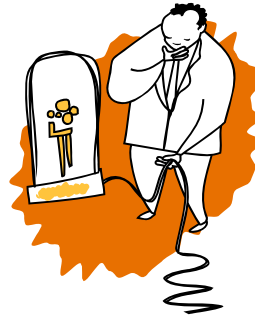


The Corporation and the Free Market

Peter G. Klein
University of Missouri

Mises University
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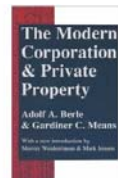


Corporate governance

- ▶ Separation of ownership and control (Berle–Means problem)
- ▶ Note on **delegation**
- ▶ Internal control mechanisms
 - Board of directors
 - Proxy contest
 - Performance-based compensation
 - Market for managers
- ▶ External control mechanisms
 - Product-market competition
 - Discipline from suppliers of capital
 - Market for corporate control (Manne)
 - ▶ Mergers
 - ▶ LBOs



Adolph A. Berle, Jr. (1895–1971)



Mises and corporate governance

▶ On the stock market

[The Berle–Means doctrine] disregards entirely the role that the capital and money market, the stock and bond exchange, which a pertinent idiom simply calls the “market,” plays in the direction of corporate business. . . . [T]he changes in the prices of common and preferred stock and of corporate bonds are the means applied by the capitalists for the supreme control of the flow of capital. The price structure as determined by the speculations on the capital and money markets and on the big commodity exchanges not only decides how much capital is available for the conduct of each corporation’s business; it creates a state of affairs to which the managers must adjust their operations in detail.

— Mises, *Human Action* (1949), pp. 306–07.

▶ On market socialism

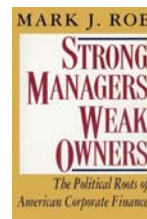
Is the market for corporate control efficient?

▶ The volume of takeover activity

- Empire-building: too many takeovers?
- Free-rider problem: too few takeovers?
- Raiders as entrepreneurs

▶ Government intervention and corporate governance

- Promotion of “bureaucratic management” (Mises)
 - ▶ Taxes and regulations that distort profit
 - ▶ Laws interfering with hiring and promotions
 - ▶ Threat of arbitrary antitrust or regulatory activity
- Restrictions on institutional ownership (Roe)
- Anti-takeover legislation



The corporation and the state

- ▶ Is the corporation a creation of the state?
 - Two kinds of limited liability
 - The history of corporate law
- ▶ Government intervention and firm size
- ▶ Problems with alternative organizational forms
 - Sole proprietorships and partnerships
 - Worker-owned cooperatives

Can the government protect shareholders?

- ▶ The general problem: government regulation of quality and safety
- ▶ Fooling all of the people all of the time
- ▶ Government failure (Giuliani, Spitzer)
- ▶ Securities laws and regulation
 - Disclosure rules
 - Prohibition on insider trading
 - Separation of auditing and consulting
- ▶ Enron, WorldCom, and the free market