Petri Mäntysaari

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Theories of Commercial Law, Corporate Governance and Corporate Law

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Prof. Dr. Petri Mäntysaari
Hanken School of Economics
Department of Accounting and Commercial Law
Handelsesplanaden 2
65100 Vaasa
Finland
petri.mantysaari@hanken.fi

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Chapter 1
Introduction

Organisation form has an important impact on business performance.[1] Legal institutions such as laws and legal instruments help to organise the firm.[2] This makes commercial law, the law of corporate governance, and corporate law important research areas in legal science.

However, commercial law, the law of corporate governance, and corporate law all share the same problem: they lack a proper theoretical basis. This is unfortunate, because all scientific research is theory-based in social sciences. The lack of a proper theoretical foundation can raise doubts about the scientific quality of research, reduce access to leading journals and to external funding, reduce universities' internal funding, and make the area less attractive to researchers. Moreover, if the purpose of a theory is to predict objective reality, the lack of a proper theoretical basis raises questions about the relevance of existing research.

These three areas of law share this problem partly for the same reasons. (a) First, these areas are *interlinked*. Commercial law is a large branch of law that covers commercial contract law, corporate law, the regulation of corporate governance, and many other issues. Since the codification of commercial law in France and Germany, commercial contract law and corporate law have been regarded as its main areas. Large parts of corporate law regulate questions of corporate governance. (b) Second, mainstream legal research has as its starting point existing *legal norms* applied and interpreted by the court. Because of the vast number and diversity of legal norms, it is difficult to define their common characteristics in a relevant way and to formulate theories that would explain sector-specific

[1] Williamson OE, The Modern Corporation: Origins, Evolution, Attributes, J Econ Lit 19 (1981) p 1543 (on Chandler 1962).

[2] For institutions in general, see North DC, Institutions, Institutional Change and Economic Performance. Cambridge U P, Cambridge (1990) pp 3–4 (definition); Ostrom E, Crawford S, Classifying Rules. In: Ostrom E, Understanding Institutional Diversity. Princeton U P, Princeton Oxford (2005), Chapter 7, pp 190–191 (classification); Aoki M, Toward a Comparative Institutional Analysis. The MIT Press, Cambridge, Mass. (2001) pp 26–27, 186 and 197 (elements).

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phenomena rather than phenomena common to all legal norms. (c) Third, it may be difficult to fill the theoretical void by using *economic theories* as a model, because economic theories are not necessarily compatible with existing norms. (d) Fourth, both corporate law and corporate governance are heavily influenced by *theories of the firm*.[3]

The problem will thus require a coordinated solution in legal science. The purpose of this book is to discuss the reasons for the absence of theories in present research, and to develop a theoretical framework for commercial law, the law of corporate governance, and corporate law. In legal science, the theoretical framework should be able to predict legal phenomena.

The key to the proposed theoretical framework is the choice of the *perspective of the firm* in commercial law and corporate governance. In this book, it will replace competing perspectives such as the perspective of the judge (legal dogmatics), the investor (shareholder primacy), or the stakeholder (the stakeholder theory). Choosing the perspective of the firm can, perhaps contrary to popular wisdom,[4] make it easier to formulate theories and develop commercial law as a science. One of the obvious benefits is that it can help to explain the behaviour of firms and many legal institutions used by firms. The choice of the perspective of the firm does not mean that managers would be given freedom to pursue whatever interests they choose or society directs (managerialism).[5]

The perspective of the firm must, of course, be defined. Once this has been accomplished, one can study the firm's generic commercial objectives and the legal tools and practices that firms use to reach them. This is the area of general commercial law. Corporate governance is a particular context in which the firm uses legal tools and practices to address particular governance-related issues in addition to the generic issues. This is the area of the law of corporate governance. Corporate law is a collection of legal norms that regulate three important contexts: corporate governance; corporate finance; and the existence of corporations.

The chapters of this book reflect the fact that theories of commercial law, corporate governance, and corporate law are connected.

Chapter 2 discusses economic theories of the firm. As the chosen perspective is that of the firm, economic theories of the firm set the scene for much of the rest of the book.

Chapters 3 and 4 provide the foundation for the study of commercial phenomena in legal science. A reader interested in corporate governance can skip these two chapters. Chapter 3 discusses existing theories of commercial law. Whereas

[3] For corporate law, see Bratton WW, The New Economic Theory of the Firm: Critical Perspectives from History, Stanford L Rev 41 (1989) pp 1471–1527.

[4] See, for example, Merkt H, Wirtschaftsrechtsvergleichung im Zeitalter der Globalisierung: Tendenzen, Aufgaben, Perspektiven, ZVglRWiss 103 (2004) p 266: "Am Ende: von der Wissen- zur Wirtschaft?"

[5] See, for example, Bainbridge S, Director Primacy: The Means and Ends of Corporate Governance, Northw U L Rev 97 (2003) pp 547–549.

theories of the firm are irrelevant for existing theories of commercial law, they are very important for Management-based Commercial Law (MBCL), a new theory of commercial law proposed in Chap. 4. MBCL is defined as a "functional" rather than normative area of law.[6] According to MBCL, the firm uses legal tools and practices in order to reach its objectives.

Chapters 5 and 6 discuss existing theories of corporate law and corporate governance. A new legal theory of corporate governance is proposed in Chap. 7. The starting point of the proposed theory of corporate governance is that there are legal entities and organisations. Certain issues must be addressed because of the existence of legal entities, and further questions because of the existence of organisations.

Chapters 8 and 9 develop the theory of corporate governance further. While Chap. 7 answers the question what issues must be addressed, it does not tell you how they should be addressed. According to Chaps. 8 and 9, the self-enforcement of the governance model and its ability to foster innovation are important drivers when firms choose their governance models.[7] Chapter 8 explains how the sustainability of the firm can be increased by making its governance model more self-enforcing. In Chap. 9, it is argued that the firm is not sustainable unless its governance model also fosters innovation.

A new theory of corporate law is proposed in Chap. 10. According to the proposed theory of corporate law, corporations are legal tools used by firms. Corporate law consists of three main areas: corporate governance; corporate finance; and existential issues. Self-enforcement and innovation-related issues are incorporated into the proposed theory.

[6] All theories should be functional, but there is a distinction between normative and functional areas of law in legal science.

[7] A related approach can be found in Aoki M, Toward a Comparative Institutional Analysis. The MIT Press, Cambridge, Mass. (2001) pp 2–3: "... the synchronic problem, where the goal is to understand the complexity and diversity of overall institutional arrangements across the economies as an instance of multiple equilibria of some kind, and the diachronic problem, whereby the goal is to understand the mechanism of institutional evolution/change in a framework consistent with an equilibrium view of institutions, but allowing for the possibility of the emergence of novelty."