Ostrom's analysis can be scaled further down: each action situation can itself be analyzed in terms of nested levels of governance. We set this possibility aside here.

[156] Ostrom (n15) 55-57, 109, 179-180. See also Michael D McGinnis, 'Networks of Adjacent Action Situations in Polycentric Governance' (2011) 39 *Policy Studies Journal* 51.

[157] Adapted from Ostrom (n15) 59.

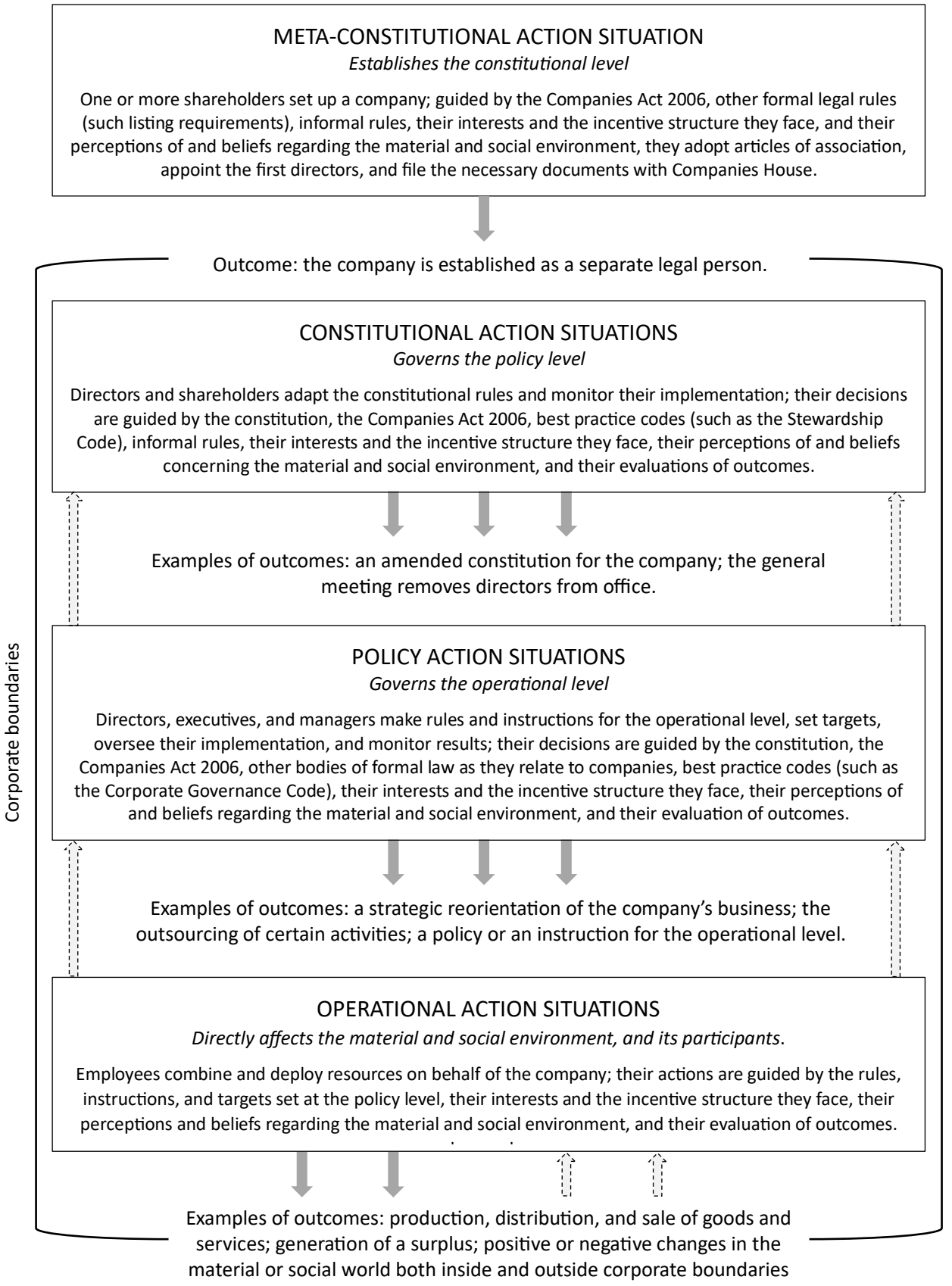

Figure 2. An Ostromian visualization of the company

Figure 2 paints a more realistic picture of how companies operate than Figure 1. We do not take this to mean that the nexus-of-contracts model ought to be discarded. Indeed, it remains relevant at a higher level of abstraction – as a useful first approximation of the contractual relationships a company may have with various constituencies. But if we want to look closer at the connections between the company and the organization it enables and supports, and in the process understand how action situations are interrelated across different governance levels, then we should turn to Figure 2.[158] The difference between Figure 1 and Figure 2 is not merely that the former is more abstract than the latter; the two figures do not visualize the same thing. To broaden company law theory is not simply to focus on the same thing in a less abstract way but also to expand and shift somewhat the focus. Instead of simplifying the object of analysis, our Ostrom-inspired narrative model provides a thicker representation that complicates our understanding of the company.[159] The result is less parsimonious, but it enables a better understanding of how companies are run.[160]

Action at the meta-constitutional level by one or several entrepreneurs (initial subscribers to the memorandum) and the Registrar constitutes the company as a legal actor governed by its articles of association. The legal entity serves as the nexus for contractual relationships with internal and external parties, enabling and supporting an organization, whose governance spans the constitutional, policy, and operational levels. These therefore lie within the corporate boundaries. In constitutional-level action situations, directors and shareholders can adapt the articles and monitor their implementation. The larger the organization, the greater the diversity of policy action situations and the greater the spread of operational action situations. In the largest companies, directors assume responsibility for the general setting of strategy and formal policy, while various committees (such as the remuneration committee) formulate domain-specific policies and procedures. Senior managers interpret and adapt directorial decisions to the divisions or departments they are

[158] Hansmann similarly noted that the nexus-of-contracts diagram, representing how contractual relationships are organized around a common central party, and a conventional organizational chart, representing the way authority is exercised through a cascade of relationships, serve different purposes. See Hansmann (n145) 892.

[159] By 'complicating rather than simplifying', we follow Gilson (n14) 16.

[160] 'To explain the world of interactions and outcomes occurring at multiple levels', Ostrom observed in her Nobel lecture, 'we … have to be willing to deal with complexity instead of rejecting it … We should continue to use simple models where they capture enough of the core underlying structure and incentives that they usefully predict outcomes. When the world we are trying to explain and improve, however, is not well described by a simple model, we must continue to improve our frameworks and theories so as to be able to understand complexity and not simply reject it.it.' See Elinor Ostrom, 'Beyond Markets and States: Polycentric Governance of Complex Economic Systems' (2010) 100 *American Economic Review* 641, 665.

responsible for. The process continues down further levels of junior managers, all the way to operational action situations. In Figure 2, this is captured by the downward-pointing arrows.

The upward-pointing arrows at the bottom of Figure 2 represent the idea that information about positive or negative changes in the material or social world – both inside and outside the corporate boundaries – resulting from operational actions is perceived and evaluated by the actor(s) at that level and taken into account in the next iterations.[161] It is also captured by actors at the policy level, enabling them to monitor and evaluate the effects of their instructions, revising these accordingly. It is furthermore fed up to constitutional-level action situations, such as meetings of the board of directors or the general meeting, where the directors' or the shareholders' evaluations may on occasion lead them to act. With time, lawmakers will receive information about the outcomes generated by the meta-rules they have set and, based on their own evaluations and other policy orientations, may decide to adjust the Companies Act or the other complementary bodies of law constituting and regulating the companies' activities at all levels. Overall, these feedback loops, represented by downward- and upward-pointing arrows, underpin the dynamics of organizational change.

Companies and their governance thus change incrementally, in path-dependent ways. This neither always ends in nor always requires legal codification. An important result of Ostrom's work – based on decades of extensive field work, and game-theoretic, experimental, and empirical analysis – is that self-governance is sometimes preferable to external regulation.[162] Although conflicts of interest over resource uses that lead to free-riding, collective action, and commitment problems can be found in action situations at all levels of any given organization, participants are often capable of crafting formal and informal rules and procedures to create the conditions in which reciprocity and trust can overcome opportunistic temptations.[163] In doing so, participants may evaluate procedures and outcomes based on economic efficiency, but they are just as likely to use other evaluative criteria, including: equity; adaptability, resilience, and robustness; accountability; and conformance to general morality.[164] How different people understand these criteria may vary.

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[161] See Ostrom (n15) 104-113 for an analysis of how individual process information and evaluate outcomes.

[162] Elinor Ostrom, James Walker and Roy Gardner, 'Covenants With and Without a Sword: Self-Governance Is Possible' (1992) 86 *American Political Science Review* 404; Ostrom (n159).

[163] Ostrom et al (n138); Elinor Ostrom, 'A Behavioral Approach to the Rational Choice Theory of Collective Action' (1998) 92 *American Political Science Review* 1.

[164] Ostrom (n15) 66-68.

Conflicts of interest are thus not the only relevant conflicts in the organizational context. The heterogeneity of evaluative criteria means that interpersonal (or intergroup or interdivisional) conflicts may arise when people (or groups or divisions) evaluate outcomes of decisions about resource uses, or procedures used to reach those decisions, using different criteria. To avoid the incidence and potentially detrimental effects of such confrontations concerning valuation and therefore governance, organizations strive to develop a set of overarching norms and shared mental models that provide a sense of community and shared identity, with a view to preventing excessive cognitive dissonance and facilitating settlements about orders of value.[165] Durable organizations promote a corporate culture that tacitly acts as a 'glue' binding their members together into relatively cohesive wholes.[166] To the extent that they succeed, this set of overarching norms becomes part of their constitutional structure, in the sense that it affects the rules governing the policy and operational levels.

6 APPLICATIONS AND EXTENSIONS

We have argued that the theoretical isolations imposed by agency-theoretic thinking in company law scholarship, while leading to significant progress in the field, have also suppressed or directed attention away from some of the most basic features of company law. The focus on board-level actors has furthermore contributed to decoupling the analysis of the company from the organization it is meant to enable and support. This has left company law scholars with relatively little to say about the realities of how companies are run. Our Ostrom-inspired narrative model of the company seeks to overcome these tensions and limitations. We now need to explain in more detail how it achieves this objective. This should allow us to gain a better understanding of the law as it stands and places us in a stronger position to evaluate the likely consequences of certain normative interventions, in areas ranging from executive compensation and reporting to corporate criminal liability. We can also extend the discussion to broader corporate governance debates.

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[165] See n116 above. On the issue of value heterogeneity and the importance of overarching norms in the Ostromian perspective, see Paul D Aligica and Vlad Tarko, 'Co-Production, Polycentricity and Value Heterogeneity: The Ostroms' Public Choice Institutionalism Revisited' (2013) 107 *American Political Science Review* 726.

[166] Gindis (n95) 40; Micheler (n16) 28. See also Geoffrey M Hodgson, 'Corporate Culture and the Theory of the Firm' in John Groenewegen, *Transaction Cost Economics and Beyond* (Kluwer 1996) 255-256.

6.1 The company

Mainstream company law scholarship holds that the creation of a separate legal entity, with its own asset pool that can be used to bond contractual commitments with third parties, is an essential role of company law.[167] This is a vital insight, but company law has at least one other essential role that has been overlooked: it provides a 'procedural framework for autonomous organizational action'.[168] An organization's separate legal personality is both a vector for collective action – a 'legal anchor allowing it to interact with the world'[169] – and an institutional device that preserves its self-governance capacity. For example, as Jonathan Hardman argues in line with the theoretical framework advanced here, the remedies protecting the interests of minority shareholders, while balancing the interests of minority and majority shareholders, predominantely protect the company and its business from interference by one class of its participants.[170] In addition to providing a framework for autonomous decision-making, the law lays down the rules that determine when and by whom the organization can be bound in its corporate capacity, and defines how and to whom information about organizational actions should be revealed. Arguably, although it can accommodate shelf companies or special purpose vehicles that do not trade, both historically and in practice today, 'company law is designed for the operation of organizations'[171] that do.

An agency-theoretic perspective, which frames everything through the lens of conflicts of interest among board-level players, can conceivably explain the imperative to reveal information through reporting. But if we are right that company law is designed for the operation of autonomous organizations, and not just deal with conflicts among a subset of the relevant participants, it is difficult to see how agency theory can help us understand why company law enables and supports the organization's self-governance capacity. In comparison, our thicker understanding of the company as an incorporated organization does a better job of capturing the empirical phenomena company law is designed to support.[172] This

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[167] Hansmann and Kraakman (n48); Hansmann et al (n49).

[168] Micheler (n16) 63. See also Eva Micheler, 'Separate Legal Personality: An Explanation and a Defence' (2024) *Journal of Corporate Law Studies* (https://doi.org/10.1080/14735970.2024.2365170).

[169] Micheler (n16) 63. See also Gindis (n123) 508.

[170] Jonathan Hardman, 'An Institutional Analysis of UK Ostensible Minority Shareholder Protection Mechanisms' (2023) 23 *Journal of Corporate Law Studies* 397.

[171] Micheler (n16) 32, 77.

[172] The question of how terms such as 'company', 'corporation', 'firm', and 'organization' ought to be defined in law and the social sciences has recently been discussed in: Simon Deakin, David Gindis and Geoffrey

requires a broader view of corporate boundaries: an analysis that remains fixated on board-level actors misses the organization's nested levels of governance; it overlooks a whole range of action situations that affect corporate performance and therefore should be within the scope of company law scholarship.

6.2 Management and organizational practices

When one's model of the company is disconnected from the reality of the organization it is meant to enable and support, one can only assume that whatever happens at the board level somehow feeds down through the policy and operational levels, leading to some desired overall corporate performance or result. This seems naïve, especially in large (listed or private) companies.[173] In our model, when instructions are passed down from the constitutional and policy levels to the operational level, there is no reason to expect their automatic execution, because actors at this level have their own interests and neither necessarily hold homogenous beliefs about their environment nor necessarily evaluate their situations or the instructions they receive using the same criterion. Yet this expectation appears to underpin practices such as performance-related executive compensation – and may explain the absence of a strong empirical relationship between executive remuneration and corporate performance.[174]

Our approach generates a hypothesis as to why this might be the case. Performance pay can drive a wedge between how directors and executives perceive their place and role in the organization, and how other actors perceive those things, especially when packages awarded to constitutional- or policy-level actors are perceived as excessive by operational level actors. The overall result can be a deterioration of the sense of collective identity and belonging that helps attenuate free riding, collective action, and commitment problems, thereby magnifying these problems.[175] So while agency costs may have been reduced, the net

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M Hodgson, 'What Is a Firm? A Reply to Jean-Philippe-Robé' (2021) 17 *Journal of Institutional Economics* 861; Jonathan Hardman, 'The Nexus of Contracts Revisited: Delineating the Business, the Firm and the Legal Entity' (2022) 34 *Bond Law Review* 1; Jonathan Hardman 'Fixing the Misalignment of the Concession of Corporate Personality' (2023) 43 *Legal Studies* 443; David Gindis and Geoffrey M Hodgson, 'The Legal Nature of the Firm' in *Research Handbook on the Theory of the Firm*, edited by Josef Windsperger and Aveed Raha (forthcoming Edward Elgar).

[173] Although some management scholars suggest that the greater the discretion of top-level managers, the more their backgrounds and choices affect corporate performance. See: Donald C Hambrick and Phyllis A Mason, 'Upper Echelons: The Organization as a Reflection of Its Top Managers' (1984) 9 *Academy of Management Review* 193.

[174] See n85 above.

[175] A similar point is made by Pepper (n90) 33.

result is uncertain, and the possibility that performance pay may not lead to better corporate performance cannot be ruled out. A lesson here is that instead of encouraging the alignment of pay to the 'successful delivery of the company's long-term strategy' (UK Corporate Governance Code 2024, Principle P), policymakers might wish to investigate whether a shift away from performance pay practices can enable directors to better adhere to the purpose and values of the company.

Relatedly, a model of the company that focuses on board-level actors likely assumes that whatever happens at the operational level gets fed up to the policy and constitutional levels. Again, except the smallest companies, this seems naïve. Our model does not assume any form of automatic or seamless movement of information about outcomes and positive or negative changes in the material or social world from operational action situations to the policy or constitutional levels. As a company grows and managerial levels are added, the feedback loops become more complex, and it becomes increasingly difficult and costly for the upper levels to monitor and evaluate outcomes.[176] This helps explain why reporting, which requires directors to collect and record information about outcomes produced at operational levels, is an imperfect legal tool. While recording and reporting requirements formalize the feedback loop into law and governance practices, the production of verifiable information that can bring about the sorts of organizational changes required to meet policy objectives, like environmental protection, is difficult.[177] Appropriately designed legal and regulatory interventions need to take this into account, as do legal scholars.[178]

Christian Witting, in work that complements our perspective, has recently suggested that mid- and higher-level managers in large companies should be brought within the fold of corporate governance regulation.[179] Corporate criminal liability provides a good illustration.

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[176] Williamson provides related reasons grounded in organization theory for the intrinsic limitations of boards in monitoring and managing. See Oliver E Williamson, 'Corporate Boards of Directors: In Principle and in Practice' (2008) 24 *Journal of Law, Economics and Organization* 247; Oliver E Williamson, 'Corporate Governance: A Contractual and Organizational Perspective' in Lorenzo Sacconi, Margaret Blair, R Edward Freeman and Alessandro Vercelli *Corporate Social Responsibility and Corporate Governance: The Contribution of Economic Theory and Related Disciplines* (Palgrave Macmillan 2011).

[177] Karen Morrow, 'Informational Requirements and Environmental Protection' in E Lees and JE Viñuales JE *The Oxford Handbook of Comparative Environmental Law* (Oxford University Press 2019); Daniel Attenborough, 'Corporate Disclosure on Climate Change: An Empirical Analysis of FTSE All-Share British Fossil Fuel Producers' (2022) 23 *European Business Organization Law Review* 313.

[178] The effectiveness of regulatory interventions thus crucially depends on organizational and managerial factors, and not just on the type of regulatory regime. On the latter, see Iris HY Chiu, 'An Institutional Theory of Corporate Regulation' (2019) 39 *Northwestern Journal of International Law and Business* 85.

[179] Christian Witting, 'The Place of Managers in the Corporate Governance Architecture' (2024) *Journal of Corporate Law Studies* (https://doi.org/10.1080/14735970.2024.2350142).

The doctrinal position that companies could not themselves be criminally liable started to change in the 1940s.[180] Initially, the identification doctrine was used to determine whose acts were to be characterized as the acts of the company.[181] This led to a focus on the directing mind and will of the company, which was normally thought to be located at the policy level, in proximity of the board of directors. This worked well for small companies, where the directors were operationally involved. With large companies, however, the doctrine was problematic: boards were typically too far removed from the action situations where the criminal harm was produced to display the necessary mental element triggering criminal conduct.[182] The consequence was that low-level employees were held personally responsible, but there was no responsibility for hazardous management practices that bred criminal conduct. It was widely accepted that this was wrong.[183]

By the late 1980s, the Health and Safety Executive formed the view that accidents were the result of failure in systems for controlling risk, and that individual carelessness was merely a (more or less important) contributory factor.[184] The Sheen Report into the *Herald of Free Enterprise* accident found that the company was 'from top to bottom' infected with 'the disease of sloppiness'.[185] In such circumstances, a focus on the policy level alone could not address the problem – on the contrary, this encouraged directors to delegate health and safety practices to the lowest and remotest operational level possible.[186] In response, the most recent statutory interventions rely on a 'failure to prevent' approach,[187] which implicitly rests on the idea that company law provides a procedural framework for autonomous organizational action and that corporate culture matters.[188] Thinking further along these lines, Elise Bant and Rebecca Faugno have proposed the concept of 'systems intentionality', which assumes that corporations manifest their state of mind through their de facto systems of conduct, policies

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[180] Celia Wells, *Corporations and Criminal Responsibility* (2nd ed Oxford University Press 2001).

[181] *R v ICR Haulage* (1944) KB 551, 559.

[182] Law Commission, *Criminal Liability in Regulatory Contexts* (Law Com No 195, 2010) paras 5.53–5.68 and 5.90; see also Law Commission, *Involuntary Manslaughter* (Law Com No 237, 1996) paras 6.35–6.39.

[183] *Involuntary Manslaughter* (n180) para 1.10. See also Celia Wells, 'Corporate Criminal Liability: A Ten Year Review' (2014) 12 *Criminal Law Review* 849.

[184] *Involuntary Manslaughter* (n180) para 7.13.

[185] Mr Justice Sheen, MV *Herald of Free Enterprise*: Report of the Court (No 8074), Department of Transport (1987) para 14.1; *Involuntary Manslaughter* (n180) paras 6.55 and 8.45–8.50. See also CMV Clarkson, 'Kicking Corporate Bodies and Damning Their Souls' (1996) 59 *Modern Law Review* 557.

[186] *Involuntary Manslaughter* (n180) para 1.17.

[187] See most recently Economic Crime and Corporate Transparency Act 2023 (c 56) s 199.

[188] Micheler (n16) 93-97.

and practices, the quality of which can be evaluated when decisions about attributing corporate criminal responsibility are made.[189] It is hard to conceptualize this approach without a model of the company that integrates the underlying organization.

6.3 Broader corporate governance debates

Our narrative model of the company is neutral as regards the 'shareholder vs stakeholder' debate.[190] The nested levels of governance that it visualizes are there irrespective of how power is allocated among directors, shareholders, and other constituencies. But institutional theory more generally adds depth to any discussion of such matters. In particular, it shows why the imperative to maximize shareholder returns and, correspondingly, minimize agency costs, which established itself during the 'market-friendly' 1980s,[191] is a normative and political construct.[192] Organizational institutionalism helps us see that the meaning of existing or proposed corporate governance rules and practices is constructed or contested across overlapping fields of law (including legislatures, courts, law schools, law journals, and the legal professions) and business (such as business schools, the business press, finance journals, the accounting and auditing professions, consultancies, and the investor community).[193]

The new conceptions of value and methods of valuation strategically promoted by institutional entrepreneurs at the turn of the 1980s[194] spread across these fields simultaneously, spurred by the merger boom and the rise of new categories of investors and

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[189] Elise Bant and Rebecca Faugno, 'Corporate Culture and Systems Intentionality: Part of the Regulator's Essential Toolkit' (2023) 23 *Journal of Corporate Law Studies* 345.

[190] On this, see n10 above.

[191] Romano (n18); Cheffins (n18); Brian R Cheffins, 'Corporate Governance since the Managerial Capitalism Era' (2015) 89 *Business History Review* 717, 731. See generally Brian Cheffins, *The Public Company Transformed* (Cambridge University Press 2018).

[192] See Alexander Styhre, *The Making of Shareholder Welfare Society: A Study in Corporate Governance* (Routledge 2018).

[193] Edward J Zajac and James D Westphal, 'The Social Construction of Market Value: Institutionalization and Learning Perspectives on Stock Market Reactions' (2004) 69 *American Sociological Review* 433; Marion Fourcade and Rakesh Khurana, 'From Social Control to Financial Economics: The Linked Ecologies of Economics and Business in Twentieth Century America' (2013) 42 *Theory and Society* 121; Neil Fligstein, 'The Theory of Fields and Its Applications to Corporate Governance' (2016) 39 *Seattle University Law Review* 237.

[194] Examples include financial economists (such as Michael Jensen or Stewart Myers) promoting new ideas like 'agency costs', 'free cash flow', or 'adjustment present value', and consultancies (such as LEK/Alcar and Stern Stewart), promoting new metrics like 'economic value added', 'market value added', or 'shareholder value added'. See Julie Froud, Colin Haslam, Sukhdev Johal and Karel Williams, 'Shareholder Value and Financialization: Consultancy Promises, Management Moves' (2000) 29 *Economy and Society* 80; Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams, *Financialization and Strategy: Narrative and Numbers* (Routledge 2006).

new kinds of capital markets, which quickly became legally codified. This shifted the balance of power from managers to shareholders.[195] Today, it is difficult to depart from the institutional logic of shareholder primacy because it is part of our business culture – in Ostromian terms, it is part of the meta-constitution of society. Shareholder value-driven notions of 'good' governance are entrenched across the entire range of relevant fields of law and business, such that any attempt to promote socially responsible corporate practices are invariably transformed into something compatible with shareholder value. For example, this seems to be the case with environmental, social, and governance reporting standards, as Dorophy Lund and Elizabeth Pollman have argued.[196] The prevailing institutional logic even supports the belief that profit or shareholder wealth maximization are a legal duty.[197]

Colin Mayer's influential project aiming to convince business that profit maximization is an inadequate aim, to be replaced with the pursuit of profitable solutions to the problems faced by people and planet, can be seen as an attempt by an institutional entrepreneur to change the social norms that influence how companies view their place in society and what society expects of them.[198] Firms, as Eric Orts has recently argued, have a 'plurality of normative purposes', created internally by their participants and externally by law and social norms.[199] These must be reconciled where they conflict.[200] Efforts to develop new methods of valuation, such as integrated reporting,[201] and new concepts, such as double

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[195] Fligstein (n193) 252-260. This process was accompanied by a major shift in the 'cultural grammar of governance'. See Jeroen Veldman and Hugh Willmott, 'The Cultural Grammar of Governance: The UK Code of Corporate Governance, Reflexity and the Limits of "Soft" Regulation' (2015) 69 *Human Relations* 581. A more general discussion of the role of politics in corporate governance can be found in: Mark J Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford University Press 2003); Peter A Gourevitch and James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (Princeton University Press 2005).

[196] Dorothy S Lund and Elizabeth Pollman, 'The Corporate Governance Machine' (2021) 121 *Columbia Law Review* 2563, 2612-2615.

[197] Leo E Strine, 'Our Continuing Struggle With the Idea That For-Profit Corporations Seek Profit' (2012) 47 *Wake Forrest Law Review* 135; Stephen M Bainbridge, *The Profit Motive: Defending Shareholder Value Maximization* (Cambridge University Press 2023)

[198] Colin Mayer, *Firm Commitment: Why the Corporation is Failing Us and How to Restore Trust In It* (Oxford University Press 2013); Colin Mayer, *Prosperity: Better Business Makes the Greater Good* (Oxford University Press 2018). See more generally British Academy, *Principles for Purposeful Business* (2019), https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business. The discussion is succinctly connected with corporate law in Colin Mayer, 'What Is Wrong with Corporate Law? The Purpose of Law and the Law of Purpose' (2022) 18 *Annual Review of Law and Social Science* 283.

[199] Eric W Orts, 'Toward a Theory of Plural Business Purposes' (2023) 23 *Journal of Corporate Law Studies* 437, 439.

[200] Glaudine Gartenberg and Todd Zenger, 'The Firm as a Subsociety: Purpose, Justice and the Theory of the Firm' (2023) 34 *Organization Science* 1965.

[201] Jukka Mähönen, 'Integrated Reporting and Sustainable Corporate Governance from a European Perspective' (2020) 10 *Accounting, Economics and Law* 1.

materiality,[202] seek to identify and reduce such conflicts, and belong to the same category of institutional entrepreneurship. Against this background, criticism that corporate purpose is not legally enforceable[203] may be missing the point. The purpose project seeks to modify the societal evaluations operating alongside the legal framework and inform its interpretation. Its proponents hope that a change of perspective at the meta-constitutional level of society will create a feedback loop that might lead to legal change.

When the UK Companies Act 2006 refers to the 'success of the company', it does not use the term 'maximization': 'A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard … to [certain stakeholder concerns]'.[204] Admittedly, s 172 gives priority to the interests of 'the members as a whole' over those of other stakeholders, but it nevertheless instructs directors to 'promote the success of the company', without imposing any specific actions to be undertaken in any specific timeframe, and tempering this injunction by underlying good faith.[205] On an agency-theoretic reading, s 172 endorses enlightened shareholder value maximisation. But it can also be read as the law's recognition that directors' perceptions of the organization's internal and external environment, and their appreciation of different parties' contributions, at all governance levels, are subject to their honest evaluation of what is best for the company itself.[206] In fact, Susan Watson and Lynn Buckley's historical analysis suggests that at no point since the emergence of companies with permanent capital has the directors' duty to act in good faith has been owed to the shareholders collectively.[207]

Our Ostromian perspective is compatible with either interpretation, though it sits better with the latter because it reinforces our argument that an essential role of company law is that it enables and preserves autonomous organizational action. What our model also recognizes

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[202] Félix E Mezzanotte, 'Corporate Sustainability Reporting: Double Materiality, Impacts and Legal Risk' (2023) 23 *Journal of Corporate Law Studies* 633.

[203] David Kershaw and Edmund Schuster, 'The Purposive Transformation of Corporate Law' (2021) 69 *American Journal of Comparative Law* 478; Paul Davies, 'Shareholder Voice and Corporate Purpose: The Purposeless of Mandatory Corporate Purpose Statements' (2023) ECGI Working Paper 694/2003, https://ssrn.com/abstract=4397435.

[204] Companies Act 2006, s 172(1).

[205] Micheler (n16) 131-134.

[206] Andrew Keay, 'Ascertaining The Corporate Objective: An Entity Maximisation and Sustainability Model' (2008) 71 *Modern Law Review* 663.

[207] Susan Watson and Lynn Buckley, 'Directors' Positive Duty to Act in the Interests of the Entity' (2024) *Journal of Corporate Law Studies* (https://doi.org/10.1080/14735970.2024.2350142).

is that directors' judgments are influenced by their personal backgrounds and values,[208] the characteristics of the action situations they find themselves in, and the attributes of the broader community within which the company is embedded. All these factors shape how directors understand their obligations, interpret the law, and evaluate stakeholder contributions. When directors make decisions about what is best for the company, they thus rely on a multiplicity of evaluative criteria: efficiency is important, but so are equity, resilience, accountability, and conformance to general morality. The freedom to navigate in good faith what Amir Licht calls 'value complexity'[209] lies at the foundations of the company's self-governing capacity.[210]

Policymakers and legislatures have taken note of the fact that social norms can sometimes have a greater impact than formal law. In seeking to foster self-regulation, they effectively co-opt market actors as corporate regulators.[211] This is in part how the use of soft law instruments, such as the UK Corporate Governance Code and the Stewardship Code, has been justified.[212] In the same vein, the aim of efforts to change board composition – promoted by the Davies Review[213] and the Parker Review[214] – is to influence social practices, not to recommend formal legal change. While the government insists that the aim is to inform investors about corporate practices, and thus allow market participants to allocate funds according to their preferences,[215] it is possible, as Konstantinos Sergakis has recently suggested,[216] to view these initiatives as attempts to alter our shared social understanding of

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[208] Empirical confirmation can be found in Renée B Adams, Amir N Licht and Lilach Sagiv, 'Sharedholders and Stakeholders: How Do Directors Decide?' (2011) 32 *Strategic Management Journal* 1331.

[209] Amir N Licht, 'The Maximands of Corporate Governance: A Theory of Values and Cognitive Style' (2004) 29 *Delaware Journal of Corporate Law* 649.

[210] See also Edward B Rock and Michael L Wachter, 'Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation' (2001) 149 *University of Pennsylvania Law Review* 1619.

[211] David Kershaw, 'Corporate Law and Self-Regulation' in Jeffrey N Gordon and George Ringe *The Oxford Handbook of Corporate Law and Governance* (Oxford University Press 2015).

[212] An unintended consequence of such efforts is that they seem to encourage box-ticking. On this, see: Moore and Petrin (n8) 65; Brian R Cheffins and Bobby V Reddy, 'Thirty Years and Done – Time to Abolish the UK Corporate Governance Code' (2022) 22 *Journal of Corporate Law Studies* 709.

[213] https://assets.publishing.service.gov.uk/media/5a818543e5274a2e87dbe122/BIS-15-585-women-on-boards-davies-review-5-year-summary-october-2015.pdf.

[214] https://parkerreview.co.uk/wp-content/uploads/2023/03/The-Parker-Review-March-2023.pdf.

[215] Dionysia Katelouzou and Eva Micheler, 'The Market for Stewardship and the Role of the Government' in *Global Shareholder Stewardship*, edited by Dionysia Katelouzou and Dan W Puchniak (Cambridge University Press 2022).

[216] Konstantinos Sergakis, 'Shareholder Stewardship: Autonomy and Sociality' (2023) 23 *Journal of Corporate Law Studies* 497.

acceptable corporate practices – to influence, in the language of our narrative model, the meta-constitutional level of society.

7 CONCLUSIONS

Reliance on agency-theoretic reasoning has led to substantial advances in company law scholarship. But the narrow focus on board-level actors and phenomena has disconnected the analysis of the company from the reality of the organization it is meant to enable and support. Coase's critique of economists' tendency 'to neglect the main activity of a firm, running a business',[217] can just as well be directed at company law scholars, who rarely consider what managers or other actors below the board level do. While it is important to think about the consequences of conflicts of interest between shareholders and directors, or majority and minority shareholders – agency theory will always be relevant and useful in this respect – we need to remember that there is more to understanding the nature and structure of companies. Our view of the empirical phenomena that are relevant for company law scholarship needs to expand if we wish to tackle questions that the prevailing agency-theoretic reasoning is ill-equipped to address.

We have proposed to shift company law scholarship toward what Williamson called a 'law, economics, and organization' approach,[218] whereby the existing law and economics framework is improved thanks to the input of organization theory. What exactly an approach of this kind might involve is hardly a settled matter. We have relied on the Ostromian 'multitier conceptual map'[219] – the IAD framework – to think about what it might look like. The Ostromian perspective presents several important advantages. First, it allows us to think about companies in terms of nested levels of governance, from the board of directors and the general meeting, through the managerial hierarchy, all the way down to employees at operational levels of the organization. Second, it makes room for a broad range of behavioral assumptions, without rejecting self-interest or assuming that behavior is either rational or a deviation from rationality. Third, it helps us to combine several rich traditions of institutional theory from across the social sciences and advance a real entity theory of the company[220]

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[217] Coase (n82) 38.

[218] Williamson (n13); Williamson (n128).

[219] Ostrom (n143).

[220] Micheler (n16).

without invoking any kind of 'mysterious, non-individualist force'.[221] Taken together, these features enable us to gain a richer understanding of what the company is and how it operates.

The main purpose of our Ostrom-inspired narrative model is to organize our thinking about the company. It is simply an attempt answer to Williamson's unpretentious question, 'What is going on here?'[222] To fix ideas, we have focused on the most straightforward of cases – the single incorporated organization – where the legal entity serves as a nexus for contractual relationships with internal and external parties, facilitating the acquisition, specialization, and combination of various kinds of resources required for the production of goods and services for sale in the market. The governance of this process, which may lead to a surplus, is not limited to board-level actors but spans the constitutional, policy, and operational levels of the organization, which we accordingly include within the corporate boundaries. We believe that our model provides a reasonably good starting point for a better understanding of the purpose of company law, and has direct applications to issues of corporate governance.

That said, there is ample room for improvement. We appreciate, for example, that our model involves isolations that suppress or direct attention away from complex group structures, the effects of market competition, and many more things that company law scholars are interested in. At this stage, therefore, our discussion does not address many of important company law topics – ranging from control transactions and group liability to jurisdictional competition. We can, however, point out that an Ostromian approach to any such topic would strive to identify the relevant action situations at nested levels of governance, and take account of the fact that, in any action situation, interactions are framed not just by formal and informal rules defining the participants' positions and governing resource uses, but also by the attributes of the community and relevant material conditions. Company law scholarship has much to gain from research into the connections between human behavior, organizations, the legal forms they take, and their societal environment.

Overall, although efficiency need not be the only relevant evaluative criterion when thinking about the design of legal rules – as participants in real-world action situations understand all too well – we would argue that even if efficiency were the only game in town, broadening our view of the company to include the reality of the underlying organization

[221] List and Pettit (n95) 10. See also Gindis (n95).

[222] See n135 above.

would still be warranted. As Williamson explained, when the social and political environment in which legal rules or policies more generally are meant to lead to efficiency improvements is not fully taken into account, we can avoid unintended consequences 'that, in large measure, were foreseeable and should have been factored into the calculus'.[223] If we are right that the agency-theoretic foundations of mainstream company law theory lead it to neglect the organization that company enables and supports, then company law scholars are not fully taking into account the domain in which company law rules or corporate governance principles are meant to lead to efficiency improvements. Broadening what company law scholarship is about should therefore be required in the name of efficiency, if nothing else.

[223] Williamson (n13) 384.