Surmounting the Control Paradigm

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Colin Mayer, Firm Commitment: Why the Corporation is Failing Us and How to Restore Trust in It, Oxford University Press (2013).

Colin Mayer's *Firm Commitment* is not exactly a book about corporate law, but it's still best corporate law book I have encountered in a long while. Here a leading academic in business and finance challenges the status quo, bringing financial economics, agency theory, and corporate law to bear to persuade us that something has gone very wrong with corporate organizations in English-speaking economies.

Unlike many critics of corporate institutions, Mayer approves of large corporate entities. He points out that they allow us to partition assets off from individuals and create stable productive environments conducive to group participation. They are ubiquitous for very good reasons and do great things. But there's also a dark side. In describing it, Mayer pulls together a number of things that we all know are out there and builds them into a binary theory. On one side of the description there's a long list of phenomena, bundled up and characterized as the "control" paradigm. The market for corporate control sits at the top of the list, followed by environmental degradation, reductions in workforces, the shareholder value maximization norm, the trend to shareholder empowerment, short termism, leveraged restructuring, asset substitution, and leveraged speculation. All these work together with and within corporate entities to lead to disastrous results for society and the economy, manifested in the form of both externalities and opportunity costs. As society tries to cope with this onslaught of injury, there result layers and layers of choking regulation.

On the other side of the description of corporations lies commitment, conceived as the restraint of control. More particularly, there are layers of unenforceable cooperative obligations that encourage stakeholders to invest in corporate enterprises. Indeed, it's the genius of the corporate form that it encourages people to make these commitments. Yet, in the English-speaking economies (especially the UK), corporations are not taking advantage of this possibility due an obsession with control—a sacrifice of all to the interests of market shareholders. Other national economies have more stable corporate environments protected by controlling families or corporate groups, and their corporations do better in the sectors where commitment matters most.

This is a formidable indictment of the mindset that has held sway in academic corporate law for the past three decades. The same mindset more and more holds sway within corporate boardrooms. Mayer's description and diagnosis pull no punches, occasionally crossing the line over to argumentative exaggeration. Even so, I can't think of a more persuasive account. The question concerning constituent commitment has been fundamental to corporate law and governance for those same three decades, and no one has done a better job of laying it out.

Mayer would like to see some structural changes made in corporate entities, administering a strong dose of what's called "new governance," although the appellation doesn't seem right for a book as hard hitting as this one. If you need to constrain corporate decision-making, says Mayer, it's better to look inside the firm and take advantage of better information and more focused incentives than to look to outside regulation. He celebrates corporate diversity, counseling us that there are all sorts of organizational ways to make a widget and that some modes are better suited for some production functions. It's not the one size fits all agency account that we hear in the conventional wisdom.

He gives us a two part reform suggestion. The first part is a weighted voting scheme that instead of rewarding with more votes as the holding period extends, rewards more votes up front in exchange for an advance commitment to hold for five or ten years. The second part is a variation on two-tier governance structure: a board of trustees whose job it is to assure that management adheres to a statement of purpose, a statement that by definition is non-shareholder value maximizing in significant respects. The trustees shield the firm from market pressures, enabling commitment.

Question: Is US law flexible enough to facilitate Mayer's trust firm? Our corporate codes certainly are, if one reads them literally. You can draft any kind of voting and governance scheme you want into a corporate charter. But there still could be some questions about the operation of the duty of loyalty mandate on a board of directors subject to other constituent-directed trustee instructions. And, in fact, there is a narrow range of situations in which favoring employees over shareholders might be a breach of fiduciary duty, although I don't think the range is economically salient and I doubt it would seriously get in the way of anything Mayer advocates. Even so, the theoretical implications are sufficiently momentous that I suspect a bit of statutory tweaking would be necessary to bring in Colin's trust corporation, much as we have seen happen with B Corporations.

Tweaking aside, the lawyer in me wants to make a larger point about the connection between corporate law and the adverse conditions identified in the book. While the law facilitates the conditions, it does not require them. The law allows companies to merge and the removal of antitrust barriers makes mergers easier than ever. Yet there are no legal shotguns at these corporate weddings. The law lets corporations despoil the environment, but it doesn't force them. The law lets corporations fire people who have bestowed a lot of human capital because it doesn't give unorganized labor any rights, but it doesn't require corporate restructuring. The bad results result from market pressures.

And that leaves me in a state of disquiet as I put down the book. Corporate law is endlessly flexible. It takes national political economies as it finds them and makes adjustments necessary for widget production in particular national contexts. But can we look to it jumpstart political economic change? I doubt it.

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