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The Origins and Nature of the Shareholder Value Norm in UK Corporate Governance

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This paper provides an alternative conceptual account of the evolution of the ‘shareholder value’ norm in UK corporate governance based on a Keynesian variant of the dominant contractarian theory of the firm. It will be submitted that Keynesian contractarianism (KC) is distinguishable from orthodox contractarianism (OC) in the following 3 respects: (i) whereas OC regards the shareholder value norm as being consistent with investors’ informational rationality, KC portrays the shareholder value norm as an antidote to investors’ informational incompleteness; (ii) whereas OC regards shareholders’ legal governance rights as being a necessary pre-condition to the development of the shareholder value norm, KC portrays the shareholder value norm as evolving organically from capital market pressures even in the absence of an endogenous system of governance rights; and (iii) whereas OC regards corporate law rules as the endogenous outcome of implicit bargaining between shareholders and other corporate participants, KC views corporate law rules as the product of deliberate public policy design by the state. On this basis, the final part of the paper provides a revisionist interpretation of the concept of enlightened shareholder value in UK company law, which, in contrast to the accepted contractarian understanding of the doctrine, is both compatible with and supportive of a strong role for the interventionist state in establishing socially efficient corporate law rules.

1. Introduction

Over the past fifty years or so, Anglo-American corporate law theory has become increasingly dominated by one particular school of thought. In the early-to-middle decades of the 20th century, academic debate in the United States entailed a clash of competing views as to the corporation's rightful role in modern society, as scholars from radically different and constantly evolving ideological bases vied for supremacy on the pages of the nation's law journals and broadsheets. The Depression era of the 1930s can be roughly characterised in terms of a contest between, in the one corner, the 'pure' managerialist model of the company, which placed faith in the country's evolving professional executive sector (or "captains of industry") to assume the role of national socio-economic arbiters; and, in the other, the corporatist-managerialist model, which advocated a direct role for the government and courts in both actively defining and co-ordinating the achievement of the national public interest, on the ground that it was insufficient and, moreover, positively dangerous to rely on enlightened managerial discretion alone for the achievement of socio-economic welfare.

Whereas the 1930s witnessed widespread political and academic faith in the superiority of corporatist economic planning over 'unchained' market forces, the more prosperous economic climate of the American post-war era led to academic battle lines being drawn along more divergent paths. Accordingly, in the reformed ideological climate of the 1960s, proponents of the above managerialist theories united in opposition to the new breed of 'progressive' scholar who believed in the potential for re-invigoration of market mechanisms as a means of uniting the corporate-managerial and general public interest.

Whilst the more 'black letter' tradition of company law scholarship in the UK arguably meant that the wider social implications of corporate activities were not afforded the same degree of scholarly profile as in the US, the recessionary Britain of the 1970s nevertheless paid host to a vigorous academic debate about the structure and goals of corporate organisation in the years surrounding the publication of the short-lived Bullock proposals on industrial democracy. Debates of this nature were briefly replayed in the UK in the early 1990s when Professor John Parkinson published what remains to date the only comprehensive polemic on corporate law theory in a British context, and thereafter at the onset of the then-incoming Labour government's promised 'root and branch' review of UK company law which began in 1997 and culminated in the enactment of the Companies Act 2006.

Overall, however, the general thrust of modern development in Anglo-American corporate law scholarship has been the progressive convergence of both ideology and logic in the direction of a so-

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called ‘aggregate’ or ‘contractarian’ model of the corporation. Whilst this process has undoubtedly been more marked in the United States, the spread of influential American-inspired contributions to British scholarship over recent years (including the work of the prolific ‘Cambridge School’) coupled with the lack of viable home-grown counter-theories have together ensured the prevalence of contractarian logic to a significant extent within UK corporate law thinking and policy-making today.

2. The contractarian model of corporate law

The key prescriptive strength of contractarianism inheres in its capacity to analyse the structure and operation of the corporation in terms of the individual incentive and disciplinary patterns of its various participants. Through this neo-classical economic lens, it becomes possible to ascribe theoretically rational behaviour modes to the company’s various constituent groups based on the conceptual framework of an implicit and ongoing ‘bargain’ over their respective legal rights and share of the firm’s economic output. It is argued that the company’s equity investors as a group will on the basis of this bargain tend to secure exclusive entitlement to the residual profit generated by the firm, which other constituent groups (such as employees and debt creditors) will be willing to grant them given: (a) the latter groups’ capacity, unlike equity investors, to bargain for ‘fixed’ contractual protections against expropriation or loss of their respective investments in the firm; and (b) equity investors’ unique propensity to diversify their corporate holdings and hence efficiently absorb the ongoing risk of firm failure that is the inevitable outcome of a dynamic managerial wealth-maximisation strategy.

As necessary contractual ‘insurance’ for fulfilling this unique risk-bearing function within the firm, it is argued that shareholders will demand exclusive rights over the internal governance of the corporation, including: the right to appoint and dismiss its board of directors democratically in General Meeting; the periodic right to vote on certain extraordinary corporate policy decisions in General Meeting; and the capacity to constrain managerial misconduct and self-interest-seeking on an *ex post* basis by means of legal fiduciary controls (i.e. directors’ duties). However, contractarianism accepts that, since shareholders’ unique risk-bearing capacity depends on their ability to diversify their investments across a wide portfolio of different firms, they are necessarily limited in respect of the degree of direct attention that they can devote to overseeing any particular firm’s management team. For shareholders to spend an appreciable length of time acquiring intimate firm-specific information in relation to any one company with a view to exercising their governance rights over its management is therefore, by and large, an individually irrational strategy given that the expected costs of such action will almost certainly outweigh any consequent incremental portfolio gains.

According to contractarian logic, the rational investment strategy in the majority of cases is therefore that of ‘passive coercion’. In other words, shareholders rely on the implicit and continuing

threat to sell their investment on a liquid stock market as a ‘lever’ to enforce diligent and competent execution of management’s functions on an ongoing basis. Whilst this approach does not entail direct use by shareholders of their governance rights vis-à-vis management, it by no means negates the value of those rights. On the contrary, shareholders’ governance rights acquire significant indirect value as an effective form of ‘bargaining chip’ exercisable in their ongoing informal dialogue with each firm’s management.

The ultimate threat to any management is the possibility that the votes attached to those various shares will be amassed in a concentrated controlling block, whether as a result of: (a) a successful tender offer by an outsider aimed at acquiring actual ownership of a majority of shares; or else: (b) a proxy battle whereby a third party attempts to gain temporary control over the voting rights attached to a significant block of shares, without actually acquiring ownership of the underlying securities themselves. From a managerial perspective, both the above courses of action entail the possibility of dismissal and replacement. Moreover, insofar as any such market for corporate control will, in theory at least, be stimulated by the potential capital gains to be wrought by acquirers from instigating managerial change within underperforming target firms, then the very threat of one of the above outcomes occurring will be sufficient in most cases to drive efficient performance by boards and executives on a continuing basis.

It can thus be concluded that, even where shareholders’ governance rights are used relatively rarely in practice, they are nevertheless instrumental as a powerful ‘background’ managerial-disciplinary device. In this way, contractarianism has become normatively instrumental in highlighting the theoretic compatibility between equity investor passivity and the doctrine of shareholder primacy, thereby successfully responding to earlier managerialist claims as to the inability of passive investors to exert effective control over the corporate wealth-creation and –distribution process.

In addition, by explaining the evolution of company law rules (and, in particular, shareholders’ rights) in terms of an implicit bargain between the company’s various participant groups, contractarianism has succeeded in presenting existing patterns of company law rules as the endogenous outcome of a historical process of private ordering. According to this logic, the very survival value of prevailing rules is *a priori* proof of their efficiency, such that any attempt by the state to vary the established legal order via legislative intervention represents an illegitimate intrusion into the realm of individual choice. The only exception is where the sole purpose of such intervention is to provide a lower cost method of achieving an outcome that would otherwise be agreed by participants contractually (e.g. putting limited liability on a statutory footing or codifying the director’s fiduciary duty). In this latter range of cases, company law effectively operates as a set of voluntary ‘off-the-shelf’ rules designed to mitigate the transaction costs that contractors would otherwise encounter if required to incorporate these common ‘terms’ into every corporate ‘agreement’ where they were deemed mutually desirable.

3. Investor rationality and the ECMH

Contractarianism's underpinning doctrine of 'passive shareholder primacy' is necessarily reliant for its effective realisation upon the existence of a liquid and efficient stock market, whereby relevant information is incorporated quickly and comprehensively into the prevailing clearing price of each issued corporate security. This in turn depends on the existence of legal and other institutional mechanisms that enable the continual publication of credible information on firm performance for the benefit of investors. Indeed, it goes without saying that in the absence of a reliable informational sub-structure, a liquid market in corporate securities is impossible. Moreover, investors themselves must be sufficiently discerning so as to be both able and willing to process this information effectively in: (a) making informed stock selection choices based on historical and projected corporate performance; and (b) determining whether the particular 'basket' of governance protections put in place by any firm's management (whether via self-design or else by 'adoption' of national company law rules) offers a sufficiently robust insurance against the risk of loss or expropriation of shareholder value.

It is at this point that contractarianism encounters a potential paradox. Since the normative basis of shareholder primacy under contractarian logic is dependent on equity investors' *detachment* from micro-level governance of any particular firm(s), contractarianism must consequently provide an alternative explanation for how firm-specific information impacts on investor choices in the absence of any direct proprietary monitoring process. For this purpose, contractarianism relies heavily on the assumption that corporate share prices *in themselves* provide a credible and comprehensive reflection of the information that is relevant to the income-generating potential of any particular investment. Or, at the very least, it assumes that prevailing prices will reflect all of the information that is currently *publicly* available in relation to any company, as inferred by the semi-strong version of the efficient capital markets hypothesis (ECMH) in law and finance theory. However, this assertion is inherently circular absent any more thoroughgoing enquiry into the actual capital market pressures and institutions that effect the continuing production, dissemination and incorporation of information into securities prices.

In what is arguable the most authoritative account of the contractarian model of corporate law to date, Frank Easterbrook and Daniel Fischel attribute this information-processing function to 3 main groups of capital market participant. First, they cite the category of 'informed traders' such as professional fund managers and mutuals, who strive to 'beat the market' by uncovering new information about a company before it becomes more widely disseminated, thus gaining the financial benefits of first mover status. According to Easterbrook and Fischel, such actors through their basic stock selection decisions fulfil a valuable arbitrage role by ensuring that newly discovered information

quickly impacts on the demand for, and resultant price of, any company's securities. This provides a credible signal to which the many less-informed investors on the market will subsequently respond, up to the point where the potential gains to be made from purchasing the security are effectively cancelled out by its higher price.

Secondly, Easterbrook and Fischel refer to the crucial processing role of professional 'informational intermediaries', which include securities underwriters, analysts and independent auditors. An especially important role in this regard is allegedly played by high-profile investment banks, which are said to put their valuable reputation on the line when establishing the 'correct' price for newly issued corporate securities in the light of privately acquired firm-specific information. As such, the established public offering price of a corporate equity can be regarded by investors as a credible reflection of that firm's performance and future prospects. To a lesser extent, the authors claim, securities analysts fulfil a similar information-verification role when staking their reputations on recommendations made to uninformed investor clients, whilst auditing firms likewise place their reputational capital at risk when certifying the accuracy and integrity of a company's periodic financial statements.

The finally type of capital market participant referred to by Easterbrook and Fischel in this regard are stock exchange operators themselves. The authors explain that, "[b]ecause the success of an exchange depends on the amount of trading, exchanges have incentives to adopt rules governing trade that operate to the benefit of investors" so as to "attract more trades, reducing the costs (and increasing the profits) of those who run the exchanges." It is claimed that, to this end, "exchanges have an incentive to adopt rules that require listed firms to disclose the amount and type of information that investors demand", and further that "[c]ompetition among organized exchanges for both the listing of firms and the business of investors...increases the incentives of the exchanges to adopt beneficial rules."

For the above reasons, then, even in the absence of a mandatory state-imposed system of corporate disclosure regulation, efficient market-induced mechanisms are likely to evolve so as to ensure the efficient inculcation of relevant information into corporate securities prices. Not only are these mechanisms believed to represent an adequate substitute for direct one-on-one supervision by investors of individual firms, but they moreover enhance the quality of corporate governance by substituting the cumulative allocative decisions of the capital market for the necessarily limited supervisory competences of the individual investor. It is accordingly through the above course of logic that the contractarian model of the corporation succeeds in establishing that shareholder passivity is to a significant extent compatible with an informationally efficient corporate securities market, in spite of the typically limited degree of direct communication that takes place between the financial-investment and corporate-managerial communities respectively on a day-to-day basis.

4. The common alignment of shareholder value with investor rationality

Contractarianism is often regarded to be the ideological antithesis of the earlier managerialist theory of the corporation associated most notably with the work of Berle and Means. Whilst both schools of thought begin by acknowledging the significance of the separation of ownership and control within the modern public corporation, they adopt radically different conclusions from one another as to both the positive and normative implications of this phenomenon in terms of corporate governance.

From a positive perspective, managerialism sought to establish the weakness of orthodox organisational and product market pressures acting on corporate managers, and the resultant diminution within public corporations of the traditional entrepreneurial imperative to generate residual proprietary value. Contractarianism in contrast set out to relocate, conceptually, the primary source of managerial market discipline at the level of the corporate capital market rather than the primary market for the firm's goods and services, whilst at the same time re-explaining shareholders' orthodox governance rights in terms consistent with a financial rather than entrepreneurial model of investor behaviour. From a normative point of view, meanwhile, it may be said that whilst managerialists (in differing ways from one another) typically aimed to *exploit* the perceived fact of shareholder disempowerment within the individual corporation for direct social policy ends, contractarians in contrast set out to *mitigate* the separation of ownership and control by reference to inert market and contingent legal mechanisms that were arguably already present within the institutional framework of the corporate capital market.

In one notable respect, however, these two schools of thought share a significant and as-yet unacknowledged commonality. This is the fact that both Berle-Means managerialism and Easterbrook-Fischel contractarianism assume a direct alignment between: on the one hand, investors' degree of access to corporate information and resultant level of economic rationality; and, on the other, the strength of the shareholder value norm as an operational constraint on managers. In other words, rational and informed shareholders are regarded under both models as representing an effective safeguard against managerial dominance of the corporation, this assumption being explicit within contractarianism and implicit in managerialism. Or, to turn the issue on its head, both managerialism and contractarianism proceeds on the common basis (explicit within managerialism and implicit in contractarianism) that, where investors are uninformed and hence lacking in economic rationality, they are incapable of utilising available governance mechanisms to their advantage thereby effectively ceding corporate control to managers.

Thus, under the Berle-Means model of the corporation, the inevitable limitations in shareholders' firm-specific knowledge render them incapable of enforcing their legal governance rights effectively on an intra-firm basis, with the result that the corporate operating norm of

shareholder value loses its coercive force. On the contrary, however, contractarianism's revived 'passive-coercive' portfolio investors are equipped with ready access to macro-level information given the existence of efficient share pricing mechanisms.ⁱ By buying and selling securities on a liquid secondary market, these investors generate share price movements which, in turn, trigger any one or more of the various market-disciplinary mechanisms to which managers are subject. Through this process, investors' revived informational competence accordingly feeds through to the reinvigoration of the shareholder value norm, by virtue of the working of capital market pressures and, in turn, the evolution of shareholder-oriented corporate law rules.

It may therefore be concluded that, in spite of their profound differences in other respects, both managerialism and contractarianism are united in recognising the fundamental importance of investors' informational rationality as a precondition to the effective functioning of the shareholder value norm in public corporations.

5. The concept of investor *irrationality* in economic thought

It is noteworthy that the contractarian theory of the corporation began its development during a period when many scholars had started to question the continuing analytical validity of orthodox economic assumptions about human behaviour and decision-making. In particular, the early-to-mid-20th century witnessed a sustained academic attack on the traditional conceptual model of 'economic man': as a rational agent, equipped with complete information and foresight of the consequences of his actions, operating within competitive markets in pursuit of the goal of utility maximisation.

One of the earliest and most famous intellectual opponents of the classical doctrine of 'economic man' was John Maynard Keynes, who stressed in his *General Theory* that "human decisions affecting the future, whether personal or political or economic, cannot depend on strict mathematical expectation, since the basis for making such calculations does not exist."ⁱⁱ According to Keynes, this meant that:

*"[m]ost, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as a result of animal spirits – of a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities."*ⁱⁱⁱ

Keynes' insights in this regard were re-enforced by the behavioural scientist Herbert Simon, who denounced "the classical economic theory of markets with perfect competition and rational agents" as

a “deductive theory that requires almost no contact with empirical data once its assumptions are accepted.”^{iv} Simon argued that, as a more relevant “alternative interpretation”, economists should recognise that “most real-life choices...lie beyond the reach of maximising techniques”,^v and therefore that “rationality in real life must involve something simpler than maximization of utility or profits.”^{vi} Accordingly, Simon suggested a more realistic model of economic behaviour which depicted business decision-makers as being motivated by the search for a moderately “satisficing” rate of return, determined through adjustment of their levels of aspiration “until goals reach levels that are practically attainable.”^{vii}

In a similar vein, the economist Armen Alchian claimed that, “where foresight is uncertain, ‘profit maximisation’ is meaningless as a guide to specifiable action.”^{viii} Alchian conceptualised entrepreneurial decision-making as “[a]daptive, imitative and trial-and-error behaviour”^{ix} based upon “imperfect foresight and human inability to solve complex problems containing a host of variables.”^x Alchian believed that, under such uncertain conditions, businesspersons would pursue the relatively modest goal of generating *positive* (as opposed to maximum) levels of profit, which would fall to be determined by the whole range of possible outcomes that might follow from any proposed strategic decision.^{xi}

The problem of inert human uncertainty was widely thought by scholars to take on particular significance in the context of large public corporations. In Keynes’ view, the effect of the so-called separation of ownership and control was the bifurcation of the dual productive and financial elements of traditional entrepreneurial behaviour into the separate activities of “enterprise” and “speculation”. Keynes defined “enterprise” as “the activity of forecasting the prospective yield of assets over their whole life”, which he regarded as being a socially beneficial endeavour insofar as it increased the general stock of capital available for the expansion of national production and employment. The activity of “speculation”, on the other hand, Keynes did not regard as being so worthy from the general community’s point of view, given the inevitable mismatch between financial investors’ typically short-term time horizons and the much longer-term capital needs of industry.^{xii}

Keynes claimed that, “[i]n former times, when enterprises were mainly owned by those who undertook them or by their friends and associates, investment depended on a sufficient supply of individuals of sanguine temperament and constructive impulses who embarked on business as a way of life, not really relying on a precise calculation of prospective profit.”^{xiii} However, Keynes expressed concern that:

“[a]s a result of the gradual increase in the proportion of...equity...which is owned by persons who do not manage and have no special knowledge of the circumstances, either actual or prospective, of the business in question, the element of real knowledge in the valuation of investments by those who own them or contemplate purchasing them has seriously declined.”^{xiv}

In any event, argued Keynes, speculators had little reason even to make efforts to acquaint themselves with the intricacies of a corporation's actual business processes, given that the high liquidity of their investments permitted easy exit from a firm or even a whole industry via simple sale of any of their holdings on a public securities market. Moreover, insofar as investors could make rapid and regular capital gains by trading corporate securities purely on the basis of projected changes in general market confidence (what is today known as 'bubble trading'), it made little sense for them (even investment professionals) to expend resources researching the characteristics of the underlying businesses themselves.^{xv} Whilst an investment strategy geared towards the longer-term capital yield of underlying industrial assets could be potentially more profitable than speculative bubble trading, it was nevertheless a considerably riskier strategy given the high degree of uncertainty involved. And, insofar as (unlike short-term bubble trading) long-term 'yield' investment entailed 'tying up' investment capital in fixed assets over long periods of time, it was also a relatively costly strategy that was open only to those of ample financial means.

Keynes' views on this issue were shared to a significant extent by other esteemed Anglo-American social scientists of the 20th century. A notable inclusion in this category was Adolf Berle. In his later work from the 1950s, Berle alluded to the idea that passive financial shareholders typically lacked the element of business knowledge and acumen which was necessarily involved in active entrepreneurial decision-making. Berle argued that, as a consequence, shareholders were prone to make conservative investment judgements that discouraged creative innovation in industry.^{xvi} However, the fact that by the 1950s Berle viewed shareholders as a relatively powerless corporate constituency vis-à-vis management and the regulatory state meant that, in his opinion, this was not a particularly serious problem from a wider social perspective.

Keynes' 'investor irrationality' thesis was later expanded by John Kenneth Galbraith in his famous 1973 work *Economics and the Public Purpose*. Galbraith claimed that, even to the limited extent shareholders were inclined to intervene in the operational affairs of corporations in which they were invested, any action that they took or demands that they made in this regard were inherently irrational, given the inability of these 'outsiders' to acquire sufficient information or expertise to be able to pass judgement on the merits of managers' strategic decisions. Galbraith believed that, not only were shareholders physically detached from the day-to-day running of the corporation's business, but they were also excluded from what he termed the corporate "technostructure". Galbraith used this term to denote the collective body of officers (including senior managers) who enjoyed supremacy, as a group, over the base of scientific and technical skills, knowledge and expertise upon which the company's ongoing productive operations were dependent. Galbraith argued that, in the mid-to-late-20th century economy, corporate activities were becoming increasingly technical and specialised in nature. In this new environment, the nexus of politico-economic power within the corporation

comprised those that possessed the relevant *knowledge* (as opposed to the wealth) which underlay the industrial enterprise, thereby effectively ‘externalising’ shareholders from the corporate wealth-creation and –distribution process.

6. Aligning shareholder value with investor irrationality: the legacy of Keynes

In contrast to scholars such as Berle and Galbraith, who viewed investor irrationality as a prelude to managerial domination of the corporate wealth-creation and –distribution process, Keynes contrarily did not regard irrationality as being a necessary source of weakness for shareholders. This finding, as explained further below, may come as a source of surprise to many corporate law theorists given that Keynes has hitherto been cast as a protagonist of corporate managerialism in the same vein as Berle and Means.

Admittedly, in his earlier work written prior to the onset of the Great Depression, Keynes appears to have adopted a corporatist-managerialist stance markedly similar to the position which would later be taken by Adolf Berle in the United States. Writing in the mid-1920s, Keynes referred to “the trend of joint stock institutions, when they have reached a certain age and size, to approximate the status of public corporations rather than individualistic private enterprises.”^{xvii} Keynes believed that “[o]ne of the most interesting and unnoticed developments of recent decades has been the tendency of big enterprise to socialise itself.”^{xviii} In a much-quoted passage published in 1926, Keynes explained how:

“[a] point arrives in the growth of a big institution...at which the owners of the capital, i.e. the shareholders, are almost entirely dissociated from the management, with the result that the direct personal interest of the latter in the making of great profit becomes quite secondary. When this stage is reached, the general stability and reputation of the institution are the more considered by the management than the maximum of profit for the shareholders [and] [t]he shareholders must be satisfied by conventionally adequate dividends”^{xix}

Keynes even went so far as to suggest that the then-prevalent public debate on nationalisation of industry was “irrelevant”, given that “[t]he battle of Socialism against unlimited profit is being won in detail hour by hour.”^{xx}

However, in Keynes’ later work written in the midst of the Depression era of the 1930s, he seemed to place markedly less faith in the capacity of corporations to “socialise themselves” in the way that he had earlier predicted. This more pessimistic perspective on the potential for effective managerialism was apparent in Keynes’ most famous thesis, namely his *General Theory of*

Employment, Interest and Money published in 1936. Keynes' *General Theory*, like Berle and Means' *Modern Corporation* 4 years earlier, was aimed ultimately at suggesting an effective public policy response to the circumstances of the Great Depression. However, whereas Berle and Means chose to concentrate on issues of corporate concentration and managerial hegemony, Keynes focussed instead on what he regarded to be the economically detrimental effect of unregulated public investment markets and, in particular, the weakness of corporate capital markets as a medium for channelling public savings into socially beneficial industrial projects. Although, unlike *The Modern Corporation*, Keynes' *General Theory* was not directly concerned with the topic of corporate governance, some of his conclusions nevertheless had profound (and, it must be said, *neglected*) corporate governance implications.

From a governance perspective, Keynes' main point of contention concerned the "liquidity" of financial capital, meaning the ease with which any investment could be quickly transformed into money form. Keynes' contrasted this transient and fleeting quality of financial capital with the more entrenched and durable nature of industrial capital, noting how by virtue of a liquid stock market "[i]nvestments which are 'fixed' for the community are thus made 'liquid' for the individual."^{xxi} Keynes believed that "[d]ecisions to invest in private business of the old-fashioned [entrepreneurial] type were...largely irrevocable, not only for the community as a whole, but also for the individual."^{xxii} However, "[w]ith the separation between ownership and management which prevails to-day and with the development of organised investment markets, a new factor of great importance has entered in...[insofar as] the Stock Exchange revalues many investments every day and the revaluations give a frequent opportunity to the individual (though not to the community as a whole) to revise his commitments."^{xxiii}

It was at this point in the argument that Keynes' reasoning departed from that of Berle and Means. Berle and Means believed that, in view of the high liquidity of financial capital, shareholders would come to depend entirely for their income on the capital gains to be wrought from the sale of a company's securities on the secondary market, and hence would no longer rely upon dividend payments as a source of income. The effect of this development, in Berle and Means' view, would be to vest management with the effective power to confiscate the corporation's profit stream privately, whilst shareholders would be left to rely merely on "intangible expectations of future dividends" in determining the market price of a firm's equities.

However, whilst Berle and Means for the above reasons viewed capital market liquidity as a factor contributing towards shareholder disempowerment within public corporations, Keynes contrarily regarded liquidity as being the institutional foundation of shareholders' *influence* vis-à-vis corporate managers. Keynes observed how "the daily revaluations of the Stock Exchange, though they are primarily made to facilitate transfers of old investments between one individual and the other, inevitably exert a decisive influence on the rate of current investment."^{xxiv} This was because the price

of a company's existing securities on the secondary market inevitably dictated the terms on which that firm could raise fresh capital by issuing new shares on the primary capital market, thereby providing managers with a continuing incentive to take measures aimed at maintaining the favour of shareholders. Otherwise, managers would be forced to raise new equity capital at a relatively low rate of return, which from the firm's perspective would be tantamount to a rise in the general rate of interest.

Of course, as explained above, Keynes regarded financial investors (or "speculators") as being fundamentally irrational, lacking "real knowledge" about the circumstances of the firms in which they were invested and hence prone to engage in ill-informed bubble trading based on mere changes in financial market sentiment. Thus, even to the extent managers were driven to maintain favour with shareholders by virtue of the pressure of the primary capital market, *prima facie* it did not automatically follow that shareholders would be in a position to determine in an informed manner whether managers had duly fulfilled their expressed commitments in this regard. However, when one takes into account the further fact that, in a liquid public capital market, investors have many *other* readily available uses for their savings besides corporate equity itself, the theoretic balance of power between shareholders and managers begins to change considerably.

This is due to the crucial factor, first noted by Keynes, that in a liquid and competitive market for new corporate capital, investors' expectations as to what counts as an adequate rate of return on an investment are conditioned not just by comparison to the rates of return obtainable in other (managerially-controlled) corporations, but, moreover, in relation to alternative *non*-corporate uses for that investment.^{xxv} In its most basic and obvious form, the opportunity cost of a corporate equity investment from a shareholder's point of view is simply to "hoard" their money in an interest-bearing savings account, so that the national bank 'base' rate of interest effectively sets a minimum acceptable threshold on a corporation's periodic rate of return on equity (as determined by a combination of dividend distributions and/or capital gains following from financial outperformance).^{xxvi} Moreover, shareholders' definable expectation as to an acceptable rate of return becomes effectively 'enforceable' in the event that a corporation wishes to raise new equity capital, with the effect that the very possibility of having to 'go to the market' for capital at some point in future serves to condition managers' strategic outlook in line with the expectations of public investment markets.

In contrast to later-day contractarians, who regard shareholders' 'market control' over managerial investment and distribution decisions as a socio-economic 'force for good' given the former's assumed risk-bearing and supervisory capabilities, Keynes was markedly less optimistic about the social utility of shareholder primacy. Keynes complained that "certain classes of investment are governed by the average expectation of those who deal on the Stock Exchange as revealed in the price of shares, rather than by the genuine expectations of the professional entrepreneur."^{xxvii} Keynes argued that, as a result of this inert informational weakness, stock markets were failing to fulfil their

“proper social purpose” of “direct[ing] new investment into the most profitable channels in terms of future yield”,^{xxviii} concluding pessimistically that “[w]hen the capital development of a country becomes the by-product of the activities of a casino, the job is likely to be ill-done.”^{xxix}

Keynes’ suggested solution to the above problems of investor short-termism and capital misallocation chimed with his general politico-economic stance as an advocate of corporatist ‘managed capitalism’. On a general level, Keynes essentially argued that the state should assume an active co-ordinating role within the economic sphere whilst preserving the basic competitive-individualistic fabric of the capitalistic marketplace. As one important part of this overall development, Keynes predicted that “the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, [would take] an ever greater responsibility for directly organising investment.”^{xxx} Keynes believed that, to some extent, the state had already begun (by 1936) to assume an important responsibility for co-ordinating capital allocation within the British economy, as illustrated by:

“[the] growing class of investments entered upon by, or at the risk of, public authorities, which are frankly influenced in making the investment by a general presumption of there being prospective social advantages from the investment, whatever its commercial yield may prove to be within a wide range, and without seeking to be satisfied that the mathematical expectation of the yield is at least equal to the current rate of interest”.^{xxxi}

Keynes’ predictions in this regard were to be re-affirmed by the widespread nationalisation of Britain’s public utilities and key infrastructure industries instigated by Clement Atlee’s post-war Labour government a decade later. Indeed, nationalisation would prove to be the main institutional means whereby successive British governments were (for better or worse) to realise Keynes’ influential proposal for substituting “prospective social advantages” in place of projected commercial yield as the central yardstick for assessing the viability of investment projects within nationally important industries.

7. Towards a Keynesian model of contractarianism

On an analytical level, Keynes’ account of the development of the shareholder value norm in public corporations shares one striking common feature with the later contractarian model of the firm. This is the fact that both theories, in spite of their markedly different historical and political standpoints, regard the doctrine of shareholder value as an endogenous concept arising from inert capital market pressures rather than the deliberate policy design of the state. It is suggested that, for this reason, the

Keynesian conceptualisation of corporate governance and shareholder value can be regarded as an ‘alternative’ model of contractarianism in its own right, albeit one premised on the *converse* dual logic of informational incompleteness and investor *irrationality*.

As explained above, orthodox contractarianism assumes that investors will have sufficient access to relevant information in respect of each corporation to enable them to decide: first, whether that firm’s securities constitute a viable investment option in view of historical and projected business performance; and, secondly, whether the firm’s corporate governance system (including relevant national corporate law rules) provides credible safeguards against managerial loss or expropriation of wealth. In other words, contractarian logic presents investors’ rationality as being *antecedent* to the establishment of a shareholder-oriented corporate governance system, so that efficient rules and institutions of governance are established *by virtue of* shareholders’ general condition of rationality. Once the shareholder rationality hypothesis breaks down, though, the chain of cause and effect is *reversed*, so that prevalent governance norms are more realistically regarded as the institutional *cause*, rather than outcome, of shareholders’ purported ‘rationality’: in other words, corporate governance norms represent an endogenous institutional response to shareholders’ ‘default’ condition of irrationality.

The idea that governance institutions evolve as an antidote to investors’ informational limitations is a long-established position within the transaction costs model of corporate governance, as advanced by Oliver Williamson on the basis of Ronald Coase’s path-breaking work on markets and firms. In essence, the transaction costs theory of corporate governance represents a variant of the orthodox contractarian model, only modified to deal with certain (purportedly) more realistic characteristics of human behaviour and, in particular, human beings’ natural informational limitations. Williamson, like Keynes, begins on the premise that individuals have naturally limited foresight and hence cannot with certainty predict the consequences of their actions, meaning that they run the risk of exploitation by opportunistic and better-informed competitors. In the context of corporate governance, equity investors’ limited informational capacity means that (unlike debt investors or employees) they cannot predict the variety of potential uses to which their unsecured and uniquely open-ended investment might be put by the firm’s management, with the result that shareholders bargain for protective governance rights as a form of institutional ‘insurance’ which, conveniently, enables the firm to attract capital for highly risky and specialised investment projects at a manageable cost. The main utility of governance rights from a shareholder’s point of view, meanwhile, resides in the formal influence that they afford in respect of the internal management affairs of the corporation, including ultimate power of appointment over the board of directors itself.

Whilst the Keynesian version of contractarianism (KC), like the above transaction costs model, regards the shareholder value norm as an institutional antidote to equity investors’ inevitable informational limitations, KC diverges from the transaction costs view insofar as KC does not

recognise shareholders' legal governance rights as being a necessary pre-condition to their *de facto* empowerment within the firm's hierarchy. Rather, KC portrays the shareholder value norm as evolving from capital market pressures through a purely organic process, whereby the liquidity of shareholders' capital investment on the secondary market, coupled with the periodic managerial imperative of generating equity capital at manageable cost on the primary market, compels managers to take ongoing strategic measures aimed at maintaining (or increasing) the firm's rate of return on equity so that it is at least equal to shareholders' opportunity cost of capital at macro level. Accordingly, within KC the corporate-managerial norm of shareholder value evolves as a *pre-legal* concept, which compels managerial deference to the shareholder interest even *in the absence of* an endogenous system of governance rights designed for empowering shareholders *vis-à-vis* managers within the firm's decision-making structures.^{xxxii}

Moreover, the 'pure' capital-market-based model of shareholder value advanced within KC could be said to encapsulate a more effective and less costly form of governance from shareholders' perspective than that offered by both the orthodox and transaction costs versions of contractarianism. Not only does KC (in contrast to orthodox contractarianism) present a form of managerial discipline that operates independently from the highly costly and indeterminate mechanism of the market for corporate control, but it also provides an arguably more realistic conception of the role of the capital market as an informational medium. Whereas the ECMH within orthodox contractarian thought depicts informed institutional investors and professional market intermediaries as an effective channel for the 'flow' of corporate information from managerial 'insiders' out to the general (uninformed) investment marketplace, KC takes a markedly more pessimistic view of investors' information-processing propensity. Given the inert incommensurability within Keynesian analysis of the respective types of information relevant to the logically distinct corporate activities of enterprise (predicting the prospective yield on capital assets) and speculation (predicting the prospective behaviour of the capital market itself), the challenge of ensuring a flow of entrepreneurial information sufficient to compensate for shareholders' inevitable informational deficit *vis-à-vis* managers is regarded by KC to be a necessarily unattainable task.

This does not, however, reduce the significance of the capital market as an informational device within the KC theory of the firm, albeit in a peculiarly *negative* sense. The negative value of the capital market from an informational perspective resides in its capacity to set a minimum rate of return 'threshold' for a corporate equity investment, which is determinable 'externally' by reference to the investor's opportunity cost of capital, as opposed to being 'internally' established on the basis of the specific entrepreneurial (product market) factors affecting the firm's underlying business operations. This means that, from the shareholder's perspective, any obtainable firm-specific information becomes relevant only in determining whether their expectations in respect of any corporate investment are likely to be met, but not in setting those expectations in the first place. In this

way, the institution of the liquid capital market vests shareholders with the capacity to compensate for the inevitable informational deficit that they encounter *vis-à-vis* corporate managers consequent upon the separation of enterprise (control) and speculation (ownership). Crucially, though, the capital market mechanism achieves this end not by increasing the informational base that shareholders actually enjoy in assessing managers but, rather, by *reducing* the informational base that shareholders *need* enjoy in order to be able to make an individually ‘rational’ judgement of management.

Specifically, this minimal necessary informational base comprises the difference between: on the one hand, the firm’s rate of return on equity; and, on the other, the shareholder’s opportunity cost of capital. However, this figure is no longer considered to be a consequence of the firm’s productive and commercial operations, determined *ex post*. Rather, the opportunity cost of capital is now a benchmark in itself, determined *ex ante* by reference to external market factors. At the same time, the liquidation or ‘scrap’ value of the capital assets (both fixed and human) deployed in the company’s productive operations represents an effective ‘proxy’ for the opportunity cost of a shareholder’s investment in any firm, insofar as the relatively risk-free returns realisable from selling off the company on an asset-by-asset basis provides a base-line standard for its viability as a going concern. The enhancement of shareholder welfare, according to the above logic, is attainable either via investing in projects which are successful in ‘adding value’ (via enterprise) to a firm’s otherwise liquidatable capital asset base, or else via distributional strategies (e.g. dividends or capital repurchases) which increase the company’s rate of return on equity without occasioning a corresponding rise in shareholders’ opportunity cost of capital.

In this way, the institution of the liquid capital market provides equity investors with the capacity to undertake a continuous and generalised comparison between listed companies from different industrial and geographical sectors, even in the absence of publicly-available information pertaining to the specific circumstances and performance of each firm’s underlying business. Moreover, the aforementioned opportunity cost of capital benchmark provides investors with an operational criterion on the basis of which they can informally *enforce* value-adding managerial conduct via their subsequent decisions in both the secondary and primary markets for corporate equity.

8. A revisionist interpretation of the ‘enlightened shareholder value’ doctrine

By developing the Keynesian notion of capital market liquidity in the specific context of corporate governance, KC enables re-conceptualisation of the shareholder value norm as a purely organic, capital-market-induced institution that is *not* reliant on the pre-existence of facilitative corporate law rules. At the same time, though, KC establishes that, since the shareholder value norm evolves from an initial position of widespread investor irrationality, the mere fact of its persistence cannot be regarded

as *a priori* evidence of its overall social utility. This dual finding has significant implications for how scholars perceive the proper role of corporate *law*, and, in particular, the formal governance rights traditionally enjoyed by shareholders *vis-à-vis* the corporate managerial board.

In particular, the insights of this paper challenge the orthodox contractarian view of shareholders' governance rights as endogenous, privately-constituted 'terms' of the investor-board implicit 'contract', which represent effective 'bargaining chips' for shareholders in their ongoing dialogue with management against the background of an active market for corporate control. Conversely, this paper's findings support re-affirmation of the earlier and much-neglected Keynesian conception of economic regulation as a public mechanism for actively directing, rather than passively facilitating, the (potentially destructive) activities of financial markets in the general public interest. The purpose of corporate law, according to this conception of regulation, is to provide effective mechanisms for aligning the relatively short-term 'yield' expectations of liquid capital investors with the longer-term productive horizons of industrialists (i.e. corporate managers).

Over recent years, one of the most high-profile themes of UK public policy in relation to corporate governance has been the question of how to render the managerial norm of shareholder value more 'enlightened' or 'inclusive' in nature by engendering a longer-term 'enterprise' focus on the part of boards of directors. Within English company law jurisprudence, the success of the company has traditionally been linked inextricably to management's ability to enhance the collective welfare of its members or equity-holders, with the effect that shareholder value creation is automatically regarded to be the proper fiduciary motivation for managerial decision-making. This is largely attributable to the traditional associative basis of the English 'company' which, on a conceptual level, was formally considered to emanate from the collective agreement and endeavor of its equity investors (or 'members') as constituted in their corporate 'contract' embodied in the company's articles of association. Therefore, in contrast to the Germanic 'entity' theory of the corporation, which regards the act of incorporation as giving rise to an autonomous social organisation bearing its own independent corporeal 'interest', under English company law jurisprudence there is no discernible organizational interest (besides the collective interests of the company's members themselves) for the courts to give doctrinal effect to.^{xxxiii}

To this end, the much-debated directors' duty of loyalty under section 172 of the Companies Act 2006 provides, for the first time in British corporate law history, an express statutory definition of what is meant by the formerly nebulous doctrinal criterion of the 'interest of the company'. Section 172 provides that a director of a company, in exercising his official functions, must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders as a whole, taking into account (*inter alia*) the likely consequences of any decision in the long term plus the interests of the company's employees, continuing trading partners, contingent communities, the environment, and the company's reputation for high standards of business conduct.

Like all directors' duties under the Companies Act, section 172 is mandatory and hence incapable of being 'contracted around' in a company's articles of association. Moreover, the section 172 duty is supported by a novel quasi-mandatory disclosure requirement under section 417(5), which requires the boards of all quoted companies to report on the company's conduct in respect of the various section 172 particulars in the 'business review' section of their annual directors' report.

The conceptual logic behind the doctrine of enlightened shareholder value was essentially contractarian in nature, albeit inspired by the more progressive 'stakeholder' variants of contractarianism which became prominent in Anglo-American academic thought in the 1990s.

In essence, ESV was founded on a quasi-contractarian model of the corporation as a network of ongoing relationships between the providers of various specialist 'inputs' to the firm's production process, the preservation of which was regarded to be essential to the continuing dynamism and performance of the company's business. On this basis, the doctrine of ESV was forwarded by the government's Company Law Review Steering Group as an essentially facilitative regulatory strategy, which was designed to encourage directors to afford protection to the various intangible investments made by employees and long-term trading partners in acquiring specialized skills and capabilities of value to the company's long-term wealth-generating capacity. Whilst the Steering Group was in favour of effecting moderate reform of directors' duties in this regard, it nevertheless decided to preserve the ultimate shareholder orientation of the pre-existing common law fiduciary duty on the ground that the dual goals of long-term corporate success and shareholder welfare were by and large felt to be complementary and mutually re-enforcing criteria.

Despite the *prima facie* radical appearance of the above provisions and the increased procedural onus which they entail for public company boards today, the overwhelming thrust of academic opinion on section 172 is that it will effect relatively little practical re-orientation of directors' day-to-day strategic decisions. In particular, it has been argued by a number of scholars that section 172 does not dislodge the prevalent managerial norm of shareholder value but, conversely, serves to re-affirm this principle by doctrinally explicating, for the first time, the projected economic welfare of a company's shareholders as the ultimate fiduciary litmus test for the propriety of any course of action proposed by directors. Although some of the 'additional' factors listed in section 172(1), such as adoption of a long-term strategic focus and responsiveness to employees' interests, cast light on the general type of directorial conduct that will be conducive to attaining corporate success for the purposes of the duty, there nevertheless remains a 'doctrinal vacuum' at the heart of this provision in respect of the meaning of 'corporate success' itself. In the absence of any more developed understanding by lawyers as to what this criterion entails, there is consequently a likelihood that, within public corporations, the resulting doctrinal ambiguity will be resolved by reference to the *pre*-legal norms dictated by the capital market and, in particular, the informally-received managerial imperative of shareholder value creation.

However, if section 172 is interpreted in accordance with the logic of Keynesian contractarianism, it becomes conceptually possible to distinguish the dual tenets of corporate success and shareholder welfare, thus admitting of an independent definition of corporate success in terms *other than* shareholder welfare itself. Indeed, on a literal interpretation of section 172(1), corporate success and shareholder welfare arguably appear to be logically separate and, moreover, mutually *limiting* criteria insofar as the managerial attainment of corporate success must ultimately enhance (but *not* necessarily maximise) shareholder welfare, whilst, vice versa, the ultimate enhancement of shareholder welfare must be attained *by means of* promoting the long-term success of the corporate enterprise. Thus, if one is to understand ‘the success of the company’ as entailing something different and distinct from mere shareholder value creation itself, then, in accordance with the literal wording of section 172, the requirement to achieve corporate success should properly be regarded as a factor limiting the range of circumstances in which managers can legitimately promote shareholder welfare at the expense of other considerations.

Moreover, as explained above, within Keynesian logic the respective corporate activities of ‘enterprise’ and ‘speculation’ are clearly distinguished from one another: the former representing the activity of predicting the long-term yield on fixed (productive) capital assets, and the latter denoting the typically shorter-term pursuit of an acceptable rate of return on liquid financial assets. It was further noted above that, in a world of uncertainty, where the outcome of any entrepreneurial investment is impossible to predict by equity investors (or indeed managers) with any degree of reliability, the threshold of what counts as an acceptable rate of return on equity will be dictated by the ‘external’ opportunity cost of shareholders’ investment rather than any factors intrinsic to the corporate enterprise itself. Moreover, insofar as a corporation is continually reliant on the primary market for new capital, the resultant managerial need to maintain favour with the secondary capital market provides shareholders with an informal means of ‘enforcing’ their externally-determined expectations, thereby effecting the dominance of financial (capital market) over productive (entrepreneurial) logic in determining the corporation’s general strategies and investment horizons. In this way, the ‘end’ of corporate enterprise effectively dictates the ‘means’, insofar as the capital-market-determined imperative of ‘adding value’ to the company’s otherwise liquidatable asset base sets the yardstick by which the economic viability of managerial strategies is subsequently determined.

Against this background, the concept of enlightened shareholder value can be re-understood as a regulatory measure for reversing the above chain of cause and effect. This is achieved by placing directors under a general statutory duty to adopt, as the primary criterion of corporate success, the prospective social advantages of any investment ‘on long views’ regardless of whether the projected rate of return on equity exceeds shareholders’ opportunity cost of capital. Or, to phrase the issue another way, the criterion of *corporate* success (as opposed to ‘bare’ shareholder welfare) requires that managers do not ‘write off’ any proposed or ongoing entrepreneurial project merely because the

prospective ‘yield’ value of that project on a going concern basis is lower than the shareholders’ opportunity cost of capital, in the sense of the liquidation value of the productive assets (both physical and human) involved in that project. Such an approach does not entail reducing the lexical primacy of shareholders relative to other corporate participants in the corporate distributional hierarchy. However, it does entail altering shareholders’ capital-market-determined expectations of what constitutes an adequate rate of return, by expressly requiring that managers generate only an overall *positive* or *adequate* (rather than maximum) return for shareholders based on enhancement of total enterprise value over the long-term.

This essentially corporatist interpretation of ‘enlightened shareholder value’ views the doctrine of the ‘interest of the company’ as a publicly-determined, politically-contingent phenomenon, which represents a *countervailing* influence to the pre-legal, capital-market-determined managerial norm of shareholder value. This contrasts starkly with the traditional contractarian understanding of directors’ duties and, in particular, the fiduciary duty, as one of the range of devices available to shareholders for the purpose of reducing agency costs in their relationship with otherwise-hegemonic managers. Such a view portrays section 417(5) as a means of empowering shareholders through ‘enlightenment’ by increasing their informational awareness of wider ‘enterprise-level’ factors, whilst section 172 is presented as a fiduciary mechanism for enforcing ‘enlightened’ management on the part of directors where it is perceived to be in shareholders’ overall financial interest. The overall implication is that sections 172 and 417(5) are ultimately regulatory mechanisms for ‘empowering’ shareholders *vis-à-vis* managers and, as such, they can be viewed as something that shareholders would *themselves* rationally bargain for in the absence of impeding transaction costs. However, if one accepts the Keynesian understanding of investor irrationality and shareholder value as fundamentally *consistent* concepts, then the case for empowering shareholders by means of ‘enlightenment’ to wider non-financial considerations breaks down. Moreover, insofar as Keynesian contractarianism regards shareholders’ hierarchical primacy as being established in the absence of supporting corporate law rights, then the plausibility of section 172 as a regulatory mechanism for *facilitating* shareholder empowerment is further diminished.

9. Conclusion

Whereas orthodox contractarianism portrays corporate law rules and, in particular, shareholders' governance rights, as essentially private, facilitative mechanisms resulting from an implicit bargain between equity investors and other corporate participants, Keynesian contractarianism contrarily regards corporate law rules (and, in particular, shareholders' governance rights) as direct and deliberate creatures of the interventionist state. In other words, the fact that shareholder primacy is currently the prevalent norm of UK corporate law is due less to the (purported) social optimality of this arrangement and more to the fact that, from a public policy perspective, the state regards the doctrine of shareholder primacy as being the most effective institutional means of ensuring that the productive and wealth-generating activities of the British corporate sector are conducive to the country's overall socio-economic well-being.

This finding in turn highlights the importance of distinguishing the respective meanings of the terms 'shareholder value' and 'shareholder primacy', which many commentators (admittedly including the present author) have tended to use interchangeably. The above analysis demonstrates that 'shareholder *value*' is an organic, *pre*-legal concept, which denotes the capital-market-determined managerial imperative of generating a rate of return on equity in excess of the opportunity cost of shareholders' investment in the firm. In contrast, however, 'shareholder *primacy*' is a legally-*contingent* concept, which refers to the particular rules promulgated by the state in order to engender the development of a method of corporate governance that fulfils defined public policy objectives.

The above discussion further demonstrates that the dual tenets of 'shareholder value' (SV) and 'shareholder primacy' (SP), rather than being interchangeable or even complementary terms of reference are, on the contrary, *countervailing* concepts to a significant extent. This is true insofar as SP-oriented mechanisms (such as section 172 of the Companies Act 2006) enable the direct regulatory re-configuration of SV-oriented governance practices in the longer-term interests of productive efficiency and socio-economic welfare.^{xxxiv} By the same reasoning, though, the government's policy objectives in this regard may likewise be legitimately achieved by means of an alternative distribution of corporate governance rights amongst corporate constituents *other than* shareholders, such as by allocating full powers of control over the corporation to management exclusively in the vein of a 'pure' managerialist model, or else by dividing residual control rights between shareholders and employees via a variant of Germanic co-determination.

Thus, by analysing the relationship between capital market forces and corporate law rules through a Keynesian conceptual lens, we arrive at a more sophisticated understanding of the evolution of the shareholder value norm than that provided by the orthodox contractarian theory of the firm. This has significant implications not only for the way in which academic lawyers conceive of the corporation's underlying economic and legal structure, but also for the motivating rationale of

corporate law itself. Once it is established that the shareholder value norm is prone to evolve *inefficiently* in the presence of widespread investor irrationality, the primary motivating goal of corporate law becomes that of counteracting, rather than facilitating, the market-determined ‘default’ condition of shareholder empowerment. Accordingly, if the doctrine of shareholder primacy (as opposed to ‘value’) survives as a dominant thread of corporate law doctrine in the UK today, it is due less to the (purported) private ‘optimality’ of this arrangement and more to its political instrumentality in achieving the state’s technocratically-determined conception of the public socio-economic ‘good’.

ⁱ Transaction costs version of contractarianism assumes a degree of irrationality, but like conventional contractarianism still sees this as being *incompatible* with SV

ⁱⁱ J.M. Keynes, *The General Theory of Employment, Interest and Money* (1936), 162 – 163.

ⁱⁱⁱ *Ibid.*, 161.

^{iv} H.A. Simon, ‘Theories of Decision-Making in Economics and Behavioral Science’, (1959) 49 *American Economic Review* 253, 254.

^v *Ibid.*, 259.

^{vi} *Ibid.*, 260.

^{vii} *Ibid.*, 263.

^{viii} A.A. Alchian, ‘Uncertainty, Evolution, and Economic Theory’, (1950) 58 *Journal of Political Economy* 211, 211.

^{ix} *Ibid.*

^x *Ibid.*, 212.

^{xi} *Ibid.*, 211.

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^{xiii} Keynes, *supra*, note xx, 150.

^{xiv} *Ibid.*, 153.

^{xv} => Arbitrage = individually *irrational*, even for professional investors. This contrasts with Easterbrook & Fischel’s more optimistic portrayal of securities arbitrage as discussed above.

^{xvi} A.A. Berle, *The Twentieth Century Capitalist Revolution* (1954), 38.

^{xvii} J.M. Keynes, ‘The End of Laissez-Faire’ (1926), 289.

^{xviii} *Ibid.*

^{xix} *Ibid.*

^{xx} *Ibid.*, 290.

^{xxi} *General Theory*, *supra*, note xx, 153.

^{xxii} *Ibid.*, 150.

^{xxiii} *Ibid.*, 151.

^{xxiv} *Ibid.*

^{xxv} Keynes explained that “[s]o long as it is open to the individual to employ his wealth in hoarding or lending *money*, the alternative of purchasing capital assets cannot be rendered sufficiently attractive (especially to the man who does not manage the capital assets and knows very little about them), except by organizing markets wherein these assets can be readily realised for money.” *Ibid.*, 160 – 161.

^{xxvi} Keynes claimed that, since “there is always an alternative to the ownership of real capital-assets, namely the ownership of money and debts [it therefore follows that] the prospective yield with which the producers of new investment have to be content cannot fall below the standard set by the current rate of interest.” *Ibid.*, 212 – 213.

^{xxvii} *Ibid.*, 151.

^{xxviii} *Ibid.*, 159.

^{xxix} *Ibid.*

^{xxx} *Ibid.*, 164.

^{xxxi} *Ibid.*, 163.

^{xxxii} Although orthodox contractarianism places heavy reliance on the market for corporate control (operating in conjunction with the managerial labour market) as an endogenous device compelling deference by managers to the shareholder interest, both the above markets (unlike the market for new equity capital) are necessarily reliant for their operation on a system of legal rights establishing shareholders' collective right of appointment over the board of directors.

^{xxxiii} Orthodox contractarianism regards the company's formally corporate status primarily as a method for giving effect to the otherwise contractually-achievable legal attributes of limited liability and asset partitioning.

^{xxxiv} Against the background of this distinction, it is interesting to note the statutory rule commonly regarded as being most fundamental to the existence of the shareholder primacy norm in UK corporate governance, namely the collective power of a majority of a company's shareholders under section 168 of the Companies Act 2006 to dismiss any or all of that firm's board of directors. Section 168 arguably represents the strongest practical refutation (within a British context at least) of the orthodox contractarian view of shareholders' governance rights as endogenous, 'quasi-contractual' mechanisms. Far from being merely facilitative at the behest of shareholders, section 168 has since its inception over half a decade ago been expressly mandatory in nature and is therefore incapable of being contractually or constitutionally 'over-ridden'. Whilst the mandatory status of section 168 clearly sits uneasily within the OC model of the corporation, it can be more readily explained within Keynesian-IC logic as reflecting a longstanding public policy preference for activist shareholder governance 'by voice' (and, where necessary, managerial dismissal) as opposed to the more passive (and socially detrimental) form of shareholder governance engendered by the capital market operating alone.