How Close is the End of History?

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I. INTRODUCTION

When I was invited to prepare a contribution to this conference in honor of Bob Clark, I was encouraged to offer some follow-up observations on the essay that Reinier Kraakman and I wrote on *The End of History for Corporate Law*.[2] Although that essay isn't highly representative of the work that Kraakman and I, either alone or together, have done in the area of corporate law, the topic is perhaps appropriate for the setting. For, while it's a casual piece, the essay at least tries to take a broad view of the subject. And Bob Clark is a master of the grand view, whether it's corporate tax,[3] corporate law,[4] or—even more broadly—capitalism[5] or the overall evolution of law[6].

At the same time, I confess to some hesitancy in returning to *The End of History*. That essay was written to capture, a bit provocatively, a particular perspective in a debate on convergence in corporate law that was just then gathering steam. It's been fairly successful in that respect. I'm concerned that any effort to amplify or qualify the piece might spoil the role it's come to play. Nevertheless, I'll take the risk and try to offer some further perspective on it.

Before we can ask whether, eight years after the article was written,[7] the claims it makes still manage to hold up, we first have to ask what those claims are. That is, just

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1. This essay was prepared for a conference in honor of Robert Clark at the University of Iowa College of Law, held on September 9 and 10, 2005. I am grateful to Reinier Kraakman for helpful conversations in the preparation of this article. He should not be tarred, however, with everything said here.

2. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001) (*reprinted in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 33 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

3. Robert Charles Clark, *The Morphogenesis of Subchapter C: An Essay in Statutory Evolution and Reform*, 87 YALE L.J. 90 (1977).

4. ROBERT CLARK, CORPORATE LAW (1986).

5. Robert Charles Clark, *The Four Stages of Capitalism: Reflections on Investment Management Treatises*, 94 HARV. L. REV. 561 (1981).

6. Robert C. Clark, *The Interdisciplinary Study of Legal Evolution*, 90 YALE L.J. 1238 (1981).

7. *The End of History for Corporate Law* was originally prepared for a conference entitled "Are Corporate Governance Systems Converging?," held at Columbia Law School on December 5, 1997.

what did we claim was coming to an end?

There are, in fact, at least three different types of claims that our *End of History* essay might be interpreted as making. I'll label them the *normative* claim, the *efficiency* claim, and the *factual* claim. I'll take them in turn, offering a few thoughts about the content and credibility of each.

II. THE NORMATIVE CLAIM

The strongest and clearest claim we make in the essay is a *normative* or *ideological* claim. It states that there is increasing consensus among the relevant actors, around the globe, that what we term the "standard shareholder-oriented model" of the business corporation is the most attractive social ideal for the organization of large-scale enterprise.

"Compared to what?" is the obvious question. The Article here sets a limited, but not trivial, standard: compared to (1) a state-oriented model, (2) a labor- (or, more broadly, stakeholder-) oriented model, and (3) a manager-oriented model.

By that standard, the normative claim is holding up extremely well. For example, in Japan, long a standard-bearer for the state-oriented model, the Ministry of Economy, Trade, and Industry has just released a "Corporate Value Study" proposing guidelines for takeover defensive tactics that are based on the "corporate value standard" and "the interests of shareholders as a whole," and that are explicitly patterned on Delaware law.[8] In Germany, once the most prominent advocate of the labor-oriented model, we now see academic commentary critical of codetermination as reducing shareholder value.[9] And in the U.S., home of the managerial model, the focus everywhere is on increasing the accountability of officers to corporate boards and the accountability of boards to shareholders.[10]

To be sure, there continues to emanate, particularly from continental Western Europe, a broad disquiet about the standard shareholder-oriented model. The perceived problem, at its core, seems to be that this model gives excessive rein to market forces in general—in the share market, the labor market, the product market, and elsewhere—and that the result is excessive social instability. In part, this seems just protectionist pleading for special interests, favoring workers who have jobs over those who do not, favoring shareholders who hold controlling interests over those who do not, and so forth. To that extent, these concerns are unlikely to maintain broad normative appeal, but rather will be accepted sooner or later as no more than window dressing for continued favoritism toward entrenched interests.

But this disquiet may also reflect a broader concern about social efficiency. For many individuals, social stability may have sufficient value to merit the sacrifice of a

8. For an English translation, see http://www.j.u-tokyo.ac.jp/~kanda/english.htm. For thoughtful commentary, see Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171 (2005).

9. *See, e.g.*, Gary Gorton & Frank Schmid, *Capital, Labor, and the Firm: A Study of German Codetermination*, 2 J. EUR. ECON. ASS'N 863 (2004).

10. There remain, of course, prominent and thoughtful commentators who buck the trend. Margaret Blair and Lynn Stout, for example, continue to extol the virtues of managerialism, in the name of protecting stakeholders. Yet even they are fairly restrained in the degree of entrenchment they seem willing to sanction.

substantial amount of productivity as measured, as it conventionally is, in terms of the net value of market transactions. If so, the legitimacy of the standard shareholder-oriented model may suffer in the long term, however much it may be in ascendance now. To probe this possibility a bit deeper, we must turn to the efficiency claim.

III. THE EFFICIENCY CLAIM

The *efficiency* claim holds that the standard shareholder-oriented model is the most efficient way to organize large-scale industry, and will remain so for as far as we can see. Can the efficiency claim be false if the normative claim is true, even if, for want of a better measure, we take (Kaldor-Hicks) social efficiency as our rough normative standard? The answer could be yes, if the current normative culture is mistaken about what is efficient. Of course, as suggested at the end of the previous section, if that is the case, then the current normative consensus may not be long-lived: we may all agree today that we have reached the end of history normatively, but someday, when we understand the facts better, we are going to change our minds, and the endpoint of history will recede into the distance.

The End of History was a bit cautious about pressing the efficiency claim. It implied, however, that there were good reasons to accept that claim. One reason was survival: firms, and societies, organized along the standard shareholder-oriented model seemed to be outcompeting those that were organized differently. Other reasons went more to logic, and to experience, with particular components of competing models. First, parliamentary institutions behave poorly with respect to markets in aggregating the preferences of a heterogeneous group. Voting control over a firm must therefore be confined to a highly homogeneous group. This makes sharing of voting control between investors of capital and other stakeholders very costly. Second, fiduciary rules are even less suitable as a means of achieving a workable balance between conflicting interests. Hence, imposing affirmative fiduciary duties on management to protect the interests of two or more groups simultaneously is unworkable. Third, thoroughly entrenched managers will too often mismanage or over-invest. Fourth, it is not possible to have state control without imposing on the corporation various objectives that are unrelated to productive efficiency. Since nothing in the foreseeable future seems likely to change these constraints on the organizational forms that are productively efficient, the principal competitors to the standard shareholder-oriented model will remain badly handicapped.

The most serious argument against the efficiency claim has a broader basis, however. As suggested in the previous section, the argument is that the standard shareholder-oriented model involves too steep a tradeoff between material prosperity and social order. It may be fine for Americans, who are intensely individualistic and place an exceptionally strong value on personal liberty. But for other societies, including Western Europe, that place a higher value on stability, the market forces unleashed by the standard shareholder-oriented model may be excessively corrosive of personal expectations and social relations. It is not crazy to feel that a leisurely daily walk to a dependable workplace in the well-preserved medieval city of one's birth is preferable to lower prices on MP3 players. If the current organization of business in a given society perpetuates the dominant role of workers, powerful families, managers, or the state, that may be seen not as a vice but as a virtue–a workable means of reinforcing the society's legitimate

structure of authority. It is from this perspective that the end of history claim is weakest.

IV. THE FACTUAL CLAIM

The *factual* claim holds that, whatever may be the case with respect to ideology and efficiency, practice and law are, as a matter of fact, converging on the standard shareholder-oriented model. Our article implied that the factual claim was true, but carefully avoided offering any timeframe for future convergence.

As it happens, convergence in fact has proceeded quite quickly in the few years since we wrote—even faster than we might have predicted if we'd been so adventurous as to try. Major corporate jurisdictions have adopted a wide range of shareholder-oriented corporate reforms, including stronger public and private enforcement, stricter controls on market manipulation and insider trading, improved disclosure, regulation of both affirmative and defensive tactics in takeovers, and limitations on unequal voting structures.[11] The interesting question here is not whether there is convergence toward the standard shareholder-oriented model, but rather how far it will go and how long it will persist.

Surely the corporate reforms that we see are driven in substantial part by the particular international economic and political context of the past two decades, which is characterized by strong international capital markets. We've been here before, namely in the decades before the First World War. Those were, in fact, the decades in which the joint stock company, in the same basic form as we know it today, came to be the standard form of organization for large-scale enterprise in all major economies. As Rajan and Zingales have emphasized,[12] war and depression subsequently led to substantial autarchy in the capital markets. That isolation, together with the turmoil of the times, allowed special interests to achieve vested power in corporate structures. It was in this period that nonstandard corporate models arose: employee participation as in Germany, state corporatism as in France and Japan, family dominance as in Sweden, and managerialism as in the United States. Only recently have world capital markets again opened up, and this surely goes far in explaining the recent rapid convergence toward the standard shareholder-oriented model.

If and when, once again, something happens to close down the world's capital markets—paranoia about terrorism, perhaps, or confrontation between great powers—then, even if the standard shareholder-oriented model of corporate capitalism is efficient, leading societies may once again start moving away from it, adopting corporate structures that give the state and/or important private interests more control. Today we see both China and Russia struggling with the tradeoff between state control of enterprise and access to capital on the international markets. Though both have, with occasional backsliding, resolved this tradeoff recently in favor of access to capital, and hence movement toward the standard shareholder-oriented model, it might not take much of a

11. *See, e.g.*, Marc Goergen et al., *Corporate Governance Convergence: Evidence from Takeover Regulation Reforms in Europe*, 21 OXFORD REV. ECON. POL'Y 243 (2005); Ehud Kamar, *Beyond Competition for Incorporations* 11-27 (Univ. of S. Cal. Law, Legal Studs. 05-13, 2005), *available at* http://ssrn.com/abstract=720121.

12. Raghuram Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the 20th Century*, 69 J. FIN. ECON. 5 (2003).

shock for either or both to decide that they prefer strong state control.

Ancient Rome, it appears, had by the end of the Republic developed a widely used entity form with publicly traded shares that was close in structure to a modern joint stock company.[13] The form was then abandoned under the Empire, in important part because the emperors wished to centralize state authority, and hence nationalized the activities that had been conducted by those large companies. Subsequently, nothing like the business corporation reappeared until 1000 years later, when the merchant-dominated Italian city-state of Genoa, facing a highly competitive international market, resumed the experiment.[14] As we march toward the end of history, further interruptions of this sort may await us. Or, to put it differently, one's faith in reaching the end of history for corporate law may be closely tied to one's faith in achieving Fukuyama's original *End of History* in politics.[15]

V. IS CORPORATE LAW DECONSTRUCTING?

In more recent work, Kraakman and I have focused on the long-term evolution of organizational law, and on its likely future development.[16] As we've emphasized there, the law of commercial entities has become ever more flexible, to the point where today an entity with the special form of asset partitioning provided by the corporate form—strong entity shielding[17] and limited liability—can be given any desired pattern for allocation of control and earnings, and not just those of the traditional business corporation. Moreover, these more flexible forms are being widely used; the LLC is quickly surpassing the business corporation in numbers of new entities formed. At the same time, intra-firm asset partitioning is becoming ever more fragmented and complex, as firms create increasing numbers of subentities, which themselves have a variety of different ownership and control structures.[18]

Might one conclude from this that commercial entities are deconstructing? Is the simple standard publicly traded business corporation—with earnings and control rights allocated uniformly across a single class of common stock, with governing authority delegated to a simple elected board, and with all of the firm's assets assembled in a single pool to back the firm's general obligations—simply a transitory form, well suited only for the particular phase of industrial and social technologies of the past two centuries? Might we see, to take just one possibility, that the monolithic business corporations of today

13. ERNST BADIAN, PUBLICANS AND SINNERS: PRIVATE ENTERPRISE IN THE SERVICE OF THE ROMAN REPUBLIC (1972); Ulrike Malmendier, *Roman Shares*, *in* THE ORIGINS OF VALUE: THE FINANCIAL INNOVATIONS THAT CREATED MODERN CAPITAL MARKETS 31-42 (William Goetzmann & Geert Rouwenhorst, eds., 2005).

14. *See* Guido Ferrarini, *Origins of Limited Liability Companies and Company Law Modernisation in Italy: A Historical Outline* (Centro di Diritto e Finanza, Working Paper No. 5-2002, 2002), *available at* http://www.estig.ipbeja.pt/~ac_direito/Ferrarini3.pdf.

15. FRANCIS FUKUYAMA, THE END OF HISTORY AND THE LAST MAN (1992).

16. Henry Hansmann, Reinier Kraakman, & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1335 (2006); Henry Hansmann, Reinier Kraakman, & Richard Squire, *The New Business Entities in Evolutionary Perspective*, 2005 ILL. L. REV. 5 (2005).

17. Or "strong form affirmative asset partitioning," as we dubbed it in Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 404 (2000).

18. Enron's capital structure is a striking and familiar example. The struggle over treatment of subentities in bankruptcy continues. *See In re* Owens Corning, 419 F.3d 195 (3d Cir. 2005).

give way to fluctuating sets of overlapping alliances of protean form, as sociologists have been inclined to see in high tech industries?[19]

The answer, I suspect, is no. The greater flexibility offered by the new forms—which, in any case, does not represent much of a step beyond what could already be done in practice with the close corporation—will continue to be used largely by closely held firms. Publicly traded firms will continue to have the conventional simple standard structure of ownership and control. There is likely to be more subpartitioning of assets among classes of creditors than in the past. But there will not be much subpartitioning of earnings or control rights—of the type that was experimented with in tracking stock, for example—within any given publicly traded firm. Nor will closely held firms displace publicly traded firms as society's dominant producers of goods and services.

Of course, there may well be future changes in industrial and social technologies that will ultimately call for new forms of organization for productive enterprise that we have difficulty seeing today. Yet there have been large changes in these regards over the two millennia separating us from the Roman Republic, and we nevertheless organize our largest firms in a fashion that the Romans would find familiar.

VI. A MATTER OF DETAIL

Finally, there is the question of the level of detail at which one sees convergence. Just how will nomination of directors be handled? What is the proper balance between public and private enforcement of manager duties? How will mergers and acquisitions be regulated to prevent either too much managerial discretion or too much abuse by majority shareholders?

The *End of History* essay carefully avoided saying anything specific about such matters. And with good reason. There will probably never be perfect homogeneity in the approaches taken to these issues, not only across jurisdictions but even within any given jurisdiction over time. This is not only because the political power of the various interest groups involved will remain in flux, but also because, even from a pure efficiency point of view, the best approach depends heavily on background factors such as the patterns of shareholdings and the nature of the shareholders, and these in turn are likely to adapt to the prevailing rules in ways that either undermine the effectiveness of those rules or, conversely, reduce the importance of the problem to which the rules were originally addressed.

Of course, it might be said that this leaves most of the important and interesting debates within corporate law today untouched by our thesis. And, admittedly, that's not an unreasonable thing to say.

VII. CONCLUSION

While there are many fine textbooks on corporate law on the market today, for many of us there has never really been an adequate successor to Bob Clark's superb *Corporate Law*. The duties of governing his fractious faculty have understandably distracted Bob too much in recent years for him to keep that volume up to date. And now that he's free

19. *See, e.g.*, Walter Powell, *Inter-Organizational Collaboration in the Biotechnology Industry*, 152 J. INSTIT'L & THEORETICAL ECON. 197 (1996).

of those duties, he may have other projects on his mind. But if he should return to the book, I suspect he would not find revision a terribly difficult chore. The issues are essentially the same, and so are the available answers.[20] And his next edition can be an international one. History has been on his side.

20. Kraakman and I have offered our own perspective on the issues and answers in REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL PERSPECTIVE (2004).

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