Corporate Existentialism

It has struck me lately how very different people view the corporation as a concept and how this fundamentally influence how they perceive the topics of corporate governance. Of course people's views differ, you might say, but I'm not talking about the variant opinions of the anarchist-syndicalist teenager and the middle-aged investment banker. I'm referring to variant perceptions among what most people would consider the economic and financial elite of society. To explain what I mean I propose that a short exposé of political-economic philosophy is needed as this points to the consequences of the different ways to view what a company is.

There has been business conducted almost as long as there have been people walking the earth. And businesses certainly precede states. Since people have varying access to different goods and there is a decreasing marginal utility from even more of the goods you have plenty of, the propensity to trade is deeply ingrained into mankind – variety has a value. The fact that specialization of labor increases the end result has also been evident since the hunter-gatherer-era. But early business was barter between individuals or tribes and the companies were that of the village blacksmith, why did the need for today's large companies emerge? And on an even deeper level, what is a company?

Given that we all feel that we know what a company is, it turns out to be a surprisingly tricky and multifaceted question. After searching the Internet and our family encyclopedias the following is what I concluded. At its core a corporation 1) is a venture that pools and coordinates resources such as capital and labor, but also technology, information and knowledge, 2) has some sort of fixed structure, 3) builds on voluntary contributions of several parties, 4) has one or several founders and 5) is set up to provide a commercial service, i.e. it has a business purpose.

In the more contemporary legal sense a limited liability company (LLC) adds a long list of features to the above. The LLC is a legal entity separate from its owners. The LLC is owned by its shareholders, i.e. there must exist at least one owner and one share. Note that very few would think it necessary to state that the LLC is separate from its suppliers, employees or the state. Because it is an entity separate from its owner it is a so-called going concern and as such a company can live beyond the life spans of its owners as its ownership can be transferred through a sale, a gift or through inheritance. As a legal entity it has rights and responsibilities as a physical person (it can own property, incur debt, sue and be sued etc.). However, as an artificial person it can only act through an agent, the Board of Directors, and it hasn't got the full rights of a physical person as it lacks the right to vote, to adopt children etc. Even though the name say's limited liability company, the company is fully liable for its actions – it's the owners that enjoy the limited liability as they only risk the equity capital they have contributed.

In theory a business could be run as a flexible web of market contracts between independent separate persons. In his 1937 paper *The Nature of the Firm,* Ronald Coase analyzed the origin of the firm from the perspective of the entrepreneur. Under what circumstances would it make sense for an entrepreneur to start hiring people and initiate a fixed organization instead of just contracting the product or task he needed for the moment from an external vendor? After all, the latter market based solution has huge advantages when it comes to flexibility.

According to Coase the explanation is that apart from the cost of the goods or service, there are a number of so-called transaction costs that add to the total cost of the market solution. These add-on costs include the effort to search for goods and obtaining adequate and truthful information, the effort of bargaining, the risk that trade secrets will leak out, the cost of policing and

enforcing the deals that have been struck etc. In many cases the transaction costs boil down to the fact that in the casual and temporary encounters on an ever-changing market there is a lower level of trust than in a closely-knit group.

Hence, companies form as they help the entrepreneur lower these transaction costs. As, according to Coase, there also exist diseconomies of organizational scale such as bureaucracy, inflexibility, loss of customer closeness, increased complexity leading to managerial mistakes etc. there is also a barrier for companies to grow ever bigger and therefore they have an optimal size that balances the number of internal contractual relationships with the number of external market relationships.

The reason I bring up Ronald Coase is that he sees the origin of the firm with the entrepreneur, the founder-owner(s). Without him there is no company and the proprietorship therefore lies firmly with the founder-owner. The concept of ownership has been central to mankind at least since we started to live in set settlements where possessions could be kept, instead of being nomads. The concept, as it has developed in liberal, democratic countries, states that the owner has a controlling power of the thing he owns. The owned object is in his possession to be handled as he pleases. This right is protected by law to make sure a third party doesn't violate it, but with the right also follows the responsibility to make sure that the use of the resource at hand doesn't violate the rules of society.

The dominating liberal view of ownership has never been well perceived by more collective ideologies as it places the individual and his freedom in the center. Pierre-Joseph Proudhon had a great influence on latter socialist thinkers when he argued that the only goods that were morally just to own was the one that came from the fruits of ones own manual labor. Consequent socialist leaders would go even further and abolish ownership altogether – obviously with the exception of the ownership rights belonging to the state, which they by chance controlled.

I would claim that despite the legal status as a separate entity, a company cannot entirely be seen as separate from its owner. I base this firstly on the fact that a founder-owner created the company – it would not exist without him. Secondly, I base this on the notion that the owner due to his ownership rights has a controlling power of the company he owns. Further, in my opinion the special status and the proprietorship that the owner has over what he owns does not disappear if founding owner would happen to sell part of the ownership to another party that is not the founder of the company. And the logical consequence is that even in the case of a public company with one hundred percent free float and a since long deceased founder, the right to posses the owned object as the owner wishes, still resides with the shareholders.

If you listen to many CEOs they will pay lip service to "creating shareholder value" but they still see the company as something entirely separated from the owner. I obviously don't agree - I mean of course the owner isn't the company or vice versa but they are intertwined and largely inseparable in my opinion.

This is not the view of some of today's academics discussing corporate governance where for example a Colin Mayer sees the company as a self-sufficient entity and the owners as a group are simply one of many stakeholders of equal stature in the company. As the body with the societal monopoly on brute force, the state, instead has the final say in the matter in the governance of the company. I'm not saying that this view is wrong; I'm saying that this is in its core a – conscious or unconscious – collective socialist view and that I personally don't agree with it.

One recent example of this view is a new Swedish book on corporate governance where the author discusses the topic of a limited company, saying (my translation) that it is "*a product of norms, laws and rules. The goal of the limited company is to create welfare for the society by increasing the company's ability to take risks.*" This might be

the purpose of company law and the concept of limited liability in corporate law, but it is rarely the purpose of a separate company! Reflecting on the fact that the shareholder receives the residual cash flow after other stakeholders the author states that as the owners "*are not guaranteed a return they have been put in place to run the company*." When it comes to the favored so-called stakeholder model the text states that the various "*stakeholders constitute the "company" […]*" and that there in "*the stakeholder model often exists a clear limit for the ownership in the limited company*". The view of the state as the creator of companies, the owner as a fiduciary appointee by the state and the low status of legal ownership rights are readily apparent.

To a large extent echoing Colin Mayer's book *Firm Commitment,* the author suggests that only a) the owners that pre-commit to owning a company for, as an example, 5 or 10 years should have voting rights and thus be able to appoint board members; b) to incorporate the views of the stakeholder model into company governance by setting up a trust that formulates directives to that effect and that have the power to oversee that the company complies; and c) to make sure that all the stakeholders have a say in whether to accept a hostile bid on the company. Although I sympathize with the wish to see more shareholders with a long-term well crafted agenda for the companies they own, doing this by impinging the rights of the owner of something is not the way forward. You shouldn't mend a bad thing with another bad thing.

It strikes me that perhaps the cruxes of the matter are 1) whether the founder's ownership right has a special stature when it comes to the company and 2) whether the rights of the founder-owner are transferable to the subsequent buyers of the company's shares. If they are not transferrable, the more exclusive status is confined to the original founder-owner and the public shareholder is just a financier comparable with a bank lending money. The public shareholder would in this case be in possession of some sort of second-class ownership right and the shareholder model in corporate governance would be unjust. If they are transferrable, any shareholder represents the very existence of the company and deserves a special stature. The supremacy of the owner in the shareholder model is in this later case just a consequence of this.

Very few in what I described as the economic and financial elite seam to argue against the stature of the founder as an owner. The tricky part is then the second postulate and for sure, not all things are possible to sell. However, in this case I cannot se any moral or logic reason that the full rights of the founder-owner couldn't be transferred. The concept of transferrable intellectual property rights is well established as is for example evident from the handling of patents. Not that it's needed but the possibility to sell shares and broaden the ownership also serves a societal purpose as it gives the capital for expansion and a growing economy.

There is an old saying in politics: "*Where you stand depends on where you sit*". My occupational seating is with an asset management firm, i.e. a professional owner and this could of course color my views. So my question is, what is your opinion and how colored is it by where you sit?

Mats Larsson, April 21, 2014