

The Birth of the Regulated Company in the Macroeconomic Environment*

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Abstract. *This research analyzes the mode of evolution of an economy at macroeconomic level, backward-pyramidal evolution from the capitalism structure, the appearance of the free enterprise and the corporate form of business organizations in our free market based system, at microeconomic level.*

The purpose of this paper is to enter the understanding of the specificities of the plurality of facets of the governance process. The target of this research paper are privately owned companies, but held publicly (by social parts owners or shareholders) and expressed through the state – corporation relation with its geo-social-political-economic influences.

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Introduction

The society from developed countries in the 21st century is living from the unprecedented prosperity, stemmed by the crisis which began in 2007 and it is foreseen to finalize in the last quarter of 2011. These nations have produced the highest life standards for the majority of people along history. How did this happen? It is believed that the origin of this prosperity (before and after the crisis) stands in the development of an economic system which embraces, mostly, the free enterprise, capitalism and competition. The free enterprise brings to the economic systems from developed countries the “energy” developed by competition, in which the creative minds of many individuals are liberated to follow their own interests, the more unsuppressed by regulations the better. Adam Smith wrote, firstly, in 1776 that “an invisible, self-interested hand” moved to create an entire environment for “everyone’s interest” when each of us acts on maximizing self interest (Smith, 1994, p. 148). The initial step in the amazing journey of economic development was realizing the fact that the supreme good is created and served by each of us only by the maximizing of our selfinterest. Sometimes counterintuitive on some aspects, the idea remains a revelation after 234 years from its appearance.

The concept of effectiveness of the invisible hand brought the logic of a secondary notion, that individuals that follow separate interest create intersections between the interests of them and have as an objective result the natural state of competition. Usual for the business environment, it is sustained through competition the framework for raw materials, labor, clients and investment capital. This competitive environment leads to the “survival of the fittest” which establishes the idea that, in time, some people can be afraid of the stopping of evolution by the weak; this is, actually, the most energizing aspect of the free enterprise system and competition. The third aspect of our economic system is the development of modern capitalism, in which investors capital can be united to create large amounts of investment capital necessary to finance extensive projects and large enterprises. It is an axiom that the more leeway for corporate enterprises in searching for higher profits the greater the tilt for individual and institutional investors, who can bring the necessary amount of capital. The three milestone points of the global economic system, then, will be the enterprise, competition and capitalism.

With the development of the economic system, the enterprises of an unprecedented size and complexity prospered. The obvious question was: How can these enterprises be led in the best interest for the shareholders? The premise from which we started is that governance, as we know and practice it, made the difference at macro-social, political and economic level – and at

entrepreneurial-individual level: corporate governance. Without an effective governance system there would be chaos in the inter-human relations framework. Governance is the one which establishes order in chaos. When this individuals live together in communities, there must be laws and rules about the way they relate to each other, because the conflict between them is an inherent fact through human condition. A big part of this conflicts result from different personalities and beliefs and natural competition for the limited resources. Some of them have complicated, moral issues because they fact on the lack of respect and worries for the life and properties of others, based, in turn, on basic human needs.

The moral conflict shows two faces of human nature: the good and the evil. We see the good in love and in altruism, acts of courage, acts of genius represented through the development of arts and sciences and acts of integrity, honor and duty. We see the evil in acts of hate, greed, tyranny, oppression, cowardice and lack of honesty. This kinds of battles between the forces of good and evil were the core of human drama from the beginning of time. The battle takes place in each conscious individual and between individuals and group of interests. This conflicts can be observed deploying and in other forms of government which can be observed on the all surfaces of the Earth and, normally, in the business environment.

1. The evolution of governance

In ancient times, hard labor of subsistence was gradually transformed, by the invention of tools, this being the beginning of technology. By the development of new sources of energy – first was the steam engine and, then, electricity and the internal combustion engine – have appeared machines which substantially improved productivity. In the last 60 years the technological advance exploded in all domains, based on the invention of the transistor. Once with the development of the digital technology, we had the revolution of electronics, communications, transportation, medicine and other forms of manufacturing, underlined by an exponential growth of the ability to gather and disseminate information. A necessary bind of these revolutionary forces has been the promotion of universal education. The innovation that made education available to masses was the invention of the dynamic print by Gutenberg in 1438 and the evolution of printing which fallowed through the growth of the literary background, this way becoming the foundation of the educated population. The impact of this innovation is noticeable in the old saying: “We learn to read so we can read to learn”.

As the literature developed education which brought the appearance of technology, so there was a comparable evolution in the way how our businesses are led. Individuals live in communities from the beginnings, firstly hunters, gatherers, fishermen, agricultural society and, today, industrial society. From outside, humanity hoped to discover the best ways to take decisions regarding communities – ways of governing disputes, control of the destructive behavior and to achieve goals which advance common welfare of members of the society. The effectiveness of a given governance approach was determined on the will of survival and prosperity of the society. In the beginning, the groups of individuals were small, simple and located in one place. Their governance process was simple. Through time, these groups have become large, complex, vast organizations. Tribal and feudal fiefs have evolved to nation states. Small, local properties have evolved into mega-corporations. The decision-making process has grown to reflect more and more complex government problems.

Among primary innovations in this journey from simplicity to complexity in governance there were the social revolutions of the 18th and 19th centuries, especially the American revolution and the French one and the period of illumination that followed them. Primary for those times, while the society was changing, these became more stratified, with small, ruling classes which accumulated wealth generated by the subdued masses. Wealthy nations became stronger, by force, colonizing weak nations, especially the ones rich in natural resources, for centuries, the governance was exercised by the few who imposed their point of view on the many. The powerful dictated until they were removed by internal riot or external defeat. Although the basic nature of the society changed; it was a simple case of through which monarchy changed with dictatorship and vice versa. Some changes were competent and willingly, after which nations benefited from, too, but, most common, there was much incompetence, corruption, oppression and rebellion.

The innovative governance system resulted from the action of individuals, not from the evolution of legal principles. When individuals gained power, they have imposed by forced oppression, creating revolutions. Social revolutions which followed were fed by the hunger for individual freedom and the wish for the moral imperative of how people should to behave between them. From this revolutions appeared the modern concept of democracy – a rule from the people, of the people and for the people – a concept exemplified through the Constitution of the United States of America and cleared by Abraham Lincoln's speech at the battle of Gettysburg.

2. The governance made the difference

The American experience in governance was a fragile experiment, first of its kind and with major influences on what it is now, after more than two centuries till then. It doesn't needed to succeed. Then South America was developing in a number of individual states at the same time as USA. South America have had big problems in establishing a democrat or stable regime, until today. The 20th century brought the rise and fall of totalitarian regimes from Germany, Japan and Russia, with a lot of suffering brought to the nations from surrounding areas. The end of colonial imperialism in Africa fallowed by World War Two have resulted in a continuous political instability and blood shed and in other parts of the globe, too. This experiments of self-governance in the entire world didn't succeeded not till today. We can say that today peace and prosperity are synonyms with stable and democratic governments. Nations led by totalitarian regimes through a model or another don't succeed to reach any of the previously exemplified goals.

In nation states, the governance makes the difference between the success of that society, but the good governance can not be taken for grant, by the principle: "Believe and do not." Without political and economic systems, it is almost certain that no society can reach peace and sustained prosperity.

3. Capitalism

An fundamental chapter in the evolution of governance has been the developing of the competitive economic system based on the free market which has taken us to the prosperity from three years ago, seen with small regulating syncope (self-regulating) through the crises from 1929-1933 and 2007-2011 (the crises are underlined by the theoretical approach of long cycles, Kondratiev type). Democracy created a context in which the economic system based on the free market, entitled "capitalism", can evolve. There is a clear and logical link between the concept of individual political freedom and the freedom of individuals in fallowing their economic interests. As I mentioned earlier, Adam Smith, in the classic paper "Wealth of Nations", written in 1776, described "an invisible hand of the self-interest" as being in the center of human behavior. In antithesis of negative viewing it in terms of morality, he saw it as a main inner force for economic and social development. A paradox resulted from the development of capitalism is that the collective pursuit of self interest created the prosperity from which we can all benefit. A concept that remains problematic is: "the tension between accumulating goods and nurturing of goodness, which appeared early in the American experience and rooted"

(Shi, 1985, p. 8). The role of the economic system is to supply goods and services which satisfy the needs of individuals and during the economic process can offer jobs which create revenues with which they can buy the goods and services needed and/or wanted. In a weak economy, people fight only for survival, falling prey to illness and famine. A controversial fact is that an economy that creates revenues is not necessarily an economy with high moral standards, everything depends on how wealth is created, on how it is distributed and on what is used for. Finding the equilibrium between “goods and goodness” it is a continuous debate. This is not the purpose of this paper and, for now, there can not be highlighted any solutions for this situation. Although, I want us to understand the importance and relevance of contemporary society. Clearly, ethical and moral considerations which have to enter not only in the governance of nations but and in commercial enterprises, like today the right road is relearned despite all detours on sinuous and dark ways of quick, unreal and irrational enrichment which led to the global economic crisis in which we are still in.

4. The game

The business operation in complex economic systems, each with their own characteristics of ecology (with the sense of auto regulated system of internal implementation). We can observe this systems by using the analogy with a game, where the participants compete within the limits of the games rules to get in front. This kind of games are played during history and developed at a complexity and at a level, with most of its changes spent during the last two decades. Initially, the games were local, evolving from villages to communities and to small geographical regions. In the last hundreds of years, these rose until covered whole nations. Now, the games have become global, with interconnected nations in economic unions (Cairncross, 1997, p. 119). In the majority, the rules of economic systems which we describe are predominantly determined for member countries of economic alliances.

The nature of the game in each nation reflects a number of variables: culture, education of population, political system, geography and capital and available natural resources. This attributes influence the creation of the infrastructure which can sustain the game. Of special importance in infrastructure is public safety, national transportation system (roads and railways) and the legal system (the penal and the civil one). The penal system protects people and the property and ensures the internal social order. The same we can say about an army that can protect the nation of an imminent attack. The civil system arbitrates and reinforces contracts and property rights. We find that

in the context of the resulted organizational infrastructure, the game is influenced and substantially determined by three separate institutions: the govern, governing and regulating agencies and by that individuals or groups who choose or are forced to operate outside the rules of the game.

4.1. Governance and the game

State and local, the ruling entities (parliament and presidency) and many government agencies write, approve and interpret the rules of the game. Especially, the president has an important role in this process, first of all, through his veto-right and by executive orders (these are executed together with the prime minister). In a democracy, individual constituents, as well as interest groups try to influence writing of laws in their favor. That is why, a part of the game implies the efforts of changing the rules of the game.

The governance system can create rules which strengthen or weaken prosperity. This is a complex element which is the source of constant debates and of considerable tensions. Social conscience and populist politics push us to a broad distribution of wealth, the extreme logic is an strong regulated social system (for example: Cuba or Columbia – the result it is extreme poverty for the population). Where this social systems were tested they failed lamentably at growing the revenues for the masses. This kind of systems don't include scope oriented productive behaviors of individuals. On the other hand, letting the wealth to reach, disproportionate, in the hands of interest groups was destructive for prosperity. The big challenge for this economic game is to find the equilibrium between these limits. What a society does with a part of its output is the influencing of its own economic system and, cyclic, the future output.

4.2. The structure and the game

While legislative entities and regulation agencies write the rules at macro-level, this rules are interpreted and put in practice by regulation agencies and the judiciary. The application of these implies monitoring of the taken actions and by those who play the game to find out if the rules were broken or are going to be broken. In democratic countries, this attributes of implementing the rules have created tensions between privacy rights and the power of the police in protecting common goods. The courts, which represent law enforcement, judge based on them and suffer from conflicts of interpretation, complex negotiation and locating on unstable field.

4.3. The ones outside the game

The majority of individuals and of corporate entities participate in the game and operate by its rules and regulation. There are two groups that are not in the game. One from these groups form the underground economic, from which take part the ones who play “outside” the rules. Ironically, the underground economy is based on strict rules of the game which create opportunities on the black market. This kind of rules are meant to strengthen morality, as an example, trying to limit the invasion of drugs, prostitution, illicit gambling and/or pornography, but, usually, creates negative and unwanted consequences by creating the underground economy of illicit goods and services. The second group “outside” the game is formed by those that can not or do not want to be part of the workforce. Social programs led to the creation of new members in this group, other members of the group do not have the necessary skills, the knowledge and work ethics to gain a living in a increasingly more complex work environment. More of that, over the years, many people were excluded from effective participation at the creation of the economy because of prejudices.

Those outside the game, at a minimum level, are a brake for it, but they represent a latent threat. They can destroy the game if they form a mass big enough to create its own political capacity or to riot, like they did it in many countries. In simple terms, if too many people are left behind and they can not participate at the capitalist system, the society will suffer a promulgated revolution by those outside it. It results that it is in the interest of those situated in the game to try to introduce those outside it in.

The result of the writing and the applying of rules, the governance process is the competitive environment in which the game is played. This environment is favorable or unfavorable in creating wealth. The whole world has experienced in the last century close to 70 years of the most flourishing years in history. They were sprinkled with two global economic crisis and two world wars.

The extraordinary challenge for those involved in the national governance process is that if we can return, maintain or improve an adequate level of global wealth or if will succeed to repeat in a couple of years the history of severe economic cycles and the personal suffering which unavoidable accompanies them.

5. The company

Among the most important rules of the game that evolved during time are those that addresses to the form of governance of business organizations. We take the corporative form as a given good these days, but the company/corporation is a relatively new form of organization, as it fallows.

The non-business companies are forms belonging to ancient times, initial being used for organizing towns, guilds and colonies of Rome, and in the early middle ages, these were used for universities, religious orders and other voluntary organizations that performed civic services, being, thus, subject for licensing and government surveillance. The Muscovy Company in 1555, the Spanish Company in 1577, the East Indies Company in 1601 were the first businesses with the shape of an incorporated cluster (early economic organization – precursory to the today’s multinational companies), all being created under the regime of Queen Elizabeth I of Great Britain. The London Company, that shortly renamed as Virginia London Company, appeared in 1606 (Beatty, 2000, p.6). Before the appearance of the corporation/company, businesses were organized in common properties or in partnerships.

The Supreme Court of the United States of America, under the ruling of supreme judge John Marshall, has created the necessary legislative framework for the existence of corporations/companies as we know them this day, at the beginning of the 19th century. Marshall, himself, has defined the corporate status in “Dartmouth College vs. Woodward” in the following terms:

“...A corporation is an artificial being, invisible, intangible and existing only in the contemplation of the law. Being the mere creature of law, it possesses only three qualities which the charter of its creation confers upon it, either expressly or as incidental to its very existence... (the most) important are immortality and, if the expression may be allowed, individuality; properties by which a perpetual succession of many persons are considered as the same, and may act as a single individual” (Johnston, 1997, p. 560).

To summarize, the corporation/company is a creation of the law and has legal interpretation independent of its owners. Three functions made the corporation attractive: eternal life, limited responsibility and the division of ownership that allows the transfer of ownership rights without creating ruptures in the organizational structure. In the last years, the taxonomy became more and more problematic, especially at the moment of the occurrence of the economic crisis, because of the plurality of types of companies that were created (international regulations call these companies: C. Corporations), here appears the major difference between the structures of corporations at international level: limited responsibility companies

(LLC – limited leverage company) benefit from a corporative form, but incomes are charged at owners level. This fact contrasts with traditional corporations, where the corporation, itself, pays income taxes and not the owners. After the appearance of the legal framework, the corporation became a preferred form of organizing for big companies. In 1919, corporations, represented 31.5% from total global businesses, hiring 86% of the existent workforce and producing 87.7% of the total global income. (USA Government, 1919, p. 340).

6. The trust

Another form of organizing was experienced at the middle of the 20th century by J.P. Morgan, financier, who assumed the role of unofficial guide and law creator in the absence of federal regulations. Paul Johnson, in an exceptional book, “History of the American People”, wrote that J.P. Morgan:

“...The tendency of economic activity in a free society was to produce primeval chaos, in which men fought savagely for supremacy and countless sins were committed. Freedom was needed for economic society to function efficiently, but the resulting chaos generated inefficiency as well as sin. He reasoned that some degree of order was needed, and that order could best be brought about by forms of economic concentration that imposed a degree of order without inhibiting freedom to the point where efficiency was again endangered. This valuable concentration was achieved by the corporation and the trust” (Johnston, 1997, pp. 559-560).

The story of the appearance of trusts is a complicated one. During the Civil War, USA have followed the high tariffs policy to protect their developing industries. Protectionism through high taxes was maintained by state independent corporations, which joined together to grow their political influence on USA’s government. Learning to cooperate, a number of industries have started to form trusts; sugar, tobacco, railways, bovine and oil are only some examples. Trusts reduced competition and have encouraged monopoly, as an addition to the given situation. Then the justice courts interfered and by the panic from 1893, the antitrust laws have appeared. This effort in organizing of the economic activities wasn’t legal anymore or, as time has shown, efficient.

7. The role of corporate governance

The same as with nations, governance is important in the success of individual commercial enterprises. An examination of successful businesses sustained during long periods of time shows that the board governed business

relations with efficacy (Taşnadi, 2009). The same with weak performance business, it is a normal thing to follow the problem line to the board of directors which did not observed with efficiency the business's problems (Vâlceanu, 1998, p.88). The general press shows regularly examples from the hierarchical latter, and the business press underlines rarely boards of directors with strong performance (Freeman, 2005, p. 202).

The management of the corporation is established under the leadership of a Chief Executive Officer (CEO), which reports to a Board of Directors. While the board plays many roles, the organizations understand a broad area of purposes that can be reached, this research is focused on the management/leadership/governance of stock companies that are opened to the large audience, which have as purpose the creation and serving consumers, and, if it is well done, it leads to awarding the company through profitability and value growth of stocks.

A separation between closed-private owned companies and those opened-private owned companies is that closed-private businesses tend to be directly led by the owner (boss-principle). Because the owners of private businesses are directly involved in their enterprises, they are better informed about the business relations and they represent only their own interest. They aren't empowering their control to a representative board of directors, resulting in the appearance of some potential conflicts of interest that can exist between investors and those that they hired to represent them in the business's management. Even so, many of the governance principles that apply to opened-private owned companies have applicability in those closed-privately owned.

Conclusion

This paper is chronological and logical review of the evolution of the business environment that underlines the emancipation of the governance of commercial unions, geographical regions, countries and companies through the implementation of framework, regulation, bylaws, common sense and good will, facts that today are overruled by the banking system through its core business degenerating into a world of derivatives, OTCs, margin contracts and investment banking situated on the thin line between licit and illicit economic activities, that, in the end, is tracked down to the economic recession that we are trying to suppress in these days of artificial sorrow sustained through the incompetent management of nations.

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