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Abstract
A striking feature of theorising about corporate governance, whether from the perspective of economics or in terms of a stakeholder model of the company, is that even quite basic questions posed at the outset remain to be answered. Thus, in the case of economic theorising about the firm, it has been said that findings to date must be seen as provisional in the absence of an adequate account of why contracts are incomplete. Similarly, in stakeholder theorising, the pressing problem has been identified as one of detailing the rights and responsibilities of the various stakeholders and of suggesting how conflicts among the different groups can be resolved. In view of the obstacles encountered by traditional approaches, a range of alternatives from both law and economics is considered which may be described as procedural theories. Including conventionalist economics and autopoiesis, these alternative theories are seen to offer tantalising possibilities of answering some of the questions currently confronting traditional approaches. Much work, however, remains to be done if this potential is to be fulfilled.

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CORPORATE GOVERNANCE, THE LIMITS OF RATIONALITY AND PROCEDURALISATION

Introduction

A significant problem in discussing corporate governance is that there is a lack of agreement about what may properly be brought within its ambit. For some, the issue is absolutely clear. Shleifer and Vishny, for example, in their comprehensive survey of the subject begin by asserting that '[c]orporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment' (1997, 737). Nor are they alone in adhering to this definition. In this respect, they follow a long line of writers on the firm who see the problem for corporate governance as essentially one of ensuring that those who make a financial investment have some guarantees with respect to those who have been entrusted to manage it. Increasingly, however, this view has come to be challenged by writers who feel that whatever the firm is it is surely more than simply the investors and the managers. How much more, however, is the pertinent question. As soon as the idea is raised that other 'stakeholders' form an important and integral part of the firm, it becomes unclear just where the boundaries of the firm should be drawn. And if even those proposing a narrower economic view can argue over the best governance arrangements, how much more difficult is this for those who seek to develop a more extensive model of the firm.

Given this brief sketch of the discussion of corporate governance, it would not be difficult to accept that as between the two dominant positions - 'economic' and 'stakeholder' - there is not so much a debate as either mutual indifference or trench warfare. The rapidly expanding literature on the subject therefore tends to be easily divisible into these two camps and there is little concern that stakeholder theories are regarded by economists as naive or vague or that economic theories are regarded by stakeholding proponents as narrow or unjust. It is with some caution, therefore, that a further contribution to this subject is offered. One might legitimately ask what it could reasonably expect to say that is new and might suspect that it sought simply to join in an academic bull-run. And for the contribution itself, it needs to consider whether it is entering an already saturated market or whether it offers a distinctive product. No less a figure than Sir Ron Hampel, as he took up the job of chairing the committee considering corporate governance in the UK in the light of the Cadbury Code, stated that there had been too much discussion of the subject and implied a certain disdain for the exponential growth in consultants and conferences[1] - and that was five years ago. If all that can be offered, therefore, is a recitation of the mantra of one or other of the two dominant positions ('the only stakeholder is the shareholder'[2] or 'major corporate decision making must be shared with those groups with economic and social stakes in the corporation' (Alkhafaji 1989, 111)), it is probably better not to say anything at all.

In this paper, however, the approach adopted will be to examine the recent evolution of the two dominant positions and the limits and problems which their proponents have themselves identified. Thereafter, a range of approaches will be considered which appear to offer some hope of overcoming these limits and problems. It will be suggested that the insights of these approaches represent a distinctive and potentially fruitful line of research in the field of corporate governance which, in confronting the difficulties facing the dominant economic and stakeholder theories, can equally offer the possibility of more constructive communication between them.

Points of Departure

Given the quite divergent views just mentioned about what corporate governance properly concerns, it is not easy to pin down a working definition if one is trying to approach the subject with a more open mind. However, the succinct view of the (Cadbury) Committee on the Financial Aspects of Corporate Governance that managers 'must be free to drive their companies forward but exercise that freedom within a framework of effective accountability' provides a useful starting point (Cadbury 1992, para 1.1). Not everyone will agree with the priority accorded to management in this statement, but it is nevertheless possible to extract two relatively basic principles which appear to be capable of fairly wide application: there must be sufficient *freedom* for the company to thrive and develop (otherwise no one's interests will be served) but there must be sufficient *constraint* such that no interests are allowed to hijack the company for their own ends and at the unjustified expense of others.

So far so good, but at this point the difficulties begin. To whom or what must freedom be granted? What constraints are necessary? Which interests must be considered? How is their priority to be decided? These are the eternal problems of the corporate governance debate but it is possible from them and from the principles of freedom and constraint to distinguish some guiding questions for research:

- What are the objectives of corporate governance? In other words, how is the balance between freedom and constraint to be established?
- Which are the interests that may legitimately be involved?
- What are the mechanisms by which these interests may be brought together?

With these inter-related questions in mind, the following sections will first of all review the dominant economic and stakeholder approaches to corporate governance. The purpose of this review will be to flag up the issues which these approaches themselves identify as difficulties in their own reasoning and which thus call into question their answers to the above questions. Thereafter, alternative approaches will be considered which may offer some help in dealing with such problems.

Economic Theory and Corporate Governance

A brief history of economic theories of the firm

The first question that economics asks about the firm could be phrased as follows: why are there firms? In other words, why has a firm emerged in which transactions are ordered otherwise than by means of the market? One of the earliest and best-known responses to this question was, of course, offered by Coase (1937). Recognising that firms are hierarchical organisations in which people work together to produce goods, he suggested that the market mechanism is replaced by a relationship of authority where this allows greater efficiency than would an array of individual contracting relationships.

Alchian and Demsetz (1972) developed this idea in pointing out that these advantages arise from working together when the result is more than the members of the team could achieve by working individually. But this team productive process places two key demands on the firm: metering input productivity and metering rewards. While the traditional analysis of production and distribution tends to assume effectively that productivity automatically creates a reward, they looked at the situation from the other direction. Instead they suggested that the specific system of rewarding in any given case stimulates a particular level of productivity. While the market may provide a measure of metering in some circumstances, in others it will be inadequate (for reasons of opportunism or 'shirking') and some form of monitoring will be required. It is then a question of looking to see whether the additional productivity arising from the team approach exceeds the cost of the monitoring it requires. In the case of the firm where ownership is diverse, monitoring of input productivity is delegated to agents, the management, since the alternative would be bureaucratic costs and problems of shirking among shareholders.

This *principal-agent* approach was carried further by Jensen and Meckling (1976) who suggested that the firm was simply a legal fiction serving as *a nexus for a set of contracting relationships among* *individuals* and in particular as a mechanism which minimised the agency costs of the relationship between shareholders and managers. Delegating authority to an agent, however, carries risks - not least that a shareholder may disagree with management or be dissatisfied with its performance and be unable individually to do anything about it. As a consequence, the shareholder is free to sell his share without recourse to other owners. In this way, control over management is effectively achieved by the existence of competition from would-be managers both inside and outside the firm. This understanding of the firm provides the justification for hostile take-overs or the 'market for corporate control' which was such a feature of the UK and US corporate scene in the 1970s and 1980s. The significant finding of this approach is, then, that there is no essential difference between corporate governance and the governance of ordinary contracts.

Returning to Coase's initial suggestion, it is possible to trace another development from it in the work of Williamson (1985) who proposes that firms may be the chosen institutional form in circumstances where normal market transactions would be more costly. For Williamson, there are three concepts which are fundamental to this *transaction cost* approach: bounded rationality, asset specificity and opportunism. If all three are present in a transaction, then the costs they impose may mean that the standard market mechanism of free exchange cannot operate efficiently. In these circumstances, it may be more efficient to employ organisational controls which can mitigate the problems of bounded rationality and opportunistic behaviour. The precise form of any institutional arrangement for Williamson exists on a continuum from centralised control to free market exchange and the most efficient form in any given case will depend on the frequency of the transaction and on asset specificity.

A further suggestion from economic theory about the nature of the firm comes from Grossman and Hart (1986) and Hart and Moore (1990). Recognising that not all contracts are complete at the moment of their making, they suggest that the firm serves as a means of dealing with this problem of incomplete contracting by allocating all residual (that is, uncontracted) control rights in the assets of the firm to one party, the owner. The firm thus becomes a set of jointly owned physical assets where this ownership implies decision-making power with respect to the assets in all circumstances not covered by contracts.

With these economic theories of the firm in mind, it is possible to provide a succinct overview of their basic implications for corporate governance. The use that has been made of the ideas of Alchian and Demsetz in justifying the market for corporate control has already been mentioned. The existence of a market for the shares of the firm means that efficient operation by the managers is ensured by their fear of take-over and replacement. The governance structures of the company must therefore be oriented towards ensuring the accountability of management to the shareholders. Jensen and Meckling's neutral nexus model, meanwhile, suggests simply that corporate governance is a matter of standard contract law. Regarding the firm in terms of the model developed by Grossman, Hart and Moore, priority position is again assigned to the shareholders. They have the residual decision rights as owners of the physical assets of the firm when contracts are silent - corporate control is in their hands. Approaches such as these, then, are used to bolster the broadly Anglo-American view that corporate governance is essentially about investor protection 'so that mechanisms of extensive outside finance can develop' (Shleifer & Vishny 1997, 739). Nor is this position implausible given findings that 'countries with poorer investor protection...have smaller and narrower capital markets' (La Porta *et al.* 1997, 1131). Even economists, however, will admit that these theories are - naturally - reductionist in their view of the firm and some would suggest that what they leave out of account renders their ready acceptance in practice problematical.

New Developments

The first indication among the theories considered that economics might depart from this view of corporate governance comes in the work of Williamson (1985, 1996). Deploying the tools of transaction cost economics, he seeks to determine whether any other stakeholders might properly be included in corporate governance and discovers that the 'first and simplest lesson' of this approach 'is that corporate governance should be reserved for those who supply or finance specialised assets to the firm' (Williamson 1996, 313). Recognising implicitly that this includes employees, Williamson is nevertheless quick to downplay any suggestion that this should result in their active involvement in corporate control. The 'key issue' is how they and other stakeholders (defined in asset specificity terms) can best secure that stake. Whereas a number of possible governance arrangements (such as mixed boards) might be considered, he regards these effectively as sub-optimal for 'constituencies that have a well-defined contractual relation to the firm' who instead would 'benefit by tuning up the contractual interface in a well-defined way' (1996, 314). The board is by no means such a well-defined instrument and participation on it as a residual claimant actually carries risks since those who are the 'natural' residual claimants 'will adjust the terms under which they will contract adversely'. Given that Williamson identifies equity as 'typically' the natural residual claimant, the message to other stakeholders is clear and the implications for governance are, therefore, similar to those of the other economic theories reviewed. To add weight to his assessment, he rounds off by stating that 'the cost of equity would increase if the interest group management model of the board (or some variant thereof) were to be adopted' (1996, 314). Elsewhere, however, Williamson suggests that, as regards firm-specific human capital, this must be '*imbedded in a protective governance structure* lest productive values be sacrificed if the employment relation is unwittingly severed' (1985, 242 emphasis in original) but he has been criticised for largely failing to check whether such protective governance structures actually exist and for thus falling back on traditional labour theory which sees the employees simply contracting with a well-defined firm (Blair 1997, 15-16).

The tension that is evident among these various remarks by Williamson suggests, therefore, that it is necessary to examine more closely what is involved in determining who should be the residual claimants. Such an examination has been carried out by Zingales (1998) and by Rajan and Zingales (1998) who follow Williamson in pointing out that neo-classical economics is only useful for describing standardised transactions and not for those which appear to be involved in the context of the firm - indeed, only the 'nexus of contracts' adherents really believe that there is no essential difference between the firm and the marketplace. Zingales clarifies, however, that when parties are engaged in transactions which are not standardised, the 'difference between what [they] generate together and what they can obtain in the marketplace represents a quasi-rent, which needs to be divided ex-post'. The initial contract that the parties have entered into will play a role in determining this ex-post division but because this will be incomplete, 'in the sense that it will not fully specify the division of surplus in every possible contingency', room for bargaining is opened up and it is at this point that authority or governance plays a role (1998, 497). There are, then, two conditions for the existence of a governance system according to Zingales: the generation of quasi-rents and an imperfect ex-ante allocation of those quasi-rents. Recognising this demands that consideration of corporate governance must focus on the 'link between the way quasi-rents are distributed and the way they are generated. Only by focusing on this link can one answer fundamental questions like who should control the firm' (1998, 498).

The merit of this approach is that, while it retains the rigour demanded by economics, it nevertheless appears to be more open *ab initio* than other economic approaches to the possibility that there is more to the firm than the provision of equity by shareholders and their consequent right to ultimate control - quasi-rent appears to be a much broader concept than simple surplus profit. And, indeed, Rajan and Zingales (1998) offer a definition of the firm which confirms this idea. Their view is that the firm is a 'nexus of specific investments: a combination of mutually specialised assets and people...that cannot be replicated by the market' (1998, 498; see also Rajan & Zingales 1998, 387). The question is, then, who under this model should control the firm? Or, as Zingales puts it, 'whose investments need more protection in ex-post bargaining' (1998, 500)? He approaches this question by studying the justifications usually put forward in economics for the pre-eminent position of shareholders.

The first justification is that the investment made by shareholders is simply more valuable. This Zingales dismisses without much discussion, relying on the figures quoted by Margaret Blair (1995) which suggest that the quasi-rents generated by firm-specific human capital are of the same order as accounting profits. He therefore concludes simply that 'there is no ground to dismiss human capital investments as second order to financial investments' (1998, 501). In a later work, however, which Zingales does not consider, Blair (1996) expands on these findings to make a more substantial claim with regard to firm-specific human capital and it is worth pausing to examine this in more detail.

In outline, Blair's argument is as follows. Labour economists have noticed that when employees are laid off through no fault of their own, they have to accept an average of a 10 to 15 percent pay cut in a new job. In other words, some 10 to 15 percent of their remuneration is associated with firm-specific as opposed to generic skills. Blair puts this into perspective by noting that, between 1990 and 1993, 10 percent of compensation paid to employees in the United States amounted to some $850 billion while accounting profits for the same period amounted to $991 billion. 'In other words, what we call corporate profits measures only about half of the total economic surplus being generated by corporations. The other half is typically paid out to employees' (1996, 10). On the face of it, while this is a significant and perhaps surprising figure, no problem is necessarily posed for traditional models of the firm. The amount of the surplus going to employees is paid out first as a cost to the firm and the shareholders then take the residue. Blair points out, however, that the higher wages paid to employees who have been with a firm for a longer period are neither certain nor legally enforceable, especially in periods of financial pressure.

> Hence employees with firm-specific skills not only share in the real economic residual of the firm; they also, necessarily, share in the residual risk associated with the firm....the value of the rents that employees have at risk in the typical large corporation is, in the aggregate, roughly the same order of magnitude as the value at stake that shareholders have. (1996, 11)

Sharing in the residual risk - a risk that is moreover comparable in magnitude to that run by shareholders - means that employees, for Blair, become residual claimants whose position in corporate governance, therefore, has to be considered. We will return to this issue in due course.

Turning now to the second typical economic justification for shareholder control considered by Zingales, this is the argument that other stakeholders can protect their investments better through contracts, an argument which we saw Williamson making above. Zingales, while conceding that this is a more difficult justification to dismiss, is nevertheless not convinced that it is easier to contract human as opposed to physical capital investments. Blair (1996) would presumably be less reticent. The reason for the difficulty in dismissing this argument identified by Zingales is important, however, and it is one that both he and we will return to: ‘we lack a fully satisfactory theory of why contracts are incomplete’ (1998, 501).

The final justification considered by Zingales is the one he finds most convincing, namely that other stakeholders have other sources of power ex-post to protect their investments. Nevertheless, he concludes that even that argument amounts to no more than the suggestion that shareholders should have some form of contractual protection and does not by itself justify residual control. To explain why residual rights belong to shareholders, therefore, (or perhaps better, to discover who should have residual rights) what is needed is ‘a theory of the firm that explicitly accounts for the existence of different stakeholders and models the interaction between contractual (e.g. ownership) and non contractual sources of power (e.g. unique human capital investments)’ (1998, 501), something which Rajan and Zingales (1998) attempt to do.

Very briefly summarised, their argument begins by noting that, in any given relationship, the party with residual control over an asset can receive an increased share of the surplus but has no necessary incentive to specialise since specialised assets will usually have less value outside of the relationship. The optimal arrangement, therefore, is for those providing funds (for example, the shareholders) to retain residual control but to delegate the assets to a third party (for example, a board of directors) which is not affected by concern over the opportunity loss produced by specialisation.

Zingales draws an interesting but ultimately somewhat confusing conclusion from this argument. On the one hand he states that this third party ‘should not be in the position of mere agent, who owes a duty of obedience to the principal, but should be granted the independence to act in the interest of the firm (i.e. the whole body of members of the nexus of specific investments), and not only the shareholders.’ As far as it goes, this seems to be a recognition that other parties have residual claims but he immediately follows this up with the statement that ‘[i]n sum, a broader definition of the firm allows us to understand why the residual right of control is allocated to the providers of capital and why its use is mostly delegated to a board of directors' (1998, 501).

In other words, despite a thorough consideration of the notion of residual claim with frequent suggestions that he recognises parties beyond the shareholders in this regard, Zingales ends up agreeing with the earlier economic theorists we have considered: shareholders are *the* residual claimants and *current* corporate governance arrangements are optimal. But is this really the end of the story? It would seem not.

Recall first of all Margaret Blair's persuasive argument based on firm-specific human capital. If we feed her conclusions into the Rajan and Zingales model instead of restricting it to the providers of funds, it seems at least plausible to suggest that while this accords with Zingales's statement that a governance structure should promote action 'in the interest of the firm (i.e. the whole body of members of the nexus of specific investments)' (1998, 501) it places his identification of shareholders as the sole possessors of residual rights of control in serious doubt.

That step once taken, the question then arises as to just how far we can push this economic model of the firm. Blair certainly does not imply any restriction by focusing especially on employees. Instead she argues that

> in any given firm there are likely to be a number of parties, in addition to shareholders, who have made some sort of firm-specific investments in the enterprise. Firm-specific investments of all types are at risk in the same way that equity capital is at risk and for the same reason. That is, the value of those investments ultimately depends on the ability of the enterprise to continue to generate an economic surplus [therefore] management and directors should focus on maximizing the total wealth-creating

> potential of the firm, not just on maximizing the value of the stake held by shareholders. (1996, 13)

And with a model of the firm as a nexus of specific investments, would Rajan and Zingales object to the claims of such other parties for residual control at least being tested? Surely not.

A Broader Economic Model of the Firm?

It is worth stepping back for a minute to recap on precisely what we seem to have arrived at: an *economic* model of the form which acknowledges the fact that parties *other than shareholders* make firm-specific investments which are of comparable status to those made by shareholders and which in principle open the way to their inclusion in corporate governance. The only question in such circumstances seems to be: what are we waiting for? But as is often the case, if it seems too good to be true, it probably is. Whatever the promise offered by this economic model, the process of testing the claims for residual control raised by other parties, and *a fortiori* of implementing any that are successful, will not be straightforward. Whatever its intuitive appeal, both Blair and Zingales identify problems with an extended model which seem to pose almost insurmountable difficulties - at least for economics on its own.

The problem which Blair acknowledges is that of quantifying the value of residual claims. While the returns to physical capital can be measured easily in monetary terms, 'some of the returns to investments in human capital may take other forms' (1997, 27) - to say nothing of the returns to other firm-specific investments which both Blair, and Rajan and Zingales acknowledge without specifying. So, without being able to measure what it is that ought to be maximised, it is difficult to imagine what the implications for corporate governance should be (see Blair 1996, 13).

For Zingales there is a similarly serious problem which he hinted at in dismissing the second typical justification for residual control by shareholders and which he returns to towards the end of his paper. Here he acknowledges that ‘who should have the residual rights of control depends crucially upon what the contractible rights are’ and accepts that ‘this is very difficult to argue on a priori grounds without a general theory of why contracts are incomplete’ (1998, 502). The concluding sentences of his paper, however, which follow an assessment of the utility of his approach and some suggestions as to future directions, are couched in much stronger terms: ‘[t]he most important contribution...will arise from a development of the underlying theory. Without a better understanding of why contracts are incomplete, all the results are merely provisional’ (1998, 502).

What then are we to make of these two problems? First of all, it should be noted that it would be possible for economists to deny that there is really any problem. Taking Zingales’s concern first, they might suggest that the reasons why contracts are incomplete are in fact well-known. Among the reasons most frequently cited are the following:

- the cost of taking account of an improbable contingency may outweigh the benefit of writing a clause in the contract to deal with it;
- courts and others called upon to arbitrate may be unwilling or unable to verify ex post values of variables;
- as a result of bounded rationality, parties may neglect variables where it is difficult to evaluate their effect on the contract;
- even where events would be relevant to the contract, it may be difficult or impossible to assign a probability to them (Salanié 1997, 175).

And at the very least from this list we can see that the two problems identified are inter-related. The fact that a return to a specific investment cannot easily be quantified is one way in which a contract may be incomplete. But Margaret Blair’s consequent difficulties lead us to suspect that assertions on the part of economics that incomplete contracts are understood may be too hasty. In order to consider this further, the approach of Oliver Hart, explicitly identified as the 'incomplete contracting' or 'property rights' approach to the firm, can be examined.

As was noted previously, Grossman, Hart and Moore based their approach to corporate governance on the incompleteness of contracts and suggested that the shareholders as the owners of the physical assets possess the residual control rights. Hart himself later formulated this approach more completely in order to explain 'the meaning and importance of asset ownership' (1995, 13). In answer to the question: why does ownership of physical assets matter? Hart replies that 'ownership is a source of power when contracts are incomplete' (1995, 29). Thus, '[g]iven that a contract will not specify all aspects of asset usage in every contingency...the owner of the asset has *residual control rights*...to decide all usages of the asset in any way not inconsistent with a prior contract, custom or law' (1995, 30). This is a significant power on the part of the owners but for Hart it does not stop there as he notes that '*control over nonhuman assets leads to control over human assets*' (1995, 58 emphasis in original). For Hart, therefore, incompleteness of contracts leads to the traditional Anglo-American model of corporate governance.

We need to be clear, however, about just what is involved in Hart's incomplete contracting approach. While there are economists such as Zingales who want to understand *why* contracts are incomplete, Hart has taken what has been identified as a more 'practical-minded' approach which 'completely disregards' the foundations of incomplete contracts and seeks instead to explore their consequences on models of the firm (Salanié 1997, 175). And indeed, we should perhaps be put on our guard as to the limited aims of Hart's project when he introduces it by stating that although previous theories of the firm (neo-classical, principal agent and transaction cost) have been useful for some purposes, they 'suffer from the drawback that they do not explain what happens when two firms merge' (1995, 29). There is an extent to which, then, for all the hope engendered by a theory explicitly described as an 'incomplete contracting' approach, Hart's work represents simply a refinement in standard economic thinking about the firm. It could be said, therefore, that Hart essentially says: contracts are incomplete; something needed to be done to cope with this problem; firms have developed in such a way that those who own assets are given the authority to take decisions about what will happen to those physical (and human) assets when this problem occurs.

Importantly, from the point of view of our concerns, however, Hart is also able to suggest that this is an *efficient* solution. This seems to pose a problem for those such as Blair who are proposing, however tentatively, a broader model of the firm. A firm might well be a nexus of specific investments but if giving all the residual control rights to the owners is simply efficient then discussion about other arrangements is a non-starter and Zingales's ultimate support for standard corporate governance arrangements is justified.

But this is where the importance of Zingales's closing statement becomes clear. The important issue is not *that* contracts are incomplete but *why*. By ignoring the latter issue, Hart's finding that giving residual control rights to owners is efficient is of interest only in certain circumstances, that is, where the examination of the incompleteness of contracts has not been carried out. And here we encounter what is one of the increasingly criticised problems of economics: a failure to take account fully of the status of models and theories. Lawson (1997), for example, has pointed out the way in which economists tend to misinterpret the process of abstraction that is involved in any act of theorising or modelling.

> In place of abstraction as a one-sided focus upon an aspect of a concrete entity, an aspect brought momentarily into closer view, economic modelling interprets abstraction as a focus upon the aspect in question as though it existed in isolation - and typically as though it were free of all

> internal instability as well...In the name of abstraction all features of social reality that prove inconvenient to deductivist modes of reasoning are ultimately assumed away. (1997, 234-5)

Consequently, Hart's analysis is useful as a description of why firms are organised as they are in situations where the deeper question of why contracts are incomplete has been bracketed off by theory and by practice. For as long as those brackets remain in place or their existence is ignored this analysis is able to maintain not only descriptive utility but also normative potential. Thus, such a model, like its predecessors, can serve as a support for current corporate governance arrangements. If, on the other hand, we follow Lawson's advice or take Zingales's question seriously, those brackets have to be removed - certainly if we want to keep moving towards a more adequate description of the firm but especially if we seek to make any normative claims.

Of particular importance here is the recognition that Hart's finding of the efficiency of current arrangements is specific to his bracketed description. As soon as the brackets are removed it is not simply the case that there will have to be a reassessment of the situation in terms of efficiency but rather *a reassessment of the concept of efficiency itself*. In such circumstances, not only does incompleteness become the focus, but problems of unquantifiability and incommensurability of interests can no longer be ignored as not computable. Some economists will regard such an endeavour as akin to opening Pandora's box but Rajan and Zingales for their part recognise the need to enrich the economic view of the firm with sociological insights when they conclude their paper by stating that '[n]ow that economists increasingly accept the importance of contract incompleteness, there is ample opportunity for gains from trade between the two fields' (1998, 424-5). And it could be suggested that others beyond sociologists will have something to contribute.

In conclusion, it can be suggested that such clarification as economics brings to the firm can be at the expense of what it systematically removes from view (see Teubner 1990, 70-73; Kay 1994). In examining the answers which an economic theory provides for the basic questions of corporate governance (objectives, interests, mechanisms), therefore, it is necessary to be aware of what it may be consciously or unconsciously leaving out of account and to consider that the problems which economists themselves are increasingly aware of may require answers from outside that discipline. In this regard, stakeholder theories, with their explicit openness to a broader range of interests and their critique of the narrowness of economic approaches appear to offer a potentially fruitful source for an enriched view of the firm, and it is to these that we will turn next. Whatever their superficial appeal, however, it will be necessary to consider whether they adequately address the deeper questions about models of corporate governance which the review of economic theories has revealed.

Stakeholder Models

Look to any discussion of stakeholding and the first name one usually encounters is that of R. Edward Freeman. Although the term can be traced back to the early 1960s (see Alkhafaji 1989) and finds a resonance, for example, in a series of reports in the UK during the 1970s (see Tricker 1994, 248-9), his discussion of the subject has been influential in the more recent resurgence of interest in the term. For Freeman, the crux of the argument is the need to 'reconceptualize the firm around the following question: For whose benefit and at whose expense should the firm be managed?' (1997, 67). A necessary first step in answering that question is of course to define those parties who benefit or lose as a result of the operation of the firm or, in other words, those parties who have a stake in the firm. And Freeman is not reticent about providing a clear and unequivocal definition - for him the stakeholders in a firm are management, local community, customers, employees, suppliers and owners (1997, 69).

The next step is then to define how these stakeholders should be integrated into the decision-making structure of the firm. Basing his ideas in this regard on Kant's categoric imperative, Freeman sets out what he calls the 'Stakeholder Enabling Principle' which states that 'Corporations shall be *managed* in the interests of its stakeholders' defined as above (1997, 75 emphasis added). In other words, there is to be no active involvement of stakeholders but rather an assurance that they will not be treated as means to an end. More specifically, Freeman proposes the 'Principle of Director Responsibility' which states that 'Directors of the corporation shall have a duty of care to use reasonable judgement to define and direct the affairs of the corporation in accordance with the Stakeholder Enabling Principle' (1997, 75). From other work it would appear that he has an explicitly Rawlsian scheme in mind for the implementation of this principle since he requires that inequalities between stakeholders only be accepted insofar as they improve the position of the least well-off stakeholder (see Wheeler 1997, 48). Even if Freeman sees no direct role in the firm for other stakeholders, he does not leave them at the mercy of the goodwill of management. Instead he proposes the 'Principle of Stakeholder Recourse' which provides that 'Stakeholders may bring an action against the directors for failure to perform the required duty of care' (1997, 75).

Freeman has put forward a fully-integrated model of corporate governance which sets out objectives, identifies the interests and provides a mechanism for integrating them, but his approach can nevertheless be subjected to two principal criticisms. The first relates to the definition of the stakeholders and the second to the mechanism by which their interests are to be taken into consideration. While Freeman's approach has the advantage of being very clear about who the stakeholders are, this very clarity can be a problem. In certain circumstances other parties may appear to have a stake in the firm but because of the rigidity of the classification in the Stakeholder Enabling Principle the directors would have no responsibility to take it into account nor would the parties have any recourse against them. This problem has prompted others to seek more open definitions.

Carroll (1996) reviews a range of such approaches, including the distinction between primary and secondary stakeholders and that between core, strategic and environmental stakeholders. The first distinction is defined as between those who have ‘formal, official, or contractual relationships with the firm’ and all others (1996, 76). The second distinction is more complex and sees core stakeholders as those which are essential to the survival of the firm, strategic stakeholders as those who are vital in the context of the particular threats and opportunities faced at a given moment, and the final category as all other stakeholders in the firm’s environment. This latter distinction, produced by a working group at the Second Toronto Conference on Stakeholder Theory, goes further still and recognises that stakeholders can move between categories at different times (1996, 77-8). Carroll himself goes on to consider the nature, legitimacy and power of different stakes and to subdivide generic groups of stakeholders, ultimately producing quite complex arrangements (1996, 81ff). While these approaches avoid the problem of a rigid classification, they are all presented as tools to assist managers in deciding which interests should be taken into account but say nothing about how that might be enforced. What would seem to be required, therefore, would be some much more open definition linked to Freeman’s model which accords stakeholders some recourse. That, however, brings us to the second criticism.

Goodpaster (1997), for example, while certainly agreeing that stakeholders should not be treated in a *strategic* way by management, is nevertheless concerned about the *multifiduciary* nature of Freeman’s approach. He sees the appropriate approach to stakeholders as a *synthesis* of these two extremes. Thus, while the basic fiduciary obligation to shareholders is retained, directors must carry out that obligation in an ethically responsible way. This certainly answers the concerns of those who worry about the dilution of director’s duties and the consequent difficulty of taking decisions, but the fact that Goodpaster's formulation lacks both a definition of stakeholders and any means of enforcing this ethical responsibility would appear to indicate that in practice there will always be a danger of a reversion to a strategic approach.

In the context of the recent debate on corporate governance in the UK, a number of authors have made proposals for a stakeholder approach to the firm which offer variations on the approaches discussed so far. Among these, John Kay and Aubrey Silberstone (1995) have been particularly prominent. Kay and Silberstone profoundly question the emphasis that has been placed by the Cadbury and Greenbury committees on improving the position as between shareholders and directors, doubting that the latter have either the incentive or the capacity to fulfil the role that is implicitly envisaged for them. In contrast, they propose a trusteeship model which stresses the company as a social institution rather than as a creature of private contract. By demoting the initial contract, they are able to see the directors as *trustees* of the tangible and intangible assets of the company rather than as the agents of the shareholders. The duty of directors would, then, be to preserve and enhance the value of these assets and to balance the various claims to the returns which they generate. Kay and Silberstone see this as a closer reflection of the fact that companies are essentially defined by a 'nexus of long established trust relationships'. The focus is accordingly on the evolutionary development of the corporation around a set of core skills and activities rather than a set of financial claims. Such a model also shifts the emphasis away from immediate shareholder value towards the balance of stakeholder interests and of the interests of current and future stakeholders. In terms of achieving this model, Kay and Silberstone propose only modest changes aimed at ensuring relative stability for companies over periods of some four years (by removing the threat of hostile take-over) and consultation with stakeholders over the appointment of directors.

This approach appears to offer two distinct advantages. Firstly, by using the concept of trust as a model it avoids the problems of tying the definition of stakeholders to contractual relations. Secondly, by allowing stakeholders some involvement in the selection of directors - through consultation or perhaps a stronger right - the risk of stakeholders being treated strategically is reduced. But despite these apparent advances, we are still left with some all too familiar problems. How are the stakeholders to be identified? In the last analysis, using a relationship of trust as a criterion may produce a rigid or a fluid set of stakeholders depending on where the decision lies. The fact that stakeholders will also have some involvement in deciding who the trustees (directors) will be, far from solving the problem, merely introduces an irresolvable circularity. And this difficulty is only compounded when we come to consider how different interests are to be balanced - not least those of current and future stakeholders - or indeed how that balancing is to be enforced.

This difficulty in ensuring ultimately that stakeholders are not treated in a strategic way leads others to propose a more active role for them. Alkhafaji, for example, suggests that a gap now exists between firms and society because of this problem and that in order to narrow it ‘major corporate decision making must be *shared* with those groups with economic and social stakes in the corporation’ (1989, 111 emphasis added). In common with the approaches discussed by Carroll, Alkhafaji makes no attempt to provide a once and for all definition of stakeholders but sees this as something to be established in the particular context. But moving beyond Carroll, he suggests that the nature of the relationship of each stakeholder with the firm is *also* something to be discovered in context.

While Alkhafaji does not go much further than suggesting a series of steps that might be taken in deciding on stakeholders and the nature of their relationship, his importance lies in his understanding of the difficulty of providing rigid *a priori* solutions and in his suggestion that the involvement of stakeholders in corporate decision making is a matter for procedures in context. Nor is he alone in proposing this approach. For example, basing his analysis on the identification of 'moral pluralism' and the consequent impossibility to argue that 'one position...is morally correct and the others morally wrong', Bowie (1997) suggests that the appropriate approach to stakeholder involvement is one of a just process. Such a process - which he sees explicitly in terms of Rawls's imperfect procedural justice - allows the 'various stakeholder voices [to] be heard and have some influence on the decision' (1997, 107).

That even these procedural stakeholder approaches are by no means well advanced, however, is evident from the same author's admission (writing with Beauchamp) that 'Perhaps the most pressing problems for stakeholder theory [are] to specify in more detail the rights and responsibilities that each stakeholder group has and to suggest how the conflicting rights and responsibilities among the stakeholder groups can be resolved' (Beauchamp & Bowie 1997, 54). In other words, for all the work that has been done, the basic questions remain to be answered.

In the last analysis, then, far from providing any solutions, there is instead in stakeholder theory a resonance with the problems facing the current movement in economics which is trying to develop a broader model of the firm. As soon as there is a departure from a uni-dimensional model, problems arise as to which other dimensions must be considered and how they can be reconciled. We have noted the need for something which can help to conceptualise this lacuna in economic theory in the problems identified by Blair and Rajan and Zingales, and an analogous desire is apparent in the move towards procedural solutions in stakeholder theory made by Alkhafaji and Bowie.

It is time then to consider some other approaches which may be able to provide some assistance in dealing with the problems currently confronting both economic and stakeholder theories in corporate governance.

Conventionalist Economics

The first such approach comes from within economics itself. The conventionalist movement is centrally concerned with the reductionism of standard economic approaches when applied to other social domains - what Favereau terms ‘extended standard theory’ or EST (1989) - such as we identified when considering the work of Hart above. In contrast to EST, conventionalist economics is basically concerned with the analysis of the essential role played by *non-market* forms of co-ordination, production and allocation of resources. The explicit objective is to construct a multidisciplinary theoretical framework which would allow the general question of the collective co-ordination of individual action to be dealt with. By carrying out analyses in this spirit, the ambition of the concept of convention is to understand how collective logic is constituted and stabilised (Orléan 1994, 13-16). The researchers who form this movement insist that the situations which economists study, including the firm, are most often composite situations where several principles of co-ordination co-exist. As a result, economists (and other researchers) must seek to understand how these diverse resources (market, organisational, institutional, ethical, etc.) are co-ordinated despite the apparent diversity of logics in play (Livet & Thévenot 1994).

The relevance of this approach to the problems we have identified is, therefore, clear and this impression is only reinforced when we find that one of the principal features of economic contracts which conventionalists focus on is their incompleteness. Despite this, it is a question whether in the end they can be sure of moving far beyond the findings of Hart in this regard. Conventionalists certainly have an explanation for why contracts are incomplete - they see this as a question of indeterminacy arising from both natural hazards and strategic rationality which means that forseeability is not possible (see

Aoki 1994; Eymard-Duvernay 1994; Salais 1994). But they then move on simply to insist that the non-market mechanisms (constitutive conventions) which allow the indeterminacy to be overcome must be identified if an adequate explanation of what is happening is to be achieved. For conventionalists, therefore, the organisation is the mechanism which, by means of general conventions, permits co-ordinated action to take place without the need to specify in detail and in advance what must be done in every situation. But in the end, the ‘non-market mechanism’ or the ‘constitutive convention’ which performs this role may be (and in the case, say, of UK or US firms will be) no more than the allocation of residual control rights to shareholders. That this is surely not the limit of what the conventionalists intend is clear from their desire to understand how diverse resources are *co-ordinated* - which seems to imply something more than a simple authority structure. It would seem, therefore, that in common with Hart they need to consider more closely the question of why contracts are incomplete if they are to shift from a descriptive to a normative orientation.

And in this regard, members of this movement certainly offer some tantalising indications of the direction this research must take. For example, the importance of *context* as opposed to the broad generalisations of extended standard theory is stressed. For them, it is not even *bounded* rationality that is important but rather rationality *in context* (Ponssard 1994). And their understanding of context is also particular. Thus, collective action does not occur upon the *identification* of some point of reference or focal point by the actors involved but rather on the basis of a *constructed* collective reference point which emerges from their interaction. It is this collectively constructed reference point or convention which prevents - albeit provisionally - the infinite regress initiated by strategic rationality, which deals, in other words, with the fact that perfect common knowledge can never exist.

Furthermore, the conventionalist perspective does not deny the issue of opportunistic behaviour which was raised by both the principal-agent and transaction cost approaches. But it rejects the contractualist view of the primacy of this issue which necessitates the definition of the firm as a 'nexus of contracts' aimed at preventing such behaviour. Instead, it sees the coexistence of both co-operative and opportunistic behaviour which calls for a richer analysis (Favereau 1994).

Lastly, from what has been said about the emergence of the convention from the interaction, it is clear that organisational rules are not things which are susceptible to mechanical application. Rather application will result from a dialectical process between the conventional procedures and the singularity of the dynamic environment. For Favereau, for example, this means that rules in organisations are never fixed solutions, but rather always *heuristics* (1994, 134-5). For Livet & Thévenot (1994), rules are *procedures* for dealing with conflicts of interpretation. And for Ponssard (1994), conventional procedures allow actors in an organisation to construct yet richer and more complex reference points than would otherwise have been the case. Consequently, for all of these researchers, rules understood as conventions permit the *collective learning* of the organisation (see also Midler 1994). In this way, different actors can be encouraged to question their assumptions, take account of the impact of their actions on other actors and modify their understandings in the process of constructing collective cognitive devices or reference points.

Whatever the initial reservations about the conventionalist approach to incomplete contracts, then, it is clear that they have at least begun to map out the route which will carry us much further. Evidence of this lies also in the fact that for this movement there is no single optimal form of organisation of the firm but rather a plurality of hybrids between the extremes of hierarchical and horizontal organisation, the exact combination of which is conventional - understood in the sense described here (see Aoki 1994).

Law and Corporate Governance

But if we are now provisioned with some clearer indications about where we need to go if we are to answer the profound questions underlying the dominant approaches to corporate governance - and are perhaps reassured by the fact that these indications come from within the domain of economics - we should nevertheless pause briefly before taking these steps to consider the implications of these indications for law. Up to now, at the level of practice, we have concerned ourselves principally with the difficulties facing economics when its artificial brackets are exposed and removed. The problem for law is that it too applies brackets and thus faces similar problems if these are put in question. For example, since it is no longer possible to assume the availability of an *a priori* adequate contract or rule which represents the best solution in the context of a given transaction, what role is there for law? While the drafting and enforcement of contracts or the regulation of the agent-principal relationship appears at first sight to be relatively straightforward tasks for law, notions such as incomplete contracts, collective learning and rules as heuristics look considerably more problematic.

Not all lawyers, however, are concerned about these challenges. Indeed, there are some who are full-square with conventionalist economists in many of their insights. William Bratton, for example, in language very reminiscent of the conventionalists, states that in practice ‘corporations are complexes of diverse elements that resist reduction into neat rationalised blueprints of legal and economic theory’. As a result, he claims that corporate law already avoids the ‘foundationalist error of excluding one basis as a function of respecting another’ and instead plays a ‘mediative’ role between the ‘various components and norms in the complex’. In this way, no single theory is adhered to but neither is any rejected out of hand: ‘Different conceptions of the firm, instead of being synthesized in law, are synchronized in time and circumstance’ (1994, 24).

While this accords in many respects with conventionalist economic insights into the firm, there are perhaps limits to how far we can follow Bratton. Being anti-foundationalist, he is none too impressed by demands for firm theoretical groundings while nevertheless denying that his mediative approach implies a slide into relativism since ‘it accords recognition to each [positive theory of the firm] as an objective force’ (1994, 24). There are, however, limits to how far even lawyers can be genuinely ‘comfortable with ambiguity’ (1994, 25) and indeed there is, at best, a lingering doubt that in practice corporate governance as ungrounded mediation will fail to satisfy. Would we not find ourselves confronted with the inevitability of an adherence to existing power structures in such circumstances?

This, then, raises the question of how the mediative approach can be grounded in a legal analogue to the economic recognition of the convention.

The Company Interest

An indication of the nature of such an analogue is provided by the recent work of Sheldon Leader (1995). In a closely argued analysis of UK case law, he raises the possibility of a *constituency* model of the company based on concepts of personal and derivative interest which can serve to advance the argument.

Leader notes that while it makes sense to speak of the interests of the company, it is necessary to distinguish these from the sorts of interests which natural persons have. Natural persons have desires whereas the company can only have a function. That said, the function of the company cannot be determined except in reference to the interests of the natural persons who are affected by it. Because those interests are often competing, the interests of the company cannot be reduced to any one set of them (1995, 86). Rather, the company by its very operation establishes a dynamic priority among those interests.

It is thus possible to see that persons affected by the company have two sorts of interests: *personal* interests in maintaining and improving their own position; and *derivative* interests in common with all other affected persons in seeing the purpose of the company successfully accomplished. While these interests may sometimes coincide, they will often conflict (1995, 88).

The company has no need to consider personal interests in the achievement of its purpose - although it may have to consider them from time to time as a matter of fairness. It is thus possible to say that natural persons have rights *in* the company insofar as they have a stake in its successful operation and also rights *against* the company in terms of protection against it unfairly affecting their personal interests (1995, 90).

In as much as the company in the furtherance of its purpose must take account of the interests of a number of constituencies including employees, creditors and the wider community, Leader refers to this conception of the company as the 'constituency' model (1995, 91). While he adopts this broad view, it should be noted that he does not make any demands for these broader groups to be given any direct influence in the running of the company similar to that of shareholders. He makes it clear that the model would hold good for other possible company structures including worker's co-operatives (1995, 113), but in the present article confines himself to the current UK arrangements. In these current arrangements, creditors and employees, for example, have no rights *in* the company insofar as they have no direct say in its operations. But they do have rights *against* the company if their personal interests are unfairly abused. Leader's analysis would insist, however, that the company's interest may sometimes be served by according priority to the interests of these constituencies.

Finding that no uniformity emerges from the case law, Leader sees reform of the law as requiring to clarify the notion that the company must always be run so as to further its own interests rather than the personal interests of the shareholders or of any other group. He concludes by noting that it is impossible to define in advance the full list of priorities which a company must have and thus it must inevitably be left to management to strike the right balance. That said, it must nevertheless be open to courts and regulators to intervene where that balance is not struck in the interests of the company. While this can undoubtedly place a heavy burden on these external bodies, the role envisaged by Leader is one of guaranteeing the minimal rather than the optimal interests of the company (1995, 113).

Leader's analysis accordingly represents an advance over much of stakeholder theory and provides concepts which offer a firmer grounding for a mediating role for the law in corporate governance. But at this point he remains vague. What in practice are to be the mechanisms for deciding the company interest? How are the appropriate derivative interests to be determined? Is it enough to leave this to management with a possible minimal regulatory or judicial intervention? Or is something firmer required?

As regards the question of determining the appropriate derivative interests, one of Leader's colleagues has proposed an *associative model* of the company. This would give a corporate governance role to parties when they could show that the company was not being run in its own best interests because associative rights are being disregarded. Such rights would arise from *long-term close relationships* with the company. It seems, however, that the corporate governance role remains the ability to challenge management decisions by derivative action (see Dine 1997).

Proceduralisation and Corporate Governance

Confronted with these issues, of course, conventionalist economics would agree with the impossibility of deciding in advance what the company interest is and furthermore of determining *a priori* suitable structures. It would, however, point to the emergence of conventions by which these issues can be resolved. In a similar vein, the procedural movement in legal theory contends that a substantive legal definition of the company interest is impossible. Faced with a multitude of competing interests, of market and organisational structures, and all of this in a state of constant change, the idea of providing a uni-dimensional description or a fixed normative version of the company interest is futile. The corporate interest must instead come to be considered procedurally 'as an institutional guarantee backed by law for an overall interest constituted in the multiple interest conflicts of the micropolitics within the enterprise' (Teubner 1994, 38). The resonance between the notion of 'convention' and that of an 'institutional guarantee' understood procedurally is clear. So can this movement in legal theory provide a response to the desire for a firmer mechanism or procedure for determining the dynamic priority of derivative interests which constitute the company interest?

Autopoiesis

A key figure in this movement in legal theory who has in addition explicitly considered its implications for corporate governance is Gunther Teubner. Building on the autopoietic approach of Niklas Luhmann (see especially 1995), he has not only produced a critique of the narrowness of the economic approach to the firm which bears a close similarity to that of the economic conventionalists, but has offered an alternative which is both rich and provocative. Most significantly, he provides a distinctive approach to the company interest by focusing on the 'highly advanced autonomy of the organisation' (Teubner 1994, 38).

In order to understand the particularity of Teubner's approach, it is necessary first of all briefly to consider the autopoietic systems which he views society as being composed of. For him, following Luhmann, society is functionally differentiated into communicative subsystems (politics, economy, law, science, religion, etc.) which are autopoietically or self-referentially closed. The precise nature of this closure is one of the most complex aspects of the theory and that which is apt to give rise to the greatest misunderstanding and the strongest criticism. What it implies, however, is that information is not *transferred* between systems but rather is always *internally constructed* by a system according to its own differentiating binary code (e.g. legal/illegal for the legal system; true/false for science, etc.). This obviously has serious implications for any attempt by one system to intervene in another system to control or steer its operations as well as for our notions of how communication occurs. But for Luhmann and Teubner, viewing society in this way reveals shortcomings with the standard theories of action which justify interventionist strategies or authority structures as well as demonstrating the limits of the steering and communication which these theories suggest is possible.

In considering corporate governance, Teubner applies these same ideas. For him,

> organisations are not to be seen merely as contracts, strengthened by governance structures or decision rights over non-contractables whereby payments continue to flow as before. Rather, they represent a fundamentally different form of system formation within the economy. They, too, are autopoietic systems, the elements of which comprise not payments but decisions. (1993, 134)

This, therefore, represents a radical shift in perspective on the firm. It becomes an entity with an independent existence defined by its decisions which themselves produce further decisions, sustaining the organisation by a hypercyclical linkage of decisions (1993, 134). Although this could at first sight appear to represent as thorough an abstraction as was achieved by the economic theories considered earlier, Teubner does not in fact leave other aspects out of account. He does not ‘underestimate contracts between resource holders or simply...reinterpret them *in toto* in terms of organisational structures’.

He does, however, relegate them 'to the environment of the organisation'. And the same is true of shareholders, workers, managers, suppliers and customers: they 'are not part of the organisation; rather, they constitute its environment'. Accordingly, '[c]ontracts between them or with them are...ways of regulating the environmental relationships of the organization' (1993, 134).

In this way, Teubner claims to open up a distinction existing in modern flexible firms which standard economic theories tend to collapse: that between the *contractual network* which is concerned with the motivation of 'resource holders to make effective contributions' and the *decisional network* which is 'oriented towards organizational rationality' which he sees as an orientation

> primarily towards autopoietic reproduction and secondarily towards the rationalization strategies adopted - that is, toward the goals of the organization, the relationship between ends and means, hierarchic instructions, informal expectations, and so forth. (1993, 135)

Teubner has provided greater detail in this regard elsewhere, stating that the enterprise should be 'oriented towards the securing of as high a possible yield from the production process for the guaranteeing of future satisfaction of society's needs'. This, however, presupposes that three dimensions (function, performance and reflection) can be taken simultaneously into account. *Function* is here understood as the relationship of the enterprise 'to the economy and society, that is the securing of as high a yield as possible to guarantee the satisfaction of future needs of society'. Likewise, *performance* is understood as the relationship of the enterprise 'to its various environments' including workers and suppliers of capital as well as other social and natural environments. Lastly, *reflection* 'refers to the enterprise's relationship to itself...the self-observation and self-regulation through which the enterprise defines its social identity' (1994, 43-4).

This serves to clarify why there can be no *a priori* external definition of the interest of the company: ‘The balance between function and performance cannot...be calculated externally...It works only through reflexive processes within economic practice’. From the outside, however, it is still possible to have something to say about ‘the conditions of these reflexive processes’ and ‘to formulate the corporate interests as a legal term’ (1994, 44).

> Understood as a legal procedure, the corporate interest is not therefore simply directed at the internal, discursive process of integration of the interests involved, nor at the maximum satisfaction of consumer needs or profit maximization. It aims at creating organizational structures for discursive processes that make possible a balancing of enterprise performance (for consumers, workers, shareholders, but also for the political and natural environments) on the one hand, and function (ensuring the satisfaction of future social needs) on the other. (1994, 44-5)

This means that none of the resource holders ‘has a natural claim to “sovereignty within the group”’. Instead, the ‘distribution of control rights within the firm is...governed by considerations of efficiency oriented towards the interests of the “corporate actor”, which do not coincide with the interests of any participants’. (1993, 140). Normatively, therefore, corporate governance must concern itself with strengthening ‘the institutional position of the corporate actor in order to make an impersonal context of action autonomous’ (1993, 141).
This, then, offers the advantage over the stakeholder models considered previously that it is not just a question of balancing interests but seeking to ensure that it is the independent company interest that is prioritised. Similarly, the advantage over Leader lies in the ability of autopoiesis theory to provide a conceptualisation of the various interests concerned, including that of the company itself. It will be necessary to examine these in greater detail before their

potential can be properly assessed but at this point it is necessary to note that this very approach has been the subject of strong criticism in the work of Jacques Lenoble, another author who proposes a procedural approach to law. We need, therefore, to examine more closely Lenoble's ideas to understand what their implications are for the line of reasoning we have been developing.

Contextual proceduralisation

Important for Lenoble's approach to proceduralisation is the need for public and private actors to organise their deliberative procedures so as to ensure the transformation of contexts necessary for the efficient application of the objectives defined as valid (1997, 3-4). It is apparent from the outset, therefore, that at the level of corporate governance this will lead to something more than a simple stakeholder approach with predefined actors ranged around the table. What he has in mind is the provision of a framework for the construction of actors, of the modalities of their co-operation and of the themes to be subjected to renegotiation (1997, 4). In other words, nothing is predetermined nor is anything excluded in advance - the stakeholders, the questions to be discussed and, importantly, the mechanisms of discussion are a matter of contextual discovery.

This could, however, give the impression of a somewhat freeform approach to corporate governance - not dissimilar perhaps to what Alkhafaji was pointing to - since there does not seem to be anything tangible on which decisions about these factors could be grounded in context. In such circumstances, the attraction of what were identified as reductionist economic or stakeholder approaches increases. And this effectively brings into focus the essential problem identified in this paper: over-simplify the interests and relationships in corporate governance and the limitations soon become apparent even within the terms of a given approach; but open up the question, remove the brackets, and there seems always a risk that one will be confronted with a featureless landscape upon which any attempt to impose order will again run into the problems of reductionism. It is time, therefore, to be explicit about the nature of the limitations identified in economic and stakeholder theorising so that in trying to overcome them we do not slide towards ‘anything goes’ relativism.

Basically the problem is one of *epistemology* and accordingly the aim must be to discover a sufficient understanding of the limits of rationality which we have seen that recent thinking in economic and stakeholder theory has exposed. In this regard, while Lenoble concedes that the adherents of autopoiesis such as Luhmann and Teubner certainly address this issue, he nevertheless maintains that their perspective is itself reductionist and insufficient. In order to understand the particularity of Lenoble’s claimed advance, however, it is necessary to understand his critique of the autopoietic position.

This position is criticised because it seems to suggest that each field to be regulated must be understood to contain its own distinct normative point of view (1997, 6). Thus, the determination of actors is considered according to a supposed normative homogeneity, and contextual efficiency is, therefore, ensured by respecting the formality implied in the normative closure of the system. This, however, overlooks the fact that specific contexts are permeated by *plural* normative logics. Lenoble, therefore, claims that the autopoietic approach suffers from a double formalist blindness: regarding the *determination of the collective actors* who must be mobilised to ensure an adequate definition of the measures to be adopted; and regarding the *definition of the issues* which will be the object of negotiation (1997, 13). More specifically, Lenoble sees this approach as defining actors according to their professional expertise and thus closing down the range of issues that can be discussed (1997, 20). At a more fundamental level, the autopoietic approach is seen to be insufficient because it identifies the limits of rationality as related to cognitive complexity resulting from uncertainty or unpredictability (1997, 14).

By contrast, Lenoble' hypothesis of contextual proceduralisation holds that a norm is rational, not according to any formal procedure, but only insofar as procedures allow the addition of the requirements conditioning the norm's contextual efficiency at the moment of its formal validity - that is of its application. This is because the limits of a rationality are not a question of uncertainty or unpredictability, nor even simply of pragmatic undecidability as Lenoble previously contended (1994), but rather additionally of the 'asymmetric reversibility of the operation of application of a norm' (1997, 15). The double formal blindness of the autopoietic approach, according to Lenoble, means that this dimension and the requirements arising from it cannot be identified, masking as it does the fact that the application of the norm is not a formal procedure but must be guided by the logical constraints which result from taking into account 'the necessary transformation of the background contexts' essential if the efficiency of the norm is to be ensured. Thus, the actors involved always have to be constructed according to a specific social context and this depends on the end aimed for and on the 'reconstitution by these actors of their historically constituted know-how' (1997, 10).

> This recomposition [of contexts] can only be achieved by mobilising the collective actors involved in the contexts of application so that they recompose their know-how in order to insert the coexisting valid objectives as well as possible.... It is...a question, therefore... of integrating, in a logic of argumentation which aims at validity, a dimension of recomposition of contexts and, therefore, of the construction of the means necessary for the realisation of the end in a multiple context. (1997, 15)

But despite the clear specification at last of the epistemological foundation which underlies the problems in economic and stakeholder theories, it is a question what this could mean in practice. Paradoxically, it may be that we find some guidance in this regard from the position which Lenoble criticised in seeking to clarify his approach.

Autopoiesis revisited

Recall first of all his criticism regarding the definition of actors in autopoiesis, that this was based on the normative homogeneity of experts and ignored the fact of plural logics permeating specific contexts. The first thing to notice is that this seems to contradict an earlier approving observation made about autopoiesis concerning Luhmann's insights into the existence of a variety of communicative processes and the need to provide an effective means of harmonising relationships among them (1994, 27ff). And this earlier observation, indeed, represents a much more accurate appraisal of Luhmann's and Teubner's position. Secondly, the identification of a normative logic with the experts in a given area represents a quite different criticism of autopoiesis than that usually made in this respect. More often, the theory is criticised for its apparent decentering of human agents in favour of communicative systems (Bankowski 1996). Neither of these criticisms is accurate, however. By insisting on the normative closure of communicative systems, issues become in principle open to thematisation in terms of that system by anyone, expert or not (Paterson 1996). Furthermore, the theory's insistence on a plurality of such systems exonerates it from a charge of reductionism. Where a charge of reductionism might nevertheless stick would be insofar as the theory insisted only on a *predetermined* set of such systems. But despite the appearance of such a position in some of the work by Luhmann and Teubner, it should be stressed that this position is adopted at the highest level of the theory's abstraction and that in practice the identification of such systems is an empirical question in context (see Paterson & Teubner 1998). In this regard, we can recall Teubner's identification of the corporation itself as an autopoietic system of decisions quite distinct from any of the resource holders. Thus in any context, it would be a question firstly of identifying the multitude of elementary acts or meaning operations that constitute the closure of the various processes involved.

With these points in mind, as well as the earlier account of Teubner's discussion of corporate governance, it is possible to suggest that autopoiesis may indeed answer more of the epistemological questions raised in economic and stakeholder theory than the criticisms levelled at it by Lenoble would suggest. It is, for example, sensitive to the reductionism of standard economic and narrow stakeholder theorising. And, while opening up the group of possible stakeholders, it nevertheless insists on a contextual definition and provides the conceptual tools of communicative systems to assist this definition. On the issue of the need for a mutual reconstitution of contexts by the different resource holders, it is explicit that this mutual reconstitution is an inherent aspect of communication between systems which in turn demands an avoidance of any approach to corporate governance based either on only one (for example, economic) logic or on any overly-simplistic notion of the transfer of information between resource-holding systems. Instead, a second empirical move would be the identification of the different types of mutual recontextualisation which are responsible for a meeting of closed systems. Thus, by addressing the epistemological roots of contractual incompleteness, offering a procedural and contextual approach to the definition and integration of resource-holders and providing the conceptual tools which allow the insights about the company interest to be taken seriously, autopoiesis appears to offer a response to the problems identified as underlying recent theorising about corporate governance.

Conclusions

That said, there has not been the space here to develop these ideas very far nor to address very fully the criticisms made by Jacques Lenoble, not only in the paper considered above but also in earlier work (especially 1994). Furthermore, while it was stated earlier that addressing the problems inherent in standard economic approaches requires a reassessment of the concept of efficiency, this remains as a significant outstanding task - not least when, despite the acknowledgement by some corporate lawyers of the benefits of a procedural approach to corporate governance, concern remains about the potential costs (Kubler 1987, 234-6).

This paper, however, is simply an early part of a wider international collaboration which aims to address in detail the sorts of issues which could only be broadly outlined here: the current corporate governance situation in a range of countries; the political positions in support of that situation or calling for change; the theoretical discussion of corporate governance in different disciplines; and the variety of approaches in these disciplines which seek to transcend the artificial boundaries which increasingly apparently can leave as much out of account as they allow to become clear. It is hoped that the present discussion has demonstrated the utility of examining the limits of different approaches to corporate governance as a means of identifying directions which will allow progress in a 'debate' which can all too easily become a sterile exchange between entrenched positions.

Notes

[1] See *The Sunday Times* 15 December 1996.

[2] The National Association of Pension Funds quoted in *The Times* 23 February, 1996.

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