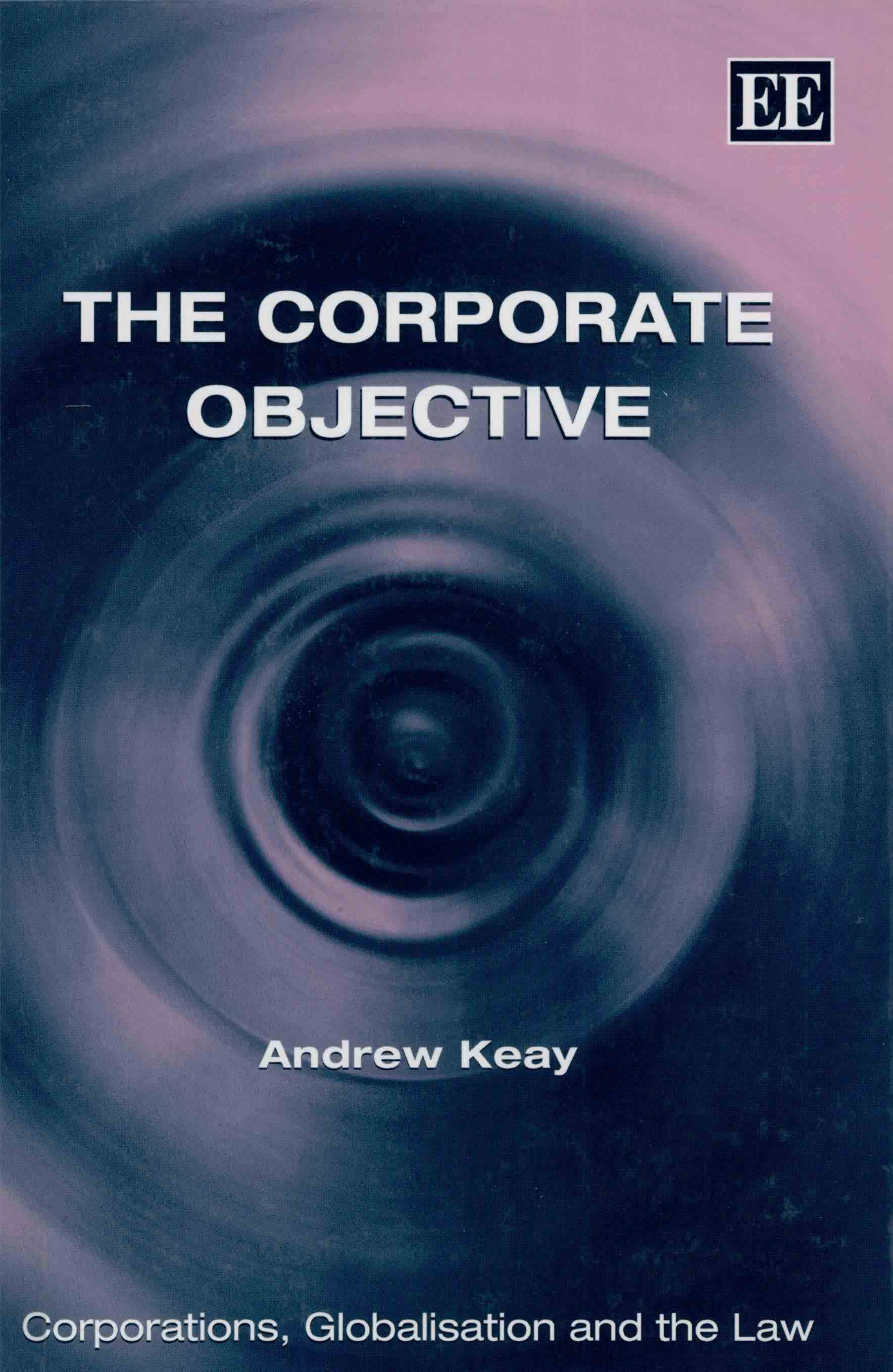

THE CORPORATE OBJECTIVE

Andrew Keay

Corporations, Globalisation and the Law

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CORPORATIONS, GLOBALISATION AND THE LAW

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Preface

Large public companies dominate the world in which we live, and have become increasingly important over the past century. Despite this fact there has never been unanimity amongst scholars, practitioners and directors as to what the objective of such companies is and should be. For many years there has been robust and, at times, caustic debate over the matter. While there has been much written on the topic I believe that there is still room for scholars to contribute to the debate, especially if they are not merely re-hashing the main points that have been made thus far.

This book seeks to consider the issue of the corporate objective normatively and to investigate what in fact should be the corporate objective. The book proposes an approach that is titled, the Entity Maximisation and Sustainability model. It is an ungainly title, perhaps, but it is descriptive of that which is proposed. Before articulating the model and seeking to apply and justify it, I discuss the two theories that have dominated the field, the shareholder primacy and stakeholder theories. It is necessary to do this for two reasons. First, I seek to synthesise, and provide in one place, the arguments for and against each theory. Hitherto, for a comprehensive appreciation of the two theories, from the viewpoint of various academic disciplines, one had to read a large volume of articles. Second, before propounding a fresh approach one must, as a matter of respect to other scholars and as a requirement for good scholarship, consider and assess the views that have been put forward for many years.

The fact that the debate is long-standing should not pre-empt further study, especially where there is not a simple re-hashing of the arguments already propounded. This work seeks to make a break from the existing situation, namely polarisation of arguments around one or other of the two predominant theories. The literature has focused on aspects of these theories, whereas this book seeks to move away from that and proposes a fresh approach, through the development of a new model, and to investigate its effects in a corporate setting.

It is acknowledged that this work will not end the debate, and it does not purport to do so. It is hoped that it will lead to further study. The value of the work is not necessarily in that it will change practical management in the short term. It is submitted that it might, however, form the foundation for further work by, and consideration of, academics, law-makers and directors. It is hoped that work will provide an underpinning for the further development of corporate governance guidelines, mechanisms or regulation.

It is further hoped that this work will lead to a fresh consideration of the role and position of investors (often known as 'stakeholders') and new approaches to issues such as how companies should distribute the profits which they accumulate. Furthermore, previous theories have focused almost solely on how the managers should act in relation to either the shareholders or all stakeholders while the model that is being proposed in the book introduces a different way of approaching how companies should be run, and what issues should be considered by the directors. It will demonstrate that the corporate objective does not have to be assessed from the standpoint of the groups with interests in the company, but by asking how the company entity should act for its own enhancement.

Some of the material in the book draws on five articles which I have written and published, and where permission of the publishers has needed to be sought I have kindly been given the permission of the publishers (named below) to use them. The articles are:

- 'The Ultimate Objective of the Public Company and the Enforcement of the Entity Maximisation and Sustainability Model' (2010) 10 *Journal of Corporate Law Studies* 35–71 (Hart Publishing).
- 'Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model' (2008) 71 *Modern Law Review* 663–698 (Blackwell Publishing).
- 'Shareholder Primacy in Corporate Law: Can It Survive? Should It Survive?' [2010] *European Company and Financial Law Review* 369–413 (De Gruyter).
- 'Stakeholder Theory in Corporate Law: Has It Got What It Takes?' (2010) 9 *Richmond Journal of Global Law & Business* 240–300 (University of Richmond).
- 'Getting to Grips With the Shareholder Value Theory in Corporate Law' accepted for publication in the *Common Law World Review* (Vathek Publishing).

The initial research that I undertook in relation to this project was supported by a grant from the British Academy, for which I am very thankful. I am thankful to the School of Law at the University of Leeds for granting me study leave to develop the book. I wish to thank several friends and colleagues who have provided me with feedback on aspects of the material that is found within this book. In particular, I thank Harry Rajak, Chris Riley, Gerry McCormack and Joan Loughrey. I am responsible for all errors and the aforementioned parties should not be regarded as in any way responsible for what I have written.

I have appreciated the support of Ben Booth from the publisher over the time I have been writing the book.

Andrew Keay
Leeds
1 January 2011

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1. Public companies: context, theory and objectives

The aim of this Chapter is simply to set the scene for the balance of the book. It seeks to consider general issues such as the power and nature of large public companies, their position in society, the objective of the book and why the focus of the book is important.

1. THE CONTEXT

The business company is a ubiquitous part of today's society. Such entities have great effects on our daily lives and have an influence over just about all that we do. The business company has been with us now in its present form, or close to it, for over 150 years. As the Honourable Justice Michael Kirby (a judge of the High Court of Australia at the time of speaking) said extra-judicially, and in relation to public companies:

> [T]he idea of an independent corporation, governed by directors and accountable to shareholders, was a brilliant one. It permitted people to raise capital from the public, to invest it without, in most cases, a danger of personal risk and to engage in entrepreneurial activity which, otherwise, would probably not occur.[1]

Michael Jensen has emitted similar sentiments and said that the public company lowered the risk of capital and permitted the spread of financial risk over the portfolios of large numbers of investors.[2] Nevertheless, the nature and operation of such companies has caused no end of discussion, argument and litigation, and the most fundamental issues relating to the company still elude us.[3] This is undoubtedly partly due to their

[1] 'The Company Director, Past, Present and Future,' address to the Australian Institute of Directors, Hobart, 31 March 1998.

[2] 'Eclipse of the Public Corporation' (1989) *Harvard Business Review* 61 at 64.

[3] C. Brunner, 'The Enduring Ambivalence of Corporate Law' (2008) 59 *Alabama Law Review* 1385 at 1385.

fundamental role as the most important institutions for social wealth creation in capitalist economies.[4]

It is trite to say that companies play critical roles in the carrying on of commerce across the world. Undoubtedly, a large element of economic activity is undertaken by companies in most, if not nearly all, of the world's nations,[5] and they have been and are the dominant economic institutions in the world. In the United States companies account for nearly 100 per cent of all national output,[6] although this includes private companies (close corporations). It is fair to say that the role of companies in society has changed remarkably over time, from small business ventures to the gigantic multinational enterprises which we see today. Leslie Hannah has stated, in relation to Great Britain, that with the developments in the twentieth century alone, British industry went from: 'a disaggregated structure of predominantly small, competing firms to a concentrated structure dominated by large, and often monopolistic, corporations.'[7] But for well over a century the public company has been 'one of the primary institutions of capitalism'[8] and has established a well-used vehicle for the ownership and control of property, the accumulation of capital and the organisation of production.[9] Clearly companies in general are the most used structure invoked by businesses around the world for running their activities.[10]

The public companies of today often are part of a complex corpo-

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[4] M. Blair, 'For Whom Should Corporations Be Run?: An Economic Rationale for Stakeholder Management' (1998) 31 *Long Range Planning* 195 at 195.

[5] M. Blair, *Ownership and Control* (Washington DC, Brookings Institute, 1995) at 17.

[6] R. Estes, *Tyranny of the Bottom Line: Why Corporations Make Good People Do Bad Things*, 1996 at 86 and referred to in C. Bagley and K. Page, 'The Devil Made Me Do It: Replacing Corporate Directors' Veil of Secrecy with the Mantle of Stewardship' (1999) 16 *San Diego Law Review* 897 at 899.

[7] L. Hannah, *The Rise of the Corporate Economy*, 2nd ed (London, Methuen, 1983) at 1.

[8] J. McCahery, S. Picciotto and C. Scott, 'Introduction: Corporate Control: Changing Concepts and Practices of the Firm' in J. McCahery, S. Picciotto and C. Scott (eds), *Corporate Control and Accountability* (Oxford, Clarendon Press, 1993) at 2.

[9] J. McCahery, S. Picciotto and C. Scott, 'Introduction: Corporate Control: Changing Concepts and Practices of the Firm' in J. McCahery, S. Picciotto and C. Scott (eds), *Corporate Control and Accountability* (Oxford, Clarendon Press, 1993) at 2.

[10] O. Couwenberg, 'Corporate Architecture and Limited Liability' (2008) 4 *Review of Law and Economics* 621 at 622.

rate grouping where the group operates in several sectors of industry and commerce, and with such groups there are often many layers of subsidiary companies. They have a professional management and a sophisticated organisational structure. Many companies continue to have a growing influence globally. In 2000, the Institute for Policy Studies released a study that showed that of the world's 100 largest economic entities, 51 were corporations and 49 were countries,[11] and 22 American corporations had market capitalisations at the end of the 1990s that were greater than the gross domestic product of 22 countries and this included reasonably significant economies such as Spain and Poland.[12] Hitachi, listed 16th on the Fortune 500 (which is Fortune Magazine's listing of the largest companies in the United States) in the late 1990s, had a larger annual revenue than the Philippines, which at the time was listed as the 40th largest country in terms of gross national product.[13] And things do not seem to be changing, for data in 2002 suggested that the number of companies in the world's 100 largest economic entities had in fact increased to 52.[14]

All companies, whether they are large or small, multinational or local, play a fundamental, multidimensional and evolving role in promoting economic growth.[15] Public companies, one major type of company and the type of company with which this study is concerned, undoubtedly have a significant amount of power in society and what they do is clearly important to us all. They conduct many businesses, some of them operating globally and netting millions of pounds, dollars, euro, yen etc per annum. In fact it has been asserted that without the company much of

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[11] S. Anderson and J. Cavanagh, 'Top 200: The rise of corporate global power,' Institute for Policy Studies, 2000, < http://www.ips-dc.org/downloads/Top_200.pdf > and referred to by the Australian Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value*, June 2006 at para 2.39.

[12] G. Morgenson, 'A Company Worth More Than Spain' *New York Times*, 26 December 1999, at 1 and referred to in L. Mitchell, *Corporate Irresponsibility* (New Haven, Yale Press, 2001) at 2.

[13] D. Logan, 'Corporate Citizenship in a Global Age' (1998) 146 *Royal Society of Arts Journal* 64 at 66 and referred to in S. Wheeler, *Corporations and the Third Way* (Oxford, Hart Publishing, 2002) at 9.

[14] S. Anderson et al, *Field Guide to the Global Economy*, 2nd ed (2005) at 69 and referred to by K. Greenfield, 'Defending Stakeholder Governance' (2008) 58 *Case Western Reserve Law Review* 1043 at n4.

[15] Department of the Treasury (Australia), *Submission 134*, p1, and referred to in para 2.34 of the Australian Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value*, June 2006.

people's enterprise would have remained locally owned and managed.[16] But companies are not merely giants in relation to economic affairs; their influence and reach is such that they feature in all aspects of social and political life as well as the economic.[17] For example, companies can be regarded as private forums in which social planning can be conducted, in such a way as to serve their own decisional criteria.[18] They own large tracts of land and significant assets, make huge numbers of contracts, and employ many millions of people. Companies have, in their function of employer, a critical role in interpreting and applying government policy in many sectors, and they can exert leverage when dealing with the communities in which they operate, often leading to concessions and other benefits. It has even been said that the United States is 'governed by international corporations which [do] not take politicians seriously.'[19] Moreover, their investment decisions can determine the rate of growth of particular sectors of business.[20] Undoubtedly many companies wield substantial power and enjoy strong bargaining positions. An example of this is the fact that the large supermarkets in western countries are able to demand that farmers who wish to be retained as suppliers provide food items at low prices.

Clearly large companies generally can dictate what is produced, how it is produced, when it is produced, and in what quantities it is produced,[21] and this has given companies something of a chequered reputation. The Confederation of British Industry stated as far back as 1973 that: 'Our style of life is determined by the activities and style of business; and the style of business is largely determined by the activities and style of our

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[16] N. Long, 'The Corporation, Its Satellites, and the Local Community' in E. Mason (ed), *The Corporation in Modern Society* (Cambridge, Massachusetts, Harvard University Press, 1970 reprint) at 202.

[17] S. Bottomley, *The Constitutional Corporation* (Aldershot, Ashgate, 2007) at 3; C. Kaysen, 'The Corporation: How Much Power? What Scope' in E. Mason (ed), *The Corporation in Modern Society* (Cambridge, Massachusetts, Harvard University Press, 1970 reprint) at 99; D. Votaw, 'The Mythology of Corporations' (1962) (Spring) *California Management Review* 58 at 68.

[18] J. Parkinson, *Corporate Power and Responsibility* (Oxford, Oxford University Press, 1993) at 1.

[19] 'Vidal votes for chaos on his way to heaven' *Sydney Morning Herald*, 24 January 1997 and quoted in J. Hill, 'Visions and Revisions of the Shareholder' (2000) 48 *American Journal of Comparative Law* 39 at 53.

[20] C. Kaysen, 'The Corporation: How Much Power? What Scope?' in E. Mason (ed), *The Corporation in Modern Society* (Cambridge, Massachusetts, Harvard University Press, 1970 reprint) at 92.

[21] See J. Parkinson, *Corporate Power and Responsibility* (Oxford, Oxford University Press, 1993) at 15.

companies.'[22] This statement is even truer today than it was 40 years ago. All of this means that it endows great power on those who manage such businesses, for typically, today, the company's articles of association or by-laws will vest the board of directors with general management powers[23] concerning the affairs of the company, and this will determine the power distribution in a company. Where directors have been given wide-ranging powers, then they alone can exercise them, and in some jurisdictions the only thing that the members can do is to pass a special resolution to amend the articles or by-laws.[24] Elsewhere, such as in the United States, not even a unanimous vote of shareholders can control the directors and what they do within their considerable powers.[25]

The reach of many large companies can be seen in their involvement in, and influence over, the mechanisms of government that determine what laws will be applied to society.[26] It has been said that 'the corporation provides the legal framework for the development of resources and the generation of wealth in the private sector.'[27] Also, some companies carry out critical 'public services' such as providing telecommunications, water, electricity and gas. Thomas Donaldson[28] has noted that 'large corporations are capable of influencing mainstream societal events and this power is not only economic, but social and political'.[29] A good example is when a large company decides either to reduce its workforce, something being seen during the recent global recession, or to relocate a factory. The ability, on the part of large companies, to exercise what the

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22 Confederation of British Industry, *The Responsibilities of the British Public Company*, 1973 at 8 and quoted in J. Parkinson, *Corporate Power and Responsibility* (Oxford, Oxford University Press, 1993) at 3.

23 For example, see in the UK, The Companies (Tables A–F) Regulations 1985, Art 70 of Table A and The Companies (Model Articles) Regulations 2008, SI 2008/3229, reg 2, Sch 1, art 5 (private companies); reg 4, Sch 3, art 5 (public companies). In the United States, see Delaware General Corporation Law, s.141(a) (2009) and Model Business Corporation Act, s.8.01 (2008).

24 *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113.

25 S. Bainbridge, *The New Corporate Governance* (New York, Oxford University Press, 2008) at 34.

26 L. Mitchell, *Corporate Irresponsibility* (New Haven, Yale Press, 2001) at 7.

27 *Teck Corporation v Millar* (1972) 33 DLR (3d) 288 at 314 per Berger J.

28 *Corporations and Morality* (Englewood Cliffs, NJ, Prentice Hall, 1982) at 7.

29 For further discussion concerning the political nature of a large company, see S. Bottomley, 'From Contractualism to Constitutionalism: A Framework for Corporate Governance' (1997) 19 *Sydney Law Review* 277, and his subsequent monograph, *The Constitutional Corporation* (Aldershot, Ashgate, 2007).

late John Parkinson described as 'social decision-making power,'[30] raises concerns for the reason that 'companies are able to make choices which have important social consequences: they make private decisions which have public results.'[31] Nevertheless, Sally Wheeler makes the point that it is not accurate to say that companies are all-powerful for there are instances of governments and courts limiting the power of large companies.[32] And companies do depend upon many elements that exist in the world in which they operate, including the political, social and economic environment. Having said all of that, there are clearly examples of companies operating at a level that is 'beyond that of national law,'[33] and acting so as to influence government policy and law-making.[34] All of this might lead to companies being able to extract inducements that constitute market and political benefits.[35] This has led some to assert that companies are not really private institutions, but rather they should be seen as public institutions with public obligations, and as being responsible in some of the ways in which we ordinarily associate with governments.[36] In Europe, in particular, there has been a focus on companies having a responsibility in relation to the public interest, and it has been stated that the public interest of a company increases the larger it becomes.[37] In the distant past, companies clearly stated in their charters of incorporation what the company's purpose was to be, and

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30 J. Parkinson, *Corporate Power and Responsibility* (Oxford, Oxford University Press, 1993) at 22.

31 Ibid at 10. Also, see L. Mitchell, *Corporate Irresponsibility* (New Haven, Yale Press, 2001) at 6; S. Sunder, 'Value of the Firm: Who Gets the Goodies?' Yale ICF Working Paper No. 02-15, August 2001 at 4, available at < http://papers.ssrn.com/abstract_id=309747 > (last visited, 16 June 2009).

32 S. Wheeler, *Corporations and the Third Way* (Oxford, Hart Publishing, 2002) at 10.

33 Ibid, and referring to F. Johns, 'The Invisibility of the Transnational Corporation: An Analysis of International Law and Legal Theory' (1994) 19 *Melbourne University Law Review* 893.

34 J. Parkinson, *Corporate Power and Responsibility* (Oxford, Oxford University Press, 1993) at 19.

35 C. E. Lindblom, *Politics and Markets*, 1977 at 173 and referred to in J. Parkinson, *Corporate Power and Responsibility* (Oxford, Oxford University Press, 1993) at 20.

36 For example, see D. Branson, 'The Death of Contractarianism and the Vindication of Structure and Authority in Corporate Governance and Corporate Law' in L. Mitchell (ed), *Progressive Corporate Law* (Boulder, Westview Press, 1995) at 93.

37 M. Kaye, 'The Theoretical Basis of Modern Company Law' [1976] *Journal Business Law* 235 at 239.

the charter of the British East India Company, which, of course, had great influence in the eighteenth and nineteenth centuries, was: 'serving public interests.'[38]

The fact of the matter is that companies not only play a critical role in markets and the commercial world, but they influence the lives of 'ordinary people' because they are employed by them, buy goods from them as consumers and are citizens in communities from where the companies operate. Mary Stokes sums it up neatly when she states:

> [T]he company has become an organization whose significance almost rivals that of the state. It is the primary institution for organizing and employing much of our capital and labour resources and the primary supplier of goods and services in our community.[39]

The significance of large companies can be seen in many ways, not least in the fact that their collapse can create havoc. This has occurred on many occasions in many different countries. An example is the HIH Insurance Group, which operated in Australia. It collapsed in 2001.[40] Such was the impact on Australian society, the Australian government established a Royal Commission to look into the company's management and demise. The Royal Commissioner, Justice Owen, described some elements of the impact when he said:

> HIH was one of Australia's biggest home-building market insurers. Its collapse left the building industry in turmoil. Home owners were left without compulsory home warranty insurance; the owners of residential dwellings have found that cover for defective building work has vanished; builders are unable to operate because they cannot obtain builders' warranty insurance. The cost to the building and construction industry alone has forced state governments to spend millions of dollars of public money to prevent further damage to the industry. There are thousands of other cases of personal and community hardship, each one no less devastating for those affected by it.[41]

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[38] J. Cohan, '"I didn't know' and "I was only doing my job": has corporate governance careered out of control?' (2002) 40 *Journal of Business Ethics* 275 at 292.

[39] 'Company Law and Company Theory' in S. Wheeler (ed), *The Law of the Business Enterprise* (Oxford, Oxford University Press, 1994) at 107.

[40] It involved the largest corporate collapse in Australian history.

[41] *The Failure of HIH Insurance: A Corporate Collapse and its Lessons*, Royal Commission, conducted by Justice Owen, April 2003, vol 1, (Commonwealth of Australia, Canberra) at pxiii, and accessible at <http://www.hihroyalcom.gov.au/finalreport/Front%20Matter,%20critical%20assessment%20and%20summary.HTML#_Toc37086537> (last visited, 5 April 2010).

And compared to the demise of a giant like Lehman Bros, the huge global financial services corporation, HIH's demise was relatively small, but to the many Australians, and some foreigners, who were affected by the collapse, the impact was massive.

It is established,[42] since the seminal work of Adolf Berle and Gardiner Means in the early 1930s, that in the United Kingdom and the United States, and in other countries adopting similar laws and commercial practices, public companies are marked by the principle of separation of ownership and control. That is, the people who own the company, or at least the shares in it, do not control it. Control is vested in specialist managers, often known as executives or managers. This is due to the fact that in the UK and the US the shareholding is dispersed amongst a large range of shareholders, and so not all shareholders can be involved in the management process.[43] Yet in other countries, notably Germany and Japan, shareholding is concentrated amongst a relative few, primarily banks, insurance companies and other institutions. Such shareholders are known as blockholders.[44]

2. THE NEED FOR OBJECTIVE

All purposeful activity requires some objective, and the work of a company is no different. It has been said that a company is an entity whose 'defining

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[42] There have been recent challenges to the thesis of the work. See, for example, L. Hannah, 'The Divorce of Ownership From Control From 1900: Recalibrating Imagined Global Historical Trends' (2007) 49 *Business History* 404 at 423; C. Holderness, 'The Myth of Diffuse Ownership in the United States' (2009) 22 *Review of Financial Studies* 1322. But note the response in B. Cheffins and S. Bank, 'Is Berle and Means Really a Myth?' ECGI Law Working Paper No 121/2009 and accessible at <http://ssrn.com/abstract =1352605> (last visited on 16 November 2009).

[43] Recent statistics suggest that the range of shareholders is not as broad in the UK and the US as it once was. There are indications that institutional investors have been taking a greater portion of shares in public companies. This is certainly the case in the US, for in 2008 it was reported that the portion of institutional investor ownership in the US had increased to 66 per cent (C. Brancato and S. Rabimov, *The Conference Board*, 2008, Institutional Investment Report 6, 9, 20). But the statistics in the UK are somewhat confusing and the increase of the proportion of shares held by institutional investors may not be as high as once was thought. See, A. Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That: Much Ado About Little?' (2011) 22 *European Business Law Review* 1.

[44] For a discussion of blockholders, see C.Holderness, 'A Survey of Blockholders and Corporate Control' (2005) *FRBNY Economic Policy Review* (April) 51.