Corporate and Financial Markets Law

Principals vs Principals: The Twilight of the ‘Agency Theory’

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Abstract

In this article, we maintain that the agency theory of the corporation, that has dominated the corporate law debate for the last four decades, offers a trivial and reductive description of the problems of the corporation, ignores the most significant phenomena and offers a distorted picture of issues that the law must solve. As a matter of fact, none of the predictive implications of the agency theory has proved to hold in the real world – widespread malfeasance of corporate executives is one prominent example. On the theoretical side, many of the assumptions on which the theory is based seem fundamentally flawed (one above all, the idea that all shareholders – the principals – share the same interest, which should justify the focus on the principal-agent relationship as the core of the corporation). We propose a radically different view of the corporation, that shifts attention to the principal – the shareholders – themselves. In our view, the point of corporate law is not how to make managers pursue the best interest of the one-dimensioned, profit-maximizing shareholder; the point is how to account for the – clearly existing, and non-ignorable – different interests of the shareholders and how to accommodate them in the objective-function of the corporate firm. In this perspective, other fields of discussion become much more interesting and important than those explored by the agency theory: for example, issues of shareholder (and generally stakeholder) empowerment and representation emerge as important questions in the corporate governance debate.

I. The Variegated Failures of ‘Agency Theory’

For present purposes by ‘agency theory’ (we put it in quotes, signalling the distinction from the generic reference to the problems of principal-agent relationship, agency costs, etc)[1] we mean the theory, dominant during the last four decades or so,[2] according to which:

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[1] Admittedly the agency theory literature is wide ranging and there is disagreement among theorists on many points. For a detailed examination of the various facets of the agency theory as commonly understood, see K.M. Eisenhardt, ‘Agency Theory: An Assessment and Review’ 14(1) *Academy of Management Review*, 57-74 (1989).

[2] The agency theory, originated by A.A. Alchian and H. Demsetz, ‘Production, Information Costs, and Economic Organization’ 62(5) *The American Economic Review*, 777-795 (1972), was further developed especially by M.C. Jensen and W.H. Meckling, ‘Theory of the Firm: Managerial

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1) the main problem corporate law has to solve is the agency problem which arises in the relationship between the providers of risk capital (shareholders), considered as principals, and the individuals entrusted with the task of managing the corporation, considered as agents of the former (call this element of the definition 'transaction centrality');

2) this problem can find an optimal solution in a thorough combination of rules allowing the parties to freely define their respective rights and duties and rules facilitating the unfettered operation of some market mechanism which coordinates and integrates the conflicting interests (call this element of the definition the 'integrating market').

The 'agency theory', as defined, has dominated the corporate law debate for at least the last four decades, to the point that the description of the corporation in terms of the principal-agent (shareholders-managers) paradigm is usually presented in the literature without even an explanation or the acknowledgment that there might be other paradigms and an alternative theoretical framework.[3]

In this paper, we maintain that the agency theory offers a trivial and reductive description of the problems of the corporation, ignores the most significant phenomena and offers a distorted picture of issues that the law must solve.

Even before going into the details of the numerous flaws of the theory, a simple real-life observation helps to illustrate our point.

As it is well known, the genius of the agency theory of the corporation – and of the shareholder value paradigm which constitutes its backbone – purported to rest in its capacity to solve the 'managerial sin' problem, originated by the separation between property and control, through the provision of a one-dimension, simple objective-function against which managers could be measured and monitored and that could serve as the measure of their liability to the firm: the maximization of the value of the firm for its shareholders. The argument is usually presented in terms akin to the following: shareholders, as residual claimants to the firm's assets, want to maximize the value of the firm's shares. Because shareholders are the residual claimants, the pursuit of their interest – except for occasional and amendable market failures – also ensures protection of the interests of other stakeholders of the firm (most importantly, the firm's creditors), whose claims are preferred to those of the shareholders. Therefore, the maximization of the value of the firm for its shareholders is the appropriate objective to assign to the firm's managers (and directors). Moreover, the maximization of the firm's value for shareholders is a single-dimensioned, easily measurable objective that allows for an efficient monitoring of managers and an

Behavior, Agency Costs and Ownership Structure' 3(4) *Journal of Financial Economics*, 305-360 (1976).

[3] See for example, albeit not embracing the shareholder value paradigm in itself, R. Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford: Oxford University Press, 3rd ed, 2017), 29.

efficient liability system in case of managerial malfeasance.[4]

Again, let us put aside for a moment the relevant flaws of the theory (among the many: are shareholders all the same and have they the same interest? Are third party effects of the manager-shareholder relationship negligible, as the theory advocates?), and let us stay on a purely factual plane. If the agency theory's genius was in fact a genius, we should have witnessed, to a lesser or greater extent, the following phenomena: weaker, more controlled managers; reduced malfeasance by managers as a result of a better monitoring of their behaviour; higher compactness within the principals-shareholders' class.

Instead, what we have witnessed is:

- extremely powerful executives,[5] able to destroy corporations of the dimension of Lehman Brothers and AIG without even incurring in significant liability–meaning that the power they took and exercised was legitimate, and therefore consistent with the law;[6]

- widespread, large-scale malfeasance of corporate executives – the examples offered by daily news and especially by the financial crisis of 2008 are too many to be listed;[7]

[4] See A.A. Alchian and H. Demsetz, n 2 above; F.H. Easterbrook and D.R. Fischel, 'The Corporate Contract' 89 *Columbia Law Review,* 1416 (1989); S.M. Bainbridge, 'In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green' 50 *Washington and Lee Law Review,* 1423 (1993). See also the 'enlightened shareholder value' theory advanced by M.C. Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' *Journal of Applied Corporate Finance*, Fall 2001, available at https://tinyurl.com/ya5zvfrt (last visited 25 November 2017), for a passionate defence of the simplicity and manageability of the shareholder value standard.

[5] On the power of managers as a – worrying – feature of American corporate law see the classical book by M.J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton: Princeton University Press, 1994).

[6] See W.D. Cohan, 'How Wall Street's Bankers Stayed Out of Jail' *The Atlantic*, September 2015, available at https://tinyurl.com/ycesh4ry (last visited 25 November 2017); Frontline, 'The Untouchables', 22 January, 2013, podcast at https://tinyurl.com/j5vocus (last visited 25 November 2017); 'No Crime, No Punishment' *The New York Times*, 26 August 2012, available at https://tinyurl.com/9jzbj4p (last visited 25 November 2017), noticing that 'Justice officials and even President Obama have defended the lack of prosecutions, saying that even though greed and other moral lapses were evident in the run-up to the crisis, the conduct was not necessarily illegal'; more sources in J.G. Chawla, 'Criminal Accountability and Wall Street Executives: Why the Criminal Provisions of the Doo-Franck Act Fall Short' *Law School Student Scholarship*, Paper no 451, 2014 available at https://tinyurl.com/ya2slfwr (last visited 25 November 2017).

[7] See N. Shover and P. Grabosky, 'White-Collar Crime and the Great Recession' 9 *Criminology and Public Policy* 429–433 (2010); N. Figstein and A. Roehrkasse, 'The Causes of Fraud in Financial Crises: Evidence from the Mortgage-Backed Securities Industry', IRLE Working Paper nos 122-15, 2015, available at https://tinyurl.com/y9v66dv7 (last visited 25 November 2017). See also F. Dobbin and D. Zorn, 'Corporate Malfeasance and the Myth of Shareholder Value' *Political Power and Social Theory*, Emerald Group Publishing Limited, 179-198 (2005). On the accounting malfeasance see P. Harris et al, 'Corporate Accounting Malfeasance and Financial Reporting Restatements in the Post-Sarbanes-Oxley Era' 8(1) *Review of Business and Finance Studies*, 41-48 (2017). A possible hypothesis is that the growth in corporate malfeasance was facilitated just by the loosening of the original ethics of the managerial capitalism.

- on the principals-shareholders side, the growth of new and different categories of professional investors whose investment behaviour: (i) crystallizes and concretizes well-known abstract conflicts among principals-shareholders regarding, for example, short-term vs long-term returns, maximization of profits vs ethical and sustainable investing; and – which is more important – (ii) breaks the common profit source of the shareholders' class-dividends – to the extent that professional investors plan returns on a portfolio basis rather than on a single investment basis, and/or, depending on their nature, can occasionally be interested in arbitraging among their investments to extract profits (hedge funds and the like).[8]

In short, no one of the predictive implications of the agency theory has proved to hold in the real world. Quite the contrary. This is not a theoretical objection to the theory, of course – not yet; but it is a matter for attentive thinking, also on the often-celebrated capacity of the agency paradigm to describe the corporation as it really is.

On the theoretical plane, as we have said, many critical points have and can be raised on the agency theory of the corporation. Our own radical critique will occupy the rest of this paper.

In this paper, we propose a radically different view of the corporation that, instead of being based on a principal-agent model and presenting the principal-agent problem as *the* problem of corporate law – as the agency theory does – shifts the attention to the principals themselves: shareholders and, in perspective, other stakeholders of the firm.[9] When doing so, one easily discovers that one of the critical assumptions on which the principal-agent model in corporate law is based – that all shareholders share a common interest – is theoretically untenable

[8] For a rigorous critique of the 'fictional', generic shareholder theorized by the agency theory of corporate law, see D.J.H. Greenwood, 'Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited' 69 *California Law Review*, 1021 (1996): 'I contend, rather, that corporate law theorists have missed the critical point that an agency (or trust) relationship has quite a different significance when the 'principal' (or beneficiary) is a set of legally defined interests that are not under the control of any individual or group of individual human beings who could choose to redefine or act in opposition to those interests'. See also G.S. Crespi, 'Maximizing the Wealth of Fictional Shareholders: Which Fiction Should Directors Embrace?' *The Journal of Corporate Law*, 381 (2007).

[9] The centrality of a principal-principal perspective in the corporate governance debate has been rising in part of the literature with specific reference to emerging economies: see M.N. Young et al, 'Corporate Governance in Emerging Economies: A Review of the Principal-Principal Perspective' 45(1) *Journal of Management Studies*, 196 (2008); M.W. Peng and S. Sauerwald, 'Corporate Governance and Principal-Principal Conflicts', in D.M. Wright et al eds, *The Oxford Handbook of Corporate Governance* (Oxford: Oxford University Press, 2013), 658. Our perspective is however wider and more ambitious than that usually presented in this literature, which tends to link the said centrality to the peculiar concentrated ownership structure of emerging countries' corporations but without discussing the theoretical basis of the neo-classical agency approach. In our view, on the contrary, the principal-agent problem is *not* the central one in corporate law and the principal-agent paradigm does *not* describe the corporation, regardless of the proprietary structure of the corporation itself.

and practically of little use to describe the corporation as it really is. But if the assumption is relaxed – or refused – and the idea that shareholders have mutually conflicting interests is accepted, then the descriptive and predictive capacity of the agency theory of the corporation is very weak, and very low is its appeal from the normative perspective. If shareholders are not all the same, the simple scheme proposed by the agency theory to control the managerial sin problem is of little help. The point is not how to make managers pursue the best interest of the one-dimensioned, profit-maximizing shareholder; the point is how to account for the – clearly existing, and non-ignorable – different interests of the shareholders and how to accommodate them in the objective-function of the corporate firm. In this perspective, other fields of discussion become much more interesting and important than those explored by the agency theory: for example, issues of shareholder (and generally stakeholder) empowerment and representation emerge as important questions in the corporate governance debate.[10]

[10] And legislators, regulators, and industry associations recognize this, too. We have argued elsewhere that benefit corporation legislation reflects a principal-centred view of corporate law, mainly oriented at solving conflicts among different shareholders/principals regarding if, how and to what extent they desire their investee corporation to pursue public benefit goals: see F. Denozza and A. Stabilini, 'Due visioni della responsabilità sociale dell'impresa, con una applicazione alla società benefit', paper presented at the 2017 Annual Conference of Orizzonti del diritto commerciale (Rome: 17-18 February 2017) available at https://tinyurl.com/yakcktdv (last visited 25 November 2017). In this view, the benefit corporation might also represent a favourable context to give voice to non-shareholder constituencies, to the extent that it opens the door, at least potentially, to non-shareholders' claims against benefit corporations and their directors for failing to pursue the common benefit goals the corporation has committed to. This possibility might in particular be stipulated by the Italian legislation, as better argued in the paper. See also the 2017 reform of the European so-called Shareholders Directive (Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement), recognizing that '(E)ffective and sustainable shareholder engagement is one of the cornerstones of the corporate governance model of listed companies, which depends on checks and balances between the different organs and different stakeholders. Greater involvement of shareholders in corporate governance is one of the levers that can help improve the financial and non-financial performance of companies, including as regards environmental, social and governance factors, in particular as referred to in the Principles for Responsible Investment, supported by the United Nations. In addition, greater involvement of all stakeholders, in particular employees, in corporate governance is an important factor in ensuring a more long-term approach by listed companies that needs to be encouraged and taken into consideration' (whereas no 14). Art 3g of the Directive provides *inter alia* that '(I)nstitutional investors and asset managers shall develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy. The policy shall describe how they monitor investee companies on relevant matters, including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance, conduct dialogues with investee companies, exercise voting rights and other rights attached to shares, cooperate with other shareholders, communicate with relevant stakeholders of the investee companies and manage actual and potential conflicts of interests in relation to their engagement'. At the industry level, see the stewardship programs for institutional investors organized by numerous proxy consultants: see for example Vanguard's Investment Stewardship 2017 Annual Report, available at https://tinyurl.com/y7u8cn2l (last visited 25 November 2017).

The rest of this paper, as said, contains a detailed critique of the agency theory of corporate law. Sections 2 and 3 are dedicated to a brief illustration of the two elements of our definition of the 'agency theory' we have labelled as the 'transaction centrality' and the 'integrating market'.

II. The 'Transaction Centrality'

Agency problems (in short: problems arising from the possibility that an agent gives precedence to its interest at the expense of the interest of the principal) existed and still exist in all human societies, in many disparate situations.[11] Roman emperors faced an agency problem in their relationship with their generals scattered across the frontiers of the empire; European medieval dukes faced an agency problem in their relationships with their vassals; every landowner faces an agency problem when she asks her neighbour to buy some seeds on her behalf; and so on.[12] The point is that the expressions 'agency problems' and 'agency costs', despite their apparent technicality, refer to a very generic concept and, eventually, their informative capacity is almost nil. In fact, the relevant point is not that of becoming aware that an agency problem exists, but that of defining the kind of society in which the agency problem occurs and the nature of the social economic context in which the problem arises.[13]

From this viewpoint, the framing of the corporation problems in the principal-agent theory was neither an original idea, nor a significant theoretical progress. The existence of the problem that now is called agency problem (and that of the potential presence of phenomena akin to that today called agency costs) has been recognized, with specific reference to the matters of corporate law, since the dawn of the modern industrial society, and caught the attention of all the classical economists from Adam Smith, to John Stuart Mill, to Karl Marx.[14]

[11] K.J. Arrow, 'The Economics of Agency', in J.W. Pratt and J. Zeckhauser eds, *Principals and Agents, the Structure of Business* (Cambridge: Harvard Business School Press, 1985), 37: 'The agency relationship is a pervasive fact of economic life'. S.A. Ross, 'The Economic Theory of Agency: The Principal's Problem' 63(2) *The American Economic Review*, 134-139 (1973): 'the relationship of agency is one of the oldest and commonest codified modes of social interaction (...). Examples of agency are universal'; 'Agency relationships are ubiquitous, and so are agency problems', E.A. Posner, 'Agency Models in Law and Economics' (2000), University of Chicago Law School, John M. Olin Law and Economics Working Paper no 92, available at https://tinyurl.com/y8sn6j4f (last visited 25 November 2017).

[12] Ancient examples of agency (from the Old Testament *shaliach* to the Roman *clientela*) are examined by H.C. White, 'Agency as Control', in J.W. Pratt and J. Zeckhauser eds, *Principals and Agents: The Structure of Business* (Cambridge, MA: Harvard Business School Press, 1985), 189, 198.

[13] On the problem of the social sensitivity/insensitivity of the agency theory see for example L. Heracleous and L.L. Lan, 'Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective' 49(1) *Journal of Management Studies*, 223-239 (2012); R.M. Wiseman et al, 'Towards a Social Theory of Agency' 49(1) *Journal of Management Studies*, 202-222 (2012).

[14] J.P. Henderson, 'Agency or Alienation? Smith, Mill, and Marx on the Joint-Stock Company'

Therefore, what characterizes the 'agency theory' established during the 1970s and 1980s, is not the reference to the agency (a reference, as we said, that is neither original, nor meaningful) but the conviction that the agency problem, in the context of the corporation, is *the* problem (in the sense that it is the main problem, on whose solution that of any other relevant problem in the end depends).[15]

In our view, the core of the first element of our definition is therefore the fact that the agency problem which characterizes the relationship between shareholders and managers is elevated to the rank of *the main problem* of the corporation. A transaction (that between shareholders and managers) is thereby put at the centre of the universe represented by the economic and social relationships in which the corporation is embedded. From this point of view, the agency theory reveals its close connection with the contractual theory of the firm. In this perspective (agency theory and contractual vision of the firm) the problems of the corporation are, as it were, 'narrowed' to the level of that of any ordinary transaction by which someone entrusts someone else with the power of taking decisions that can have effects on the wealth and the welfare of the first.

This 'narrowing' and 'reducing' was in our opinion the real novelty made by the 'agency theory' and was the point which was immediately noted by Gardiner Means (in his critical review of the 'reappraisal', with the Chicago lens, of his well-known co-authored book), a 'reappraisal' focusing (as the 'agency theory' does) only on the separation of ownership and control. According to Means[16] the choice of this perspective entails in fact two big omissions, the major of them being the concern for the effect of the modern corporation on the working of the economy as a whole, and the other being that

> 'the great efficiency in raising capital that the modern corporation derives from the separation of ownership and control' (is) 'a major factor in bringing about ever higher economic concentration'.

In the Berle and Means' view the main problem arising from the modern corporation is not the troubled relationship between managers and capital providers (a problem that has always existed not only in the corporation but in a lot of different situations, as in the limited partnership, in which the silent partner has a very limited control on the general partner's business decisions) but the fact that the existence of these giant enterprises cannot be integrated into the classical theory of capitalism. This broad perspective gets completely lost in the contractarian (and agency) theory of the firm, in which the main

18(1) *History of Political Economy*, 111-131 (1986).

[15] G. Zohar and R. Squire, 'Principal Costs: A New Theory for Corporate Law and Governance' *Columbia Law Review*, 767-829 (2017). The theory holds that the most important problem in corporate governance is the conflict of interests between managers (the agents) and shareholders (the principals).

[16] G.C. Means, 'Hessen's Reappraisal' 26(2) *The Journal of Law and Economics*, 297-300 (1983).

problem is considered that of favouring efficient transactions among all individual input providers, and especially that of facilitating transactions minimizing agency costs between shareholders and managers.

We therefore have labelled the first element of our definition of the 'agency theory' as 'transaction centrality', in order to stress that in the view suggested by this theory all the problems of the modern corporation are 'reduced' to the problem of facilitating efficient transactions among all stakeholders and especially, as the most important of them, that between shareholders and managers.

III. The 'Integrating Market'

The second element of the proposed definition of the agency theory (the problem can be satisfyingly solved by a combination of market mechanisms and private deals) is often absent from the prevailing definitions of this theory.[17]

It seems therefore appropriate to explain the reasons why we consider it an important and characterizing element.

As we noted before, agency problems exist in all societies: primitive, ancient, feudal, etc. In each society institutions exist that attempt to solve the problem in accordance with the values dominant in the given society. What characterizes the market society is the attempt to eliminate (or to reduce to a minimum) the very roots of the problem. Well-functioning markets are imagined as fields of action in which the invisible hand takes care of the interests of all, whilst the single actors take care only of their own interest. It follows that in a well-functioning market there is no place for the peculiar conflict of interests typical of a situation of 'agency'. No one is obliged to consider of the interests of the others, and even less to take care of them. Nothing exists akin to the conflict of interest which characterizes the position of the agent in the agency problem perspective, a perspective in which agents, who have their own interests (whose complete disregard cannot be realistically asked of anyone) enjoy a rather discretionary power to take decisions on behalf of principals unable to control minutely the agents' work process (as in the majority of the employment relationships) who can observe only the agents' final product. In the ideal market in which agents act exclusively in their interest, and no one is entrusted with the

[17] See however M.T. Moore and A. Reberioux, 'From Minimization to Exploitation: Re-Conceptualizing the Corporate Governance Problem' *Reflexive Governance in the Public Interest* (REFGOV) Working Paper no REFGOV-CG-32, 8 available at https://tinyurl.com/y94c4m3h (last visited 25 November 2017): 'A distinctive feature of the aforementioned 'agency' theory of corporate governance, in consequence, is its contrary emphasis on the role of competitive markets in solving the economic distortions which stem from the separation of ownership and control'; I.B. Lee, 'Implications of Sen's Concept of Commitment for the Economic Understanding of the Corporation' 21 *Canadian Journal of Law and Jurisprudence*, 21 (2008): 'an influential view holds that as an empirical matter markets are a more important constraint on the board and managers than legal duties (…)'.

power of acting on behalf of others, no conflict of interest can arise and no special regulation is needed.[18]

In some sense the possibility (granted by the mechanism of the invisible hand) of reaching efficient results without imposing any restraint on the actors' pursuit of their self-interest, is one of the most acclaimed and distinguishing merits of the market. Contrasted to the State and to a public administration ridden by huge agency problems, and by any kind of conflicts of interests, the market appears as an Eden of purity and simplicity.

This is the reason why it is so important for the defenders of the 'agency theory' to demonstrate that *this* agency problem (that between shareholders and managers) can be solved by private bargaining[19] and by market mechanisms,[20] with no[21] (or minimal) intervention of the law.[22] Otherwise, the law should define the rights and duties of the principal (treated as the beneficiary) and that of the agent (treated as a fiduciary), and this legal definition of reciprocal rights and duties would inevitably imply a political evaluation of the limits within which the agents shall place the interests of the principal before their own, and the principals shall afford the effects of the discretionary decisions of the agent. Presenting corporation law as a locus in which no political evaluation of this kind is needed, and the market as a locus in which every problem of interaction between corporate stakeholders can be solved with no need of special rules,

[18] According to O. Hart, 'An Economist's View of Fiduciary Duty' 43(3) *The University of Toronto Law Journal*, 299-313, 300 (1993), the neoclassical theory of the firm has nothing to say about the key issues of the stakeholder debate – fiduciary duty, board representation, voting rights – since it describes a world without conflicts of interest.

[19] In the agency theory vision 'Market Displaced Trust' (W.W. Bratton, 'Welfare, Dialectic, and Mediation in Corporate Law' 2 *Berkeley Business Law Journal*, 59 (2005)) and regulation.

[20] The competition in the firm's primary market for goods and services, the competition on the managerial labour market (E.F. Fama, 'Agency Problems and the Theory of the Firm' 88 *Journal of Political Economy*, 288-307 (1980)), the market for the financial stock of companies themselves where firms must compete with one another to raise equity capital at low cost (A.A. Alchian, 'Corporate Management and Property Rights', in H.G. Manne ed, *Economic Policy and the Regulation of Corporate Securities* (Washington, DC: American Enterprise Institute, 1969); reprinted in E. Furobotn and S. Pejovic eds, *The Economics of Property Rights* (Cambridge, MA: Ballinger, 1974) and especially the market for corporate control (H.G. Manne, 'Mergers and the Market for Corporate Control' 73(2) *Journal of Political economy*, 110-120 (1965)). 'Overall this market based corporate regime was based on the idea that the pricing of the corporation's stocks and bonds was the most efficient way of minimizing costs to shareholders for monitoring executives', in A. Styhre, 'The Making of the Shareholder Primacy Governance Model: Price Theory, the Law and Economics School, and Corporate Law Retrenchment Advocacy' *Accounting, Economics, and Law: A Convivium*, 6 (2017).

[21] H.G. Manne, 'Our Two Corporation Systems: Law and Economics' *Virginia Law Review*, 259, 270 (1967), 'one is almost tempted to suggest that the large corporation system could and would function substantially as it does if there were almost no State corporation statutes beyond provisions for incorporation'.

[22] Fiduciary duties are understood as residual (in the sense that they are a remedy needed only where the contract between principal and agent is incomplete: O. Hart, 'An Economist's View of Fiduciary Duty' n 18 above, 299-313) and subordinate (in the sense that the contract can freely dispose of them).

implies that the corporation is definitively taken away from the realm of politics in which it was located by the Berle and Means research,[23] and solidly repositioned within a purely private phenomenology.

IV. The Limits of the Market and the Recourse to Mandatory Rules and Fiduciary Duties

Unfortunately (for agency theory defenders and more generally for market apologists), the hard-core market in which all individuals take care only of their own interests, no one is bound to consider the interest of anyone else and the optimum is reached by virtue of an impersonal mechanism,[24] if ever existed, has disappeared for a long time. The majority of the most important relationships are today regulated in a way that imposes on one or both the parties of the transaction a more or less stringent duty of regard for the interests of the other party. The conflict of interest which is at the roots of the agency problem is understood as almost ubiquitous, and relevant in a lot of concrete market relations,[25] and a panoply of legal institutions, as the duty of good faith, the prohibition of the abuse of right, the fiduciary duties, and so on, testifies that the inability of the hard-core market (the market where individuals pursue their self-interest with no limit except force and fraud) to guarantee the efficiency of the transactions is widely and definitely acknowledged.

The agency relationship between shareholders and managers is in no way an exception. The utopian (or dystopian) world in which the legal duties of the managers are in no way defined by mandatory rules and some market mechanisms guarantee the total loyalty of the managers even to passive and 'apathetic' shareholders, did not materialize[26] anywhere.[27]

[23] On the eve of the establishment of the agency theory, the corporation '(…) is sometimes regarded as a private government; major concepts, questions, and standards of political science and public administration normally used in the study of public government are then applied to the corporation', F.G. Hill, 'Veblen, Berle and the Modern Corporation' 26(3) *American Journal of Economics and Sociology*, 279-295 (1967).

[24] Agency is not market but '(…) intermediate between formal organization or hierarchy, on the one hand, and market on the other', H.C. White, 'Agency as Control', in J.W. Pratt and J. Zeckhauser eds, *Principals and Agents, the Structure of Business* (Cambridge, MA: Harvard Business School Press, 1985), 187, 189.

[25] In fact, 'agency' is less a real phenomenon than a conceptual means for classifying reality: if in an interaction between individuals at least one of them is deemed compelled to take account of the interest of others, we call it an agency relationship, otherwise there is no recourse to the concept of 'agency'. In this perspective, almost every relationship can be understood as a case of 'agency': in contract law the promisor is the agent and the promisee is the principal (E.A. Posner, n 11 above) in torts the damager can be considered as the agent and the one damaged as the principal (K.J. Arrow, n 11 above, 39).

[26] A. Styhre, *Corporate Governance, the Firm and Investor Capitalism: Legal-Political and Economic Views* (Cheltenham: Edward Elgar Publishing, 2016), 24-25: legislators and courts have rejected the 'agency theory's' recommendation '(…) to modify corporate legislation so as to

The attempt[28] to convince the law makers to soften the mandatory regulation of the shareholders-managers relationship (and, more generally, of the whole functioning of the corporation) proved almost everywhere as unsuccessful.[29] So unsuccessful, in fact, that the typical legislative reaction to financial crises and corporate scandals has been, both in Europe and in the United States, the enactment of post-crisis laws largely relying on mandatory provisions. The tendency to regulate corporate firms through mandatory norms, never abandoned, has received new strength both after the corporate scandals of the early 2000s,[30] and in the aftermath of 2007-2008 financial crisis.[31]

Even if in these kinds of issues, it is difficult to measure and to draw precise reports, the overall impression however is that in general corporation law, and specifically the rules on the duties and liabilities of directors and officers, rather than becoming simpler, and more mouldable by the contracting parties (as 'agency theory' auspices and forecasts would have wanted) has become increasingly intricate and pervasive.

grant the market for corporate control further authority'.

[27] This perspective of completely deregulated corporate governance seems even less appealing today, in a world of continuous corporate scandals and recurring financial catastrophes that market – based mechanisms seem in no way able to prevent, not to mention the apparent exhaustion of some of those mechanisms as, for example, the hostile takeover which is virtually obsolete (J.R. Macey, *Corporate Governance: Promises Kept, Promises Broken* (Princeton: Princeton University Press, 2010), 10 and the market for corporate control which seems almost disappeared (L. Zingales, 'Towards a Political Theory of the Firm, Journal of Economic Perspectives' 31(3) *Journal of Economic Perspectives*, 113-114 (2017)) or the growing scepticism about the efficient market hypothesis in general (recently discussed in A. Styhre, *Corporate Governance, the Firm and Investor Capitalism* n 26 above, 14).

[28] Probably the last (important, but terribly outdated) doctrinal attempt is that of H.G. Manne, 'A Free Market Model of a Large Corporation System' 52 *Emory Law Journal*, 1381 (2003).

[29] And for good reasons, given the legitimate doubts that the recent empirical and theoretical experience casts on the capacity of market–based mechanism to ensure the results promised by the 'agency theory'. See in general on the weaknesses in the market-based model of corporate governance, M.T. Moore and A. Reberioux, n 17 above.

[30] The American Sarbanes-Oxley Act of 2002 stands as the most impressive and ponderous example.

[31] In the US, reference is made to the 2010 'Dodd-Franck Wall Street Reform and Consumer Protection Act' (Pub. L. 111–203). For the European Union, see especially the European Capital Requirements Directive – CRD IV (Directive 36/2013/EU), whose recital no 14 significantly provides: 'Whereas (…) (53) Weaknesses in corporate governance in a number of institutions have contributed to excessive and imprudent risk-taking in the banking sector which has led to the failure of individual institutions and systemic problems in Member States and globally. The very general provisions on governance of institutions and the non-binding nature of a substantial part of the corporate governance framework, based essentially on voluntary codes of conduct, did not sufficiently facilitate the effective implementation of sound corporate governance practices by institutions. In some cases, the absence of effective checks and balances within institutions resulted in a lack of effective oversight of management decision-making, which exacerbated short-term and excessively risky management strategies. The unclear role of the competent authorities in overseeing corporate governance systems in institutions did not allow for sufficient supervision of the effectiveness of the internal governance processes'.

V. The Conflicts Between the Interests of Different Groups of Shareholders

One of the most important elements of the agency theory, which has proven to be one of the most fragile, is the assumption that the shareholders-principals equally share a common interest (that of the maximization of the value of their shares) easily definable in the abstract, and almost uniquely identifiable in concrete terms.

The assumption regarding the commonality of this interest is in an agency perspective absolutely crucial. The shareholders-principals, if imagined as having a common interest, equally shared by each of them, can be treated as a single subject, thereby avoiding the delicate problems inevitably arising from the presence of different principals with diverging interests. The importance of this point cannot be overstated. The agency problem changes radically its characteristics when it is connected to a situation in which there are, instead of a single principal with a univocal interest, many principals with different and maybe conflicting interests. One of the main arguments in favour of the so-called theory of the shareholder value proceeds just from the reference to the difficult problems (first of all that of restraining the management discretionary power)[32] that would be inevitable if we had to conceive an agency relationship between the managers and the varied multitude of the stakeholders.[33]

Besides, in case of a fiduciary duty towards individuals with potentially diverging interests, it becomes very difficult to present the situation as posing a (rather) simple problem of maximization, as the 'agency theory' does. There is no common interest that can be presented as a general interest and whose maximal satisfaction can represent a reasonable goal. There is instead the need of continuously mediating between the different interests which from time to time come into conflict with each other. Therefore, the agent is inevitably entrusted with the power of balancing the conflicting interests of the principals in every concrete situation. With the other fatal consequence, the problem of limiting agents' discretion becomes almost intractable. In the case of the giant corporations, this seems extremely embarrassing, because it would imply that their policies, that impact on the lives of all of us, are decided almost discretionally by agents who practically are accountable to no one (which was in a nutshell the very

[32] 'In a nutshell, management can almost always rationalize any action by invoking its impact on the welfare of *some* stakeholder': J. Tirole, 'Corporate Governance' 69 *Econometrica*, 26 (2001).

[33] 'The evaluation of the managers' performance becomes much more difficult (R.M. Wiseman, G. Cuevas-Rodríguez and L.R. Gomez-Mejia, 'Towards a Social Theory of Agency' 49(1) *Journal of Management Studies*, 202-222 (2012). When agents must satisfy multiple and diverse, often conflicting demands, performance criteria will be more ambiguous) and the 'politicization' of firms which shall follow from considering all stakeholders as principals (and the firm as their common agent) will lower the power of incentives, A. Dixit, 'Power of Incentives in Private versus Public Organizations' 87(2) *The American Economic Review*, 378-382 (1997).

problem raised by Berle and Means that the agency theory boasts to have solved).

To sum up: formulating a problem in terms of principal-agent may be useful when we are confronted with a conflict between the interest of the principal and that of the agent. When we are on the contrary confronted with problems arising from a conflict of principal versus principal, the agency scheme is of little help. Therefore the 'agency theory' claim of having framed the most important problem of the corporation in its appropriate, and theoretically most fruitful scheme, that of the principal-agent relationship, stands or falls on the possibility of acknowledging the existence of an interest common to all shareholders, thereby creating the condition for treating the shareholders of a given corporation as a single individual.

Observed from the viewpoint of the shareholders as they actually are, and not as they are imagined by the agency theory, the adoption of the perspective which treats the shareholders of a given corporation as they were a single individual comes at a great cost. This perspective ignores the evident reality of shareholders with diverging interests,[34] especially as to the way in which the profits of the corporation shall be *produced*.[35] This is an important point. The agency theory seems to ignore the fact that profits before being *distributed* must be *produced*. Production comes first and is the condition for having a distribution whatsoever. In the agency theory, the two moments (production and distribution) are conflated in a generic risk that agents will use organizational resources for their own benefit. A consequence of this disregard of the distinction between production and distribution is a concentration of attention on the generic problem of the division of the surplus between managers and shareholders, which underestimates the problems specific to the productive aspects (the way surplus is produced).

This distortion of perspective is closely related to the legitimation of the recourse to a model in which the shareholder interested in maximizing the value of its stock can be considered as a sort of 'representative agent'. In fact, a model based on the idea of a representative shareholder is easier to credit in a merely distributive context, where the image of the shareholders as individuals all

[34] There is a considerable literature which focuses on the conflicts of interest between large and small shareholders (known as the principal–principal perspective), but it is mostly referred to emerging economies: V.Z. Chen, A. Sluhan, B. Hobdari, and F.W. Kellermanns, 'For Love or Money? An Extended Principal-Principal Perspective of International Acquisitions' *Academy of Management Proceedings*, 11941 (2016). This literature considers the principal-agent relationship not appropriate for analysing corporate governance in emerging-economy institutional contexts, in which the institutional characteristics of the developed economies are often absent and the conflict of interest between controlling and minority shareholders becomes paramount: K. Awasthi, 'Taking Stock of the Principal-Principal Agency Perspective: A Review and the Way Ahead', in S. Raghunath and E.L. Rose eds, *International Business Strategy* (London: Palgrave Macmillan, 2017), 17-42.

[35] F. Denozza, 'Nonfinancial Disclosure between 'Shareholder Value' and 'Socially Responsible Investing", in G. Ferrarini and E. Wymeersch eds, *Investor Protection in Europe: Corporate Law Making, the MiFID and Beyond* (Oxford: Oxford University Press, 2006), 365.

sharing the same preference (that of having more rather than less) may have some plausibility. In fact, in the distributional perspective, the assumption of an equal aspiration of all shareholders to maximize the part of the surplus destined to their category, and to minimize the one destined to the managers, may have some likelihood. In the perspective of the surplus production, the same assumption loses any credibility, since it is easy to imagine that the shareholders may have completely different preferences on the goals to be pursued and, above all, on the ways and times of their pursuit. But in a perspective in which one of the parties of the transaction is a collective party, whose members have different and often conflicting interests, the possibility of having a single maximizing transaction model fades away. What is, or appears, maximizing for some, may not be, or may not appear to be, maximizing for others. To make the most extreme example, what may seem a satisfying way of producing the desired surplus to a hedge fund may not look so to a pension fund with a completely different time horizon, and even less so to a socially responsible investor, interested in the way the corporation's profits are produced.

VI. A Transaction with a Lot of Third Party Effects

The last critique of the agency theory is the most straightforward. This theory treats the (hypothetical) transaction between shareholders and managers as a transaction void of significant third party effects. The financial crisis, if nothing else, demonstrated that the assumed absence of external effects is wrong.

To keep intact its ambition of having a precise theoretical subject (the transaction) and a univocal goal (the minimization of the transactions costs), the 'agency theory' is compelled to resort to an abstract model of an (alleged) transaction between an archetype of shareholder (representing a set of members solely interested in maximizing the overall yield of their investment) and an archetype of manager (solely interested in maximizing the value of the relationship between remuneration obtained and paid work commitment). In addition to being unrealistic (as we saw in the preceding part) this model based on archetypes also has another defect. In this context, any awareness of a series of more general problems gets lost, especially that of the effects that the socio-economic identity of the shareholders – entrepreneurs, savers, institutional investors, speculators – may exercise on the concrete functioning of the mechanisms of corporate governance and of the financial market in general.

We exemplify this point by focusing on the most important change that occurred after the 'agency theory' was established as the dominant theoretical frame in the corporate governance field. This change went almost unnoticed by the agency theory and played a very fundamental role in the development of the financial crisis. We allude to the declining role of the retail investors and the shift towards institutionalization in the financial markets.

According to some sources the share of institutional ownership of US common stock increased from approximately thirty per cent in the 1970s to over ninety per cent in 2016.[36]

The fact that the potential consequences of this transformation in the socio-economic identity of the shareholders has been underestimated by the agency theory does not come as a surprise. In the end the theory can legitimately suppose that nothing of substance happened: as households and retail investors were presumed interested in maximizing the value of their direct investments in the corporation stock, so institutional investors can be presumed, in some sense even *a fortiori*, as equally interested in maximizing the value of their clients' money, which they invest on their behalf in the corporation stock. Except, maybe, for the need to take into account another agency problem (that pertaining to the relationship between retail investors and the different institutional investors entrusted with managing their money) no relevant change is detected by the theoretical instruments of the agency theory.

In fact, the change from retail to institutional investing, represents a real revolution, even it were true that both retail and institutional investors are equally interested in maximizing the value of the money they invest in equity. The big difference between the two situations (households directly investing their savings and institutions investing on behalf of savers) is that maximizing is for the households directly investing a simple, legitimate, wish, whilst for the institutional investors maximizing is an inescapable constriction. This difference has a source whose name is competition. The institutional investors compete with each other, whilst the retail investors do not. The consequence is that under the same name of 'maximizing' we observe two different phenomena. Retail investors are free to decide, as they prefer, on the time horizon of their investments, the elasticity in the trading policies, the willingness to give confidence to unpopular managers, etc. Institutional investors are not free. They are constrained by the competition and thereby compelled to act in accordance with the imperatives fixed by the mechanism of the market in which they operate. The maximization which coincided with the simple aspiration to defend, and possibly increase, one's savings, becomes now the obsession of reaching ever bigger gains and above all higher than those of one's competitors.[37] Under the same label of

[36] *Shareholder Activism, Engagement and Proxy Fights – The 35th Annual Federal Securities Institute Miami (Florida: February 2017)* available at https://tinyurl.com/y9yuwt6s (last visited 25 November 2017). The share of institutional investors raised from six point one per cent of corporate ownership in 1950s to seventy-three per cent for the top one thousand largest US corporations in 2009, A.R. Admati, 'A Skeptical View of Financialized Corporate Governance' 31 *Journal of Economic Perspectives*, 131-150 (2017). See also A.J. Davis, 'A Requiem for the Retail Investor?' 95(4) V*irginia Law Review*, 1105-1129 (2009); D.C. Langevoort, 'The SEC, Retail Investors, and the Institutionalization of the Securities Markets' 95(4) *Virginia Law Review*, 1025-1083 (2009).

[37] J.W. Winter, 'Shareholder Engagement and Stewardship: The Realities and Illusions of Institutional Share Ownership' (2011), 6, available at https://tinyurl.com/ybd3vy75 (last visited

maximization, the pressure exerted on the managers of the investee corporations is absolutely different.

The shift from households directly investing their savings, to managers investing other people's money, has another serious consequence, which we can call the exasperation of the effects of asset managers' herding behaviour.[38] Managers of professionally investing entities have a good reason for preferring a shared mistake to a just but solitary initiative. Since nobody knows the exact moment the bubble will burst (and the moment comes of paying one's mistakes) and since leaving the betting game can, in the immediate aftermath, decrease profits, a solitary strategy of prudence, adopted too much in advance, may be fatal to the manager's career. This mechanism has heavily contributed to the recent crisis by discouraging even more conscious managers from reducing the risks they were taking.

The importance of both phenomena (the obsessive pressure exerted on the mangers of the investee corporations and the herding behaviour of the managers) analysed here seems undeniable. The role they play in the financial crisis we believe is obvious to anyone.

VII. The 'Transaction Centrality', and the 'Integrating Market' Views Reconsidered

The 'agency theory' stands on a couple of implied, untenable, assumptions. It is assumed, first of all, the mutual irrelevance of the various transactions agreed between the various categories of stakeholders. A second assumption is the little relevance of the shareholder initiative, in the sense that the maximal satisfaction of their interest is supposed to be reachable with no need of increasing the power they are legitimated and able to exercise within the corporation. Any attempt to set up a theoretical framework alternative to that of the 'agency theory' requires that these assumptions be abandoned.

In the first assumption (that implied by the 'transaction centrality' thesis) the efficiency of each transaction is supposed to be independent of the content of the other transactions. In fact, focusing on the efficiency of the single transaction occurring among the various stakeholders is acceptable only provided that the efficiency conditions of each transaction can be established on the base of its

25 November 2017): 'the competition leads to a pressure on asset managers to continuously show good investments results'.

[38] R.J. Gilson and R. Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias' 28 *The Journal of Corporation Law*, 715 (2002). As already noted by J.M. Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan, 1936), Chapter 12, V, 4, precisely with reference to the behaviour of professional investors, 'Worldly wisdom teaches that it is better for the reputation to fail conventionally than to succeed unconventionally', or 'It's better to be wrong with the rest of the pack than to be right'. J. Tirole, *Theory of Corporate Finance* (Princeton, NJ: Princeton University Press, 2006), 22, fn 34.

specific elements and characteristics, abstracting from the whole context and in particular from the transactions that intervene among other stakeholders. Otherwise, the problem of the efficiency of the corporation law could not be broken up, as it were, into that of the maximization of the efficiency of a set of different categories of single transactions, able to be separately examined, and we were instead confronted with the not so easy task of solving all the 'equations' simultaneously, looking for a solution that maximizes the efficiency of all the relevant transactions at the same time.

This view (the idea that the problems posed by the modern corporation can be reduced to a problem of efficiency of different series of transactions among different stakeholders) is consistent with what can be considered a fundamental feature of the neoliberal legal style, namely the shift from the attention to the functioning of the overall system, to the focus on the success of the single transactions. To say it by means of a slogan, the liberals of the Keynesian-Fordist era regarded the government of large market aggregates[39] as essential for overcoming the problems created (also on the distributive plane)by the market failures, whilst they did not care much about the regulation of the single market transactions (probably thinking that the transactions carried out in a market functioning well, by virtue of its own spontaneous mechanism, or as wisely guided by the State, tend to be naturally balanced and did not need a special attention from the regulator). Neoliberals think, on the contrary, that the essential means for overcoming market failures is that of governing individual transactions, with the aim of facilitating efficient deals and the occurrence of as many as possible transactions maximizing the welfare of the individuals involved. The implicit assumption is that if one succeeds in incentivizing the individuals to settle the greatest number of efficient transactions, the sum of these transactions will generate the maximum welfare, with no need of any intervention on the overall market configuration.

Thus, the control of credit, savings and currency variables, which was the pillar of the State intervention during the years between 1930s and 1970s, has been gradually abandoned, and in a sense 'replaced' by the regulation of the contracts of the various financial intermediaries (the MIFIDs) and by rules governing the capital and the transactions of individual banks (Basel). The control over the total amount of consumption (income policy and price control) has been abandoned and 'replaced' by the consumer contracts discipline. In antitrust law, the concern for the structure of the markets that worried the George Mason and Joe S. Bain generation has been 'replaced' by the analysis of the effects of individual practices, imagined as isolated factors of potential efficiency or inefficiency. In corporation law, as we have just seen, the 'centrality of transaction'

[39] The pillars of the system were, as is well known, demand management, use of debt to stimulate the economy, mass production. See eg C. Crouch, 'What Will Follow the Demise of Privatised Keynesianism?' 79(4) *The Political Quarterly*, 476-487 (2009).

thesis has displaced the concern, aroused by Berle and Means, about the legitimization of, and the social control over, the private economic power, and so on.

Resorting to a simple scheme, we could say that classical, nineteenth century, legal liberal thought preached laissez-faire and pursued economic equilibrium; the liberals of the Keynesian-Fordist era (approximately 1930s-1970s) preached the control of the market structure (ie of the fundamental macro-variables of the market) and pursued social equilibrium. Neoliberals preach the government of transactions and pursue the maximization of economic development and of the overall welfare.[40]

A relevant feature in neoliberal legal thought is a radical shift of perspective regarding the relationship between the public good and the regulation of private transactions. Since economic development (the public good) is conceived as the increase in the overall well-being generated by the multiplication of efficient transactions, the public good, instead of being the *independent* landmark dictating the imperatives to which the individual transactions have to structure in accordance, becomes instead itself *dependent* on the success of the single maximizing transactions. The public good is no longer the 'antecedent' that dictates the imperatives to which the private transactions must conform (be it the imperative of submitting to the iron laws of the invisible hand or the imperative of adapting to the context created by macroeconomic corrective measures, etc). The public good is simply the 'consequence' of innumerable private transactions maximizing the well-being of the transaction parties. The conscious pursuit of the success of each transaction is no longer conceived as a private matter, but as a tool for the realization of a public benefit. Transaction becomes, from every point of view, the centre of the economic universe.

In this perspective, any intervention in pursuit of the public good is doomed to adopt an atomistic vision in which the problems of the single transactions appear as the decisive starting points and the status of the whole system as a simple function of the way in which each transaction is geared.

This perspective must be abandoned. Its core idea, that of the existence of a multitude of various transactions, socially dis-embedded and independent of each other, is untenable. If nothing else, the financial crisis has shown that the effects of the transactions are mostly interdependent and that a regulation suitable from the viewpoint of a given transaction may have negative consequences on the functioning of other parts of the system and on the system as a whole. We can exemplify this point by resorting to an already examined fact: the relationship between the institutional investors and the managers of the investee corporations. The transactions between the two categories, inspired by the ideology of maximizing shareholder value, may have very well solved the agency problem from the

[40] F. Denozza, 'Introduzione. Regole e mercato nel diritto neoliberale', in M. Rispoli Farina, A. Sciarrone Alibrandi and E. Tonelli eds, *Regole e Mercato* (Torino: Giappichelli, 2017), II, XV.

viewpoint of the contracting parties. In fact, the managers of the period before the crisis reached unprecedented gain levels, becoming the most paid managers in history. The investors, in turn, have received for years enormous dividends, well above the growth rate of the gross domestic product. Even if we detract from the sum of these two increases in well-being the losses suffered by some investors at the time of the bubble burst, the overall result remains, from the viewpoint of the participants in the transactions regulating the agency problem, surely positive. But if we consider that this regulation contributed, as we have already explained, to the development of the financial crisis, the evaluation of the way in which the relationship between mangers and shareholders was regulated is not positive. Coming to the second assumption, another element characterizing the agency theory is, as we saw, the faith in the possibility of finding a point of equilibrium in which a good mix of few (mostly enabling) rules, appropriate agreements and market mechanisms, incentivizes the managers to give precedence to the interests of their principals (up to the natural limit within which this withdrawal from self-interested behaviours can be realistically claimed to an individual who still remains a rational egoist). In this vision, the maximum possible satisfaction of the interests of both categories, and thus the efficiency of the transaction, can be reached not only (as we underlined before) with no, or with a very limited, recourse to mandatory rules, but even with no need of an active intervention of the shareholders in the ordinary course of the corporate business. The result is presumed to be *automatically* guaranteed by the equilibrating working of the market forces. This is one of the most baffling features of the 'agency theory', a theory which claims to have the protection of the shareholder interest as its highest goal, but radically refuses to advocate and support any increase of the shareholder rights within the corporation. In fact, a general empowering of the shareholders has never figured among the main goals and recommendations of the agency theory adherents, at least until the recent years.[41] This could be considered a rather odd characteristic of the agency theory and of the shareholder value movement in general. The theory qualifies the shareholders as the category whose interests must be considered the most important and the most in need of protection, but the same theory does not bother to give them the legal powers they need to protect themselves. Given that shareholders are naturally able to manage their own interests, the justification of this apparent oddity based on the so called rational apathy of the shareholders is not convincing. In the worst scenario, empowering shareholders struggling with rational apathy and collective action problems could prove largely useless.

[41] See for example the debate triggered by opinions favouring shareholder empowerment as in the case of L.A. Bebchuk, 'The Case for Increasing Shareholder Power' 118 *Harvard Law Review*, 833 (2004), or the discussions on shareholder voting (J.R. Macey, n 27 above, 199, fn 26). On the problem of the 'directors' dictatorship', established despite the flaunted primacy of the shareholders, see also M. Ventoruzzo, 'Empowering Shareholders in Directors' Elections: A Revolution in the Making' 8(2) *European Company and Financial Law Review*, 105-144 (2011).

But that is not a good reason for giving up the possibility of occasional, advantageous, recourses to a direct monitoring of the managers by the shareholders. In any case the central point is the dissemination of a vision in which there is no necessary coincidence between the interests (assumed) protected and the interests whose holders are empowered. This vision ended up influencing even non-adherents to the 'agency theory'. Consequently, the whole problem of corporate governance and corporate social responsibility has been seen in recent decades much more as a problem of exactly defining the interests directors and managers must take into account in their decisions,[42] than as a problem of restructuring the distribution of powers among the various categories of stakeholders.

VIII. From the Allocation of Fiduciary Duties to the Distribution of Control Rights. A Direction for Further Research

The situation described at the end of the previous section is changing. On the one hand, shareholders have in fact demonstrated a remarkable ability to intervene actively in publicly traded corporations[43] and, on the other hand, there seems to be a growing tendency to increase shareholder democracy.[44] This is a tendency that, especially in Europe, seems to be supported by the conviction that the active participation of shareholders in the affairs of the companies may lead to an improvement in the functioning of the market and of the overall economic system.[45] Even if with great caution and hesitations, EU lawmakers seem to have adopted the idea that an improvement of the governance of European corporations requires a legal system able to incentivize a stronger and more active control of the managers by the investors. Apart from any judgement on the feasibility, and the potential results, of the European

[42] This is also the approach of the so-called 'team production theory of corporate law': see M.M. Blair and L.A. Stout, 'A Team Production Theory of Corporate Law' 85(2) *Virginia Law Review*, 247 (1999).

[43] B.R. Cheffins, 'The Team Production Model as a Paradigm' 38 *Seattle University Law Review*, 397, 400 (2014): '(…) over the past few years there has been a surge in shareholder influence in publicly traded corporations, prompted primarily by activism campaigns hedge funds have launched'.

[44] OECD, Directorate for Financial and Enterprise Affairs, *Corporate Governance and the Financial Crisis, Conclusions and Emerging Good Practices to Enhance Implementation of the Principles*, 24 February 2010, notes the '(…) substantial strengthening of shareholder rights in the OECD area and other market in recent decades (…)'; D. Katelouzou, 'Reflections on the Nature of the Public Corporation in an Era of Shareholder Activism and Shareholder Stewardship' (2016), available at https://tinyurl.com/y8oqlg53 (last visited 25 November 2017): 'The idea that shareholder power is a positive corporate governance attribute underpins recent policy efforts to instil greater shareholder democracy into the modern corporation on both sides of the Atlantic (…)'.

[45] On the worldwide debate about increasing shareholder legal powers see G.W. Dent Jr, 'The Essential Unity of Shareholders and the Myth of Investor Short-Termism' 35 *Delaware Journal of Corporate Law* 97, 148 (2010).

project[46] of entrusting investors with a supervisory role towards managers of the investee corporations,[47] one of the basic idea sunder pinning this project deserves in our opinion approval and support. It is the idea of directly empowering actors instead of insisting on relying on a benevolent attitude of directors and managers (be it imposed by rules, or obtained by a clever use of market mechanisms). This idea implies a shift of perspective in which the protection of shareholders' interests starts to be entrusted not *only* to other individuals' (directors and managers) incentives and duties, but *also* to the self-defence of the category.

This attitude should be in our opinion be generalized and extended to all the stakeholders whose interests are deemed worthy of protection.

Corporate governance, properly understood, not only provides for the allocation of fiduciary duties[48] but also the distribution of control rights. If the control right is understood as 'the right for a player (or a group of players) to affect the course of action once the firm has gotten started',[49] a distribution of control rights which involves even non-financial stakeholders, without necessarily equating their control rights to that of the shareholders (as it is for example in the case of the German so-called *parithaetische Mitbestimmung*) is easily conceivable.

It is worth noting that a right to affect does not necessarily imply a right to participate in the decision. Assigning rights to appoint directors is not the only way to give stakeholders the possibility of affecting the corporate decisions. Other less invasive rights are easily conceivable. In addition to the right to be informed (which is already able to affect the corporate decisions, given that deciding in secret is different than deciding transparently) other rights can be imagined. For example, a right (of relevant stakeholders) to be periodically heard by the board of directors or a right to be consulted before making decisions that may affect them.

Obviously, all these rights (information, audition, consultation) and others, can be imagined as rights negotiated by the stakeholders as contractual counterparties. This is in fact the vision of the nexus of contracts theory, in

[46] J. Winter, 'The Financial Crisis: Does Good Corporate Governance Matter and How to Achieve it?' (August 2011, DSF Policy Paper, no 14), available at https://tinyurl.com/ybyn3lue (last visited 25 November 2017): 'Stewardship, a structural engagement not limited in time or to a certain problem, requires something completely different' from the current investment environment.

[47] On the general problem of the respective visions of shareholders, directors and managers, see L.E. Strine Jr, 'One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?' *The Business Lawyer*, 1-26 (2010).

[48] See J.T. Macey and G.P. Miller, 'Corporate Stakeholders: A Contractual Perspective' *Faculty Scholarship Series*, Paper no 1603 (1993) available at https://tinyurl.com/ycuomxjs (last visited 25 November 2017).

[49] J. Tirole, 'Corporate Governance' n 32 above, 13.

which the stakeholders interested in interfering with the corporate decision process may secure specific control rights by contracting with the corporate managers (as it is sometimes the case especially for lenders and employees). In our perspective, instead, the stakeholders should be entrusted with control rights (in the clarified wide sense) by the law, as recognized contributors to the corporate enterprise. The goal is not only that of constraining the action of corporate leaders in a less specific and occasional way than in contractual relationships, but especially that of changing their culture. This opens a different perspective, which we discuss at length in a further work.