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Governing the Business Enterprise: Ownership, Institutions, Society

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Yuri Biondi

GOVERNING THE BUSINESS ENTERPRISE: OWNERSHIP, INSTITUTIONS, SOCIETY

Abstract: For those concerned with nature and role of the business firm in economy and society, these are challenging times. Past and ongoing financial crises and scandals have focused attention on the system of regulation, governance and disclosure in a way many may never have imagined and few welcomed. Those shortcomings relate to the primacy of shareholder value that frames and shapes the received system. Not only do reforms appear to be necessary to protect shareholders as well as other stakeholders, but also a different understanding of the relationship between the Share Exchange and the business firm. This paper introduces the proceedings of the EAEPE international conference at the CNAM (Paris, on 22 and 23 May 2008). From different disciplines and perspectives, all the featured authors will critically discuss the received system and look for a more comprehensive approach integrating accounting, economics, and law of the business enterprise.

Keywords: corporate governance, corporate law and regulation, accounting standards, shareholders value, financial crisis, financialisation

JEL classification: L20, K11, K22, G30, M40, D20, M20, H20, M14

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GOVERNING THE BUSINESS ENTERPRISE: OWNERSHIP, INSTITUTIONS, SOCIETY

Yuri Biondi*

Economies and societies are shaped by the working of business firms that raise overwhelming issues of disclosure, governance and regulation. In few decades, major trends and reforms -that appear to have led to systemic failure- have shifted the financial, economic, and legal frameworks in somewhat dramatic and unexpected ways. Behind the contingencies of recurrent financial crises, it is increasingly clear that lays the overall system of disclosure, governance and regulation of business firms and financial institutions, which constitute the financial, economic, and legal nexus that provides the institutional core of our socio-economy.

Therefore, for those interested in disclosure, governance and regulation of business affairs, these are times of blood, sweat and tears. The scandals surrounding the failures and shortcomings associated with Long Term Capital Management (1998), Enron (2001), American Home Mortgage (2008), Lehman Brothers (2008), and many others, and the financial instability experienced by financial intermediaries worldwide, cast doubt on widespread governance practices and regulatory policies that have been fostered in recent decades. Concerns are increasingly expressed regarding fair value and mark-to-market accounting that were advocated by international accounting convergence (especially the International Accounting Standards Board - IASB, and the Financial Accounting Standards Board - FASB), but also on excessive and misleading incentives driven by the primacy of shareholders' value in corporate governance and a lack of social responsibility, lack of stability in the market-based financial architecture, and unbalanced international economic relationships in the face of globalization. The emerging challenge is how to answer these issues without further distressing the entire socio-economic system. Environmental, societal, and civic needs are emerging at the core of the new agenda. Changes are required to protect stakeholders (including shareholders), and to assure the proper link between the financial and the economic system. The present system of business disclosure, governance and regulation is thus under strict scrutiny.

Starting upon distinctive disciplines and perspectives, the papers collected in this special issue aim to better understand and renew this system. Especially three disciplines are concerned by this challenge: economics, accounting, and law. The three disciplines have developed distinctive perspectives and methodologies of research in order to deal with significant financial, economic, and legal issues that actually are common concerns. However, their respective approaches rarely interact or even know each one another. This has led to an unsatisfactory situation which results

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On 22 and 23 May 2008, he promoted and convened the Eaepe International Conference on "Governing the Business Enterprise: Ownership, Institutions, Society" at the Cnam, Paris (<http://eaepe.cnam.fr>).

in a limited, partial or even biased understanding of significant problems for economy and society. Each featured scholar has then accepted to share his specialised knowledge in order to contribute to a comprehensive understanding of the disclosure, governance and regulation of business affairs. In particular:

- Clarke and Zumbansen address the current impasse as *the* crisis of the received system of disclosure, governance and regulation of the business firm driven by financialisation;
- Moore and Reberieux, and Coriat and Weinstein disentangle the misplaced role of ownership as the proper foundation of that system;
- Strasser and Blumberg, and Avi-Yonah further analyse the institutional substance of the firm as a business enterprise, and its implications for economy and society;
- Sunder and Biondi point out the institutional nature and role of accounting in the creation and allocation of resources (production and distribution of revenues) generated by this business enterprise.

Thomas Clarke and Peer Zumbansen engage the critique of the received system by addressing it as a peculiar “variety of capitalism” based on financialisation. Clarke examines how the Anglo-American model of corporate governance affords executive managers of large corporations with inordinate power and wealth, and the consequences of this system for inequality in wider society. This arrogation of an increasing share of the wealth of corporations impacts upon relationships with other stakeholders and displaces entrepreneurial objectives. Furthermore, this finance-led variety of capitalism - that has been propagated vigorously throughout the world – is criticised to have massively incited to pursue vast securitization, delocalisation and leverage that eventually caused the collapse of financial institutions worldwide, unbalanced world economic trade, and impacted severely on the employment security and living standards of working people. This radical critique puts at issue the received mode of functioning and the related making-money scope of social responsibility of business and finance. Following Zumbansen, the contested concept of “corporate social responsibility” should be an integral part of corporate governance and regulation. He adopts an evolutionary analysis that distinguishes three historical phases and paradigms of the nature and role of the business firm: first, the economic/industrial organization paradigm; second, the financial paradigm; and third, the knowledge paradigm. Whilst the industrial phase pertains to the Fordist model of capitalism, and the financial phase corresponds to the Anglo-American model driven by financialisation, the last phase opens the way to the institutional nature of the business firm that was early recognised by Berle and Means. The business firm is assuming a host of socio-economic roles in a functionally differentiated global society. Beside and behind its role as economic and financial agency, the business firm – as concept and reality – assumes important features as a public institution concerned with economic and societal purposes and scope.

The double critique addressed by these authors points out the active role that the complex and dynamic organisation of the business firm factually plays in our economy and society. Ideally drawing upon this critique, Moore and Reberieux, and Coriat and Weinstein disentangle the misplaced role of ownership as the proper foundation for disclosure, governance and regulation of this economic organisation. According to Moore and Reberieux, the conceptual boundaries of the corporate governance debate have been set narrowly in accordance with the logic of the

dominant ‘agency’ paradigm of governance. According to agency theory, the central ‘problem’ of corporate governance is the question of how to minimize the (harmful) consequences of the separation of ownership and control within public companies first identified by Berle and Means. The system of disclosure, governance and regulation of the business firm is then understood by coupling ownership and stock market pressures through competitive market-based incentive and disciplinary mechanisms. By analysing existing (US) corporate law doctrine in conjunction with recent developments in the economic theory of the firm, the authors present an alternative interpretation of the corporate governance ‘problem’ premised on the logic of institution rather than the market. Accordingly, the central governance ‘problem’ is that of how to exploit, rather than minimize, the (beneficial) consequences of the separation of ownership and control, so as to engender the development of a more dynamic and sustainable system of governance than that emanating from the free interplay of (share) market forces. This institutional perspective no longer understands the shareholders as the owners of the business firm, but recognises the firm as a legal-economic structure holding various liabilities and assets, including intangibles assets such as patents and copyrights. Coriat and Weinstein focus on the historical and institutional transformations of this intellectual property regime (IPR), more specifically patents regulatory framework, since the emergence of industrial capitalism, in the United States. Their analysis identifies three distinctive historical periods: a Victorian phase attaching intellectual property to individual inventors; the “fordist” phase of formation of corporate capitalism, dominated by large firms; and the recent period, beginning in the 1980s, characterized by the rising power of finance and financialisation. By adopting an institutional complementarities approach, they show how the characteristics and implications of IPR regimes may be understood only in relation to the transformations of the complementary institutional forms of capitalism: forms of business firms, conditions of labour relations (the “wage-labour nexus”) and characteristics of markets (product and financial markets).

As a matter of theory and fact, this institutional perspective regarding the economy of business firms goes behind the legal frontiers of the corporate form to enter the intricacies of actual enterprise groups that factually constitute our economy. Although conducted world-wide through hundreds of corporate subsidiaries and affiliates, these groups typically are, in economic reality, a single economically integrated enterprise functioning with a common objective under the control of its parent company. Yet, Strasser and Blumberg claim, the prevailing legal models neglect, for the most part, this institutional connection. Mistakenly adopting outmoded concepts inherited from the misty past, these models focus on many separate subsidiary corporations that make up the business and necessarily overlook the larger whole. The result of this outdated view is a mismatch between business reality and legal form which has led so frequently to poor legal and regulatory decision-making and ineffectual public control. In order to overcome this uncomfortable situation, the authors sketch out a new legal theory of enterprise analysis. This enterprise analysis focuses on the implementation of the underlying policies and rules of the specific body of law at issue, such as securities, tax, or bankruptcy, to determine whether the objectives of that body of law are better served in the specific matter by looking to the whole enterprise or, alternatively, to the particular corporate subsidiary entities involved. In some areas this analysis purports to replace and in other areas to supplement existing legal models that are in

fact applying it in numerous areas, though to a limited extent. Such critique of received legal-economic models and the adoption of a comprehensive enterprise perspective have one of the main areas of application in tax policy and regulation. Avi-Yonah addresses this legal-economic issue in connection with concerns of social responsibility and public welfare. Accordingly, taxation role and justification are related to the creation and allocation of resources generated by the business firm, and to the firm's overall contribution to economy and society. The author shows that the received discourse on the business firm, argued for on the basis of shareholders' primacy, is misguided and leads to paradoxical conclusions under usual constitutional principles of law and economics. The comprehensive perspective of the business firm as an enterprise entity is then advocated to better understand and guide tax policy and regulation in line with socio-economic performance and welfare of business.

This enterprise analysis stresses the institutional core that influences the creation and allocation of resources generated by the business firm. The latter is then understood as an inter-individual dynamic environment that requires an accounting system to be managed, governed, and regulated in the interests of various stakeholders, including shareholders, for economic and social purposes. It is not a hazard, therefore, that the institutional approach to the business firm shares its historical roots with accounting (Biondi et al. 2007). The last two papers address this accounting connection by exploring the fundamental economic foundations and implications of accounting systems. Sunder's analysis starts with the neoclassical model of the business firm. According to this model, the value surplus generated by the firm is assumed to accrue to its owner. In its effort to expand upon the neoclassical model, contract theory suggests a distribution of the surplus among various agents depending on the imperfections of the markets in which they transact with the firm. However, if the share of the surplus to an agent declines with the perfection of the market in which he transacts, shareholders should be expected to get only a small piece of the pie, perhaps the smallest one (because of (pretended) efficiency of stock market) violating the neoclassical assumption. To overcome this embarrassing theoretical and analytical result, the author explores an extensive value concept and its implications for the accounting representation of the business firm. In turn, Biondi's analysis replaces this connection of accounting to the economic allocation of resources within the overall framework of governance and social responsibility of the business firm. The firm is then understood as a managed dynamic system, characterized by different structures of production: institutional, organizational or epistemic (related to the place of institutions, internal organization, and knowledge within the firm). Accordingly, the accounting system is an integral part of framework, which demonstrates the joint implications of economic, accounting, and legal matters within the firm. Market and ownership fail to (provide effective and complete incentives to) manage, govern, and regulate such business affair fraught with unfolding changes coupled with asymmetries of resources, access, control and information. The accounting system enters this uncomfortable inter-individual environment by representing the economic and monetary process generated by the whole enterprise entity. In this way, the accounting system allows the business firm to exist and function autonomously from, and interactively with, financial holding of shareholders' claims traded on the Share Exchange.

In one sentence, starting from distinctive disciplines and perspectives, the whole of these papers criticise the alleged primacy of shareholders' value in the governance and regulation of business

affairs, and contribute to an understanding of the business firm as an economic organisation and institution, that is, an enterprise entity. This comprehensive perspective has significant implications for the system of disclosure, governance, and regulation of the business firm, especially regarding its relationship with financial intermediation and shareholding.

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