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978-0-521-85638-6 - *Entrepreneurs and Democracy: A Political Theory of Corporate Governance*

Pierre-Yves Gomez and Harry Korine

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Entrepreneurs and Democracy

What legitimizes power within a corporation? This question is of concern to the millions of citizens whose lives depend upon the fate of business corporations. The rules, institutions, and practices of corporate governance define the limits of the power to direct, and determine under what conditions this power is acceptable.

Effective corporate governance has long been defined in terms of economic performance. More recent studies have focused on philosophical, political, and historical analyses. *Entrepreneurs and Democracy* unites these strands of inquiry – the legitimacy of power, the evolution of multiple forms of governance, and the economics of performance – and proposes a framework for future study. It explores the opposing tensions of entrepreneurial force and social fragmentation that form the basis of legitimate corporate governance in modern societies. In doing so, it identifies a common logic that links both the democratization of corporate governance and the growth of economic performance.

PIERRE-YVES GOMEZ is Full Professor of Strategic Management at EM Lyon and Director of the French Corporate Governance Institute (IFGE, Lyon). He has published several award-winning books in French and English, including *Trust, Firm and Society* (1997) and, with Harry Korine, *The Leap to Globalization* (2002).

HARRY KORINE is Teaching Fellow in Strategic and International Management at the London Business School and Senior Research Fellow at the French Corporate Governance Institute (IFGE, Lyon). In addition to his academic and consulting activities, he is the Chairman of the Board of Forma Futura Invest AG, an independent asset management firm based in Zurich.

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Frontmatter

[More information](#)*Contents*

<i>List of figures and tables</i>	viii
<i>Foreword</i>	ix
Introduction	1
Part I Establishing the ideological foundations: the contribution of liberal political philosophy	13
Introduction to Part I	15
1 The invisible crown: political foundations of the legitimate entrepreneur	19
1 Governance by entrepreneurial direction: the dilemma of liberty in the foundational texts of liberalism	21
2 The role of the entrepreneur in the liberal logic	25
3 The entrepreneur crowned: a modern Leviathan?	36
2 Society fragmented and the role of democracy	39
1 The freedom to become an entrepreneur	40
2 The institution of democracy or how to regulate a fragmented society	47
Conclusion to Part I	54
Part II Understanding how corporate governance evolves: the contribution of history	59
Introduction to Part II	61
3 Familial governance (c.1800–1920): economic enfranchisement and the founder as entrepreneur	64
1 The entrepreneur – a child of modernity	65

Cambridge University Press

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Pierre-Yves Gomez and Harry Korine

Frontmatter

[More information](#)

vi	<i>Contents</i>
2	Discretionary power and its counterweight: the familial model of governance 75
3	Familial governance: a politically fragile equilibrium 92
4	Managerial governance (c.1920–1970): separation of powers and management as entrepreneur 99
1	The demise of the familial model of governance 100
2	Power to the experts: managerial governance 115
3	Limiting the powers of management: technocracy under social control 124
4	Equilibrium and threats to managerial governance 132
5	Post-managerial governance (from c.1970): ownership of the large corporation reaches unprecedented mass and fragments into multiple poles 136
1	Managerial governance comes under attack 137
2	From managerial governance to public governance: two new poles of entrepreneurial power 155
6	Interpreting public governance: representation and debate signify a new step towards democratization 173
1	Two forms of governance: intrinsic and extrinsic 175
2	One model of post-managerial model governance: public governance 200
3	Synthesis: public governance in the context of liberal society 212
	Conclusion to Part II 215
	Part III Corporate governance and performance: the contribution of economics 223
	Introduction to Part III 225
7	The Pure Economic Model of corporate governance: an analysis 227
1	The paradox of Berle and Means 230
2	Reaction to Berle and Means: a Pure Economic Model of corporate governance 237
3	An economic model of corporate governance in the liberal spirit 247

Cambridge University Press

978-0-521-85638-6 - Entrepreneurs and Democracy: A Political Theory of Corporate Governance

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Frontmatter

[More information](#)

<i>Contents</i>	vii
8 Critique of the Pure Economic Model of corporate governance	251
1 Empirical failures	252
2 Internal contradictions	259
3 The unseen problem: today's fragmented ownership of property	269
9 Economic performance, corporate governance, and the fragmentation of ownership	274
1 Corporate governance as a guarantee	276
2 The economic function of corporate governance as a system of guarantee	291
3 An economic interpretation for models of governance	301
Conclusion to Part III	303
Epilogue	307
<i>Index</i>	324

Cambridge University Press

978-0-521-85638-6 - Entrepreneurs and Democracy: A Political Theory of Corporate Governance

Pierre-Yves Gomez and Harry Korine

Frontmatter

[More information](#)

Figures and tables

Figures

1 Dialectic of modern governance	<i>page 55</i>
2 Public governance: two forms for a single model	213
3 Dynamic model of corporate governance	218
4 Dynamic of corporate governance as a guarantee	293
5 Process of democratization of corporate governance	305

Tables

1 The evolution of corporate governance and the procedures of democracy	219
2 Corporate governance evolves between the entrepreneurial force and the fragmentation of property ownership	310

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978-0-521-85638-6 - *Entrepreneurs and Democracy: A Political Theory of Corporate Governance*

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[More information](#)

Foreword

Entrepreneurs and Democracy is an important and timely book. For scholars of corporate governance, the book establishes a truly comprehensive political and social context for current debates on the roles and responsibilities of investors and owners in the modern corporation. And for practitioners, *Entrepreneurs and Democracy* is a highly readable guide to the historical and philosophical antecedents of some of the dilemmas they face in reconciling the demands of diverse and increasingly fragmented groups of shareholders. For example: what duty is owed to investors who do not care about the long-term prospects of the firm and wish merely to profit from the short-term upsides (or downsides) available to them through rapid changes in stock market valuations?

Authors Gomez and Korine are suitably modest in asserting their purpose as simply to create a common space for historians, economists and political philosophers ‘to talk to each other’. In fact they embrace a breathtaking array of sources, ranging from Hobbes, Locke and Smith to Tocqueville, Schumpeter and Keynes, to create a strong theoretical basis for their central assertion that democracy is vital to the effective functioning of the capitalist enterprise because ‘democracy imposes the competition of markets on the entrepreneur’.

With their arguments firmly rooted in the domain of liberal political philosophy, Gomez and Korine advance an elegant critique of the contradictions inherent in purely economic approaches to corporate governance. Interestingly they do this without recourse to the well-established arguments of stakeholder theorists who note that the assertion of shareholder versus stakeholder rights is a distraction and a false dichotomy, if not simply redundant. Instead Gomez and Korine argue that the rights of disparate and fragmented investors and owners have never been especially important to strategic decision-making in firms – especially compared with the hegemonic influence of the family owner-entrepreneurs and technocrats who dominated corporate boardrooms

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[More information](#)

and executive suites for the first two hundred years of industrial capitalism.

The authors describe the legitimacy and credibility of the entrepreneur as a vital force in establishing the confidence of investors. And they note the historic importance of the establishment of property rights and the ability to pursue profit to the notion of liberty. But Gomez and Korine describe the emergence of shareholder activism – the attempt to assert the rights of large numbers of small investors and their fund managers – as essentially a late twentieth-century phenomenon, accelerated by the somewhat ideological arguments of neoliberal economists.

Of course any attempt to assert the supremacy of the rights of non-homogeneous shareholders of the firm as though they were a uniform entity is ultimately doomed to failure because not all investors or owners want the same thing. We have only to think about the radically different interests of mutual funds, hedge funds and social investors to understand the point. Depending on orientation, shareowners may hope for short-term gains *or losses* in share price; dividend policy may be vital or irrelevant to them; and mode of engagement of the owners (regardless of size of shareholding) may range from abject failure even to vote on resolutions to physical disruption of the annual general meeting.

Add to these observations the breaking down of traditional barriers between owners, investors, managers and workers, the emergence of civil society groups and the declining relevance of labour unions (historically the main counter to the wilder excesses of industrial capitalism) and we see that simplistic advocacy of shareholder rights in a world of global capital markets is highly problematic. In the last section of the book the authors update the conclusions of Berle and Means' systematic economic analysis in *The Modern Corporation* to take account of these institutional phenomena and the growing democratization of capital. They follow this with a very respectful *coup de grâce* to the 'Pure Economic Model' of corporate governance: 'Paradoxically, the clarity of PEM allows us to see that all of the critiques of the model have a common route: what is underestimated is the degree to which property ownership is fragmented.'

Clearly, liberal democracy demands an effective response to the problem of disenfranchisement of investors and owners, whether that phenomenon is associated with agency issues or the absence of effective

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Frontmatter

[More information](#)

Foreword

xi

information exchange, exacerbated by technological or transaction cost issues. As Gomez and Korine explain, we are too early in the game of shareholder democracy and indeed theories of corporate governance to predict exactly how things will evolve. But surely corporate governance practices will need to change to embrace the increasingly powerful democratic influences that now permeate the capitalist project.

David Wheeler
Dean of Management
Dalhousie University
Halifax
Nova Scotia