"From an Incentive to a Reflexive Approach to Corporate Governance"

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ABSTRACT

This opening chapter of the book "Corporate Governance: An Institutionalist Approach" develops in a theoretical and epistemological vein the conditions of possibility of an efficient governance. I use the works of authors who have noticed and highlighted particularly well the shortcomings of the 'standard' approach to corporate governance.

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Chapter 1

From an Incentive to a Reflexive Approach to Corporate Governance

Jacques Lenoble

1. Introduction

In recent years, the question of ‘governance’ has become the subject of renewed theoretical reflection in a variety of fields, ranging from firms (corporate governance) to international relations (international regime theory) to public authorities (transformation of the modes of control of public authorities).

Still, the way in which the question of governance is normally constructed in the setting of corporate governance displays a peculiarity that is rarely emphasized. We note that, in contrast to other fields concerned with thinking the question of governance, the literature on corporate governance pays virtually no critical attention to possible limits in the models of action theory it mobilizes in order to embark upon its discussions regarding the most efficient modes of governing firms. Most authors define the question of corporate governance as the means by which shareholders control the board of directors. Their reflections are carried out from within the framework of the classical paradigms of agency theory and the theory of the firm understood as a nexus of contracts. This seems to be confirmed by the fact that, in both American and European practice, the expression ‘corporate governance’ is today thought of as an answer and not as a question: beneath the expression’s veil one usually finds a certain number of organizational modalities (related mainly to the organization and operation of the board of directors) to which institutional investors subordinate their shareholdings. Since the beginning of the 1990s, there have been some attempts to enlarge the question, primarily in order to adapt the mechanisms of governance by taking account of the interests of stakeholders other than the shareholders alone. These attempts, however, have remained marginal. In contrast, we observe a greater attention to the need to nuance the contributions offered by the economic approaches to law based exclusively on the theory of incentive contracts or of property rights in the two other sectors where the theory of governance is currently enjoying a revival. These two fields undoubtedly, and correctly, also reveal the growing

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1 For the development of the most recent trends in the contemporary debate over the theory of governance, as well as on the more theoretical proposition made in this article, see LENOBLE J. and MAESSCHALCK M. (2003), Toward a Theory of Governance: The Action of Norms, Kluwer Law International, London.


3 The other two sectors are administrative action (public policies) and the efficiency conditions of international regimes, mainly in the field of the international protection of natural resources.
success that the reflections originating in such economic approaches have to the question of governance. But it is also true that these reflections often express the desire to supplement rational choice theory by means of different approaches to action theory. It is as if, in these two other sectors, the writers remain attentive to the increasingly dominant question concerning the limits in the rational choice theory paradigm. The usual outcome is the setting up of specific deliberative devices that enable the collective learning and cooperative action that the incentive mechanisms put in place by microeconomic approaches could not bring about on their own.

What is the interest in making such an observation? Why should the scientific debate about corporate governance display the same displacement that we find in the two other fields currently pondering the question of governance? Why should the discussion about corporate governance proceed by means of the detour of an ‘epistemological’ reflection about the limits of its own theoretical presuppositions when there seems to be widespread consensus about the fruitfulness of the methodological tools operative today? The suggestion we would like to introduce in this article is precisely that such a ‘detour’ is particularly productive because it can cope with the very difficulties central to the dominant paradigm that have recently been brought to the fore. Thus, by using the debates currently taking place in the literature on corporate governance as our springboard, we propose to show the usefulness of arriving at a more complex model of action theory than the one employed, often implicitly, by authors thinking the question of governance under the lens of agency theory and property rights.

Our primary concern here is not with a radical questioning of the fruitfulness of contractarian approaches. The arguments put forward by contractarian thinkers concerning optimization appear to us to offer gains in rationality that are by no means negligible. Instead, our question is a different one4: is the manner in which contractarian approaches concerning optimization appear to us to offer gains in rationality that are by no means negligible. Instead, our question is a different one:

4 This does not mean that we endorse the criticisms raised by thinkers who use the habitual means of the ‘moral critique’ to denounce de dominance of corporate governance approaches based on a theory of contracts. The basis for this ‘moral critique’ is that the dominant juridical and economic approaches rest on a theory of efficiency that is ill acquainted with the legitimate rights of certain categories of members of the community which forms (or should form) the firm. On this subject, see some of the articles gathered in MITCHELL L. (ed.) (1995), Progressive Corporate Law, Westview Press, Boulder; see also BAINBRIDGE S. (1997), “Community and Statism: A Conservative Contractarian Critique of the Progressive Corporate Law Scholarship”, in Cornell Law Review, 82, pp. 856-904, along with the references cited). Moreover, one of the reasons for the predominance the contractarian approach to the firm exercises today appears to be the epistemological weakness of so-called ‘communitarian’ approaches to the firm and their inability to penetrate the theories of efficiency that the economic analysis of law obliges us to integrate. It is interesting to observe that the dominant strands of contractarian theory closes itself off from questioning the possible insufficiency of the action theory it makes operative. The debate within corporate governance theory seems to be conducted as if there was no longer any need to maintain the very question which led to the attempted answer constituted by the construction of this contractarian theory of the firm. In fact, it is necessary to recall that, even if many economists believe that they can do without the epistemological question, contemporary approaches to corporate governance based essentially on contract theory and the theory of property rights result from the modifications imposed on rational choice theory by way of the question of the limits of rationality. The rearrangements and improvements of the economic approach to the coordination of collective action marked notably by the progressive elaboration of the theory of contracts rest on an interpretation of the limits of rationality conceived essentially in terms of incomplete or asymmetric information. Similarly, the redefinition of the theory of the firm as a mode of coordination, an avenue for reflection first opened up by Coase, rests on the same interpretation of the limit of rationality understood as the imperfect control of the future and the need to arrange the firm’s decision-making processes in light of this limited knowledge. Surprisingly, however, thinking on corporate governance has closed off this way of questioning in such a way that no (or only a marginal) trace remains today of how useful
theories of the firm define the limits of rationality of the actors, and thus the conditions of an efficient governance of collective action, not itself ‘insufficient’? Once we have located this insufficiency, it becomes a matter of examining whether or not this insufficiency leads the contractarian approach to overlook certain institutional conditions that are necessary to an ‘efficient’ governance of firms.

We develop our argument over three stages. We shall start with a brief rehearsal of the dominant approach to corporate governance. Based on this initial discussion, we present three critical perspectives that have recently been articulated in opposition to the dominant approach. We place particular emphasis on the first two critiques, that is to say, on the critical perspectives articulated by authors with close ties to contractarian approaches and, thus, above the suspicion of heterodoxy. The first of these critiques is the one developed by Luigi Zingales, in which he argues that we must move beyond the current approaches to corporate governance given the recent transformations experienced by firms in a context of globalization. The second critical approach, the path-dependency theory, is concerned with the consequences of a comparative approach to corporate governance in both Western Europe and the US. In each instance, however, we shall show how both of these interrogations themselves run the risk of overlooking the theoretical significance of their own attempts to relativize the contractarian approaches.

In the third section we shall introduce some elements of the epistemological displacement that we would like to put forward and that should pave the way towards a more ‘reflexive’ approach to corporate governance.

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5 The third critical perspective is the competence-based theory.
6 For more details on this expression, see note 97, below.