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Paul S. Edwards

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Organizing the Socio-Legal Study of Business Associations

Paul S. Edwards†

I. INTRODUCTION

In *Criteria for Good Laws of Business Association*¹, Professor William Klein has provided useful normative parameters for the law of business associations. I believe, however, that we still have much work to do in trying to understand the positive parameters of the law, especially in a field where the object of study continues to evolve rapidly. This essay draws from the spirit of Klein’s Criteria Project to suggest three major areas of socio-legal inquiry into the law of business associations, namely, private governance, the political economy of business associations, and the role of business association law in facilitating entrepreneurship. It also argues that such inquiry should be conducted through close empirical fieldwork.

Much corporate law scholarship has been driven by high theory,² and much of this inevitably has a normative bent. Although steeped in both the major theoretical debates and the finer points of legal doctrine, I have admired William Klein’s scholarship less for its normative content than for its challenge of conventions and assumptions, always in ways that point to interesting empirical questions.

For anyone interested in a more robust agenda for socio-legal understanding of contemporary business association, Klein’s Criteria Project provides the beginnings of a useful roadmap for identifying the positive parameters for organizing the study of business associations. In some ways, however, Klein’s categorization periodically mixes functions that could be usefully disaggregated and reconfigured. Therefore, the task of this brief essay is to identify what I think is most salient in Klein’s criteria for the socio-legal scholar seriously interested in studying the institutions that govern contemporary business associations.

† Distinguished Research Scholar, Mercatus Center at George Mason University and Provost, Southern Virginia University. This essay was written for the Criteria for Good Laws of Business Association Symposium, January 8, 2005, sponsored by the *Berkeley Business Law Journal* and the Mercatus Center at George Mason University. Special thanks to Peter Boettke and Paul Aligica for their thoughts and comments on this essay.


Klein categorizes his Criteria into four broad areas: (1) Public and Private Fairness, (2) Economic Goals, (3) Control of Political and Economic Power, and (4) Minimizing Costs of Administration and Compliance. Although this categorization may work for the normative project, for the socio-legal scholar it clumps together too many institutional functions. I therefore recommend that for the socio-legal study of business organizations, we should adopt a framework attuned to important social functions served and influenced by business organizations, but that still takes seriously the individual criteria identified by Klein as potential variables.

II. PRIVATE GOVERNANCE

For the scholar interested in understanding the performance of the broad institutional framework for business associations, it is useful to distinguish between institutions and organizations. Institutions are the formal and informal rules of the game, whereas organizations are the individual actors that play the game. In the positive evaluation of business association law (the institution), we necessarily encounter business associations (the organizations). These organizations enjoy distinct legal status because of the institutional background. And what makes contemporary business associations so intriguing to theorists are all the potential conflicts of interest and agency problems associated with that legally imbued status. In short, within contemporary business associations are myriad issues of governance that raise issues of private fairness and efficiency. Rather than confuse issues of public (or institutional) fairness with private (or organizational) fairness as Klein does with his first broad categorization, I recommend that socio-legal scholars focus on each issue separately. And due to my own bias towards inductive social science, I recommend that we concentrate first on what Klein would call the “private fairness” issues associated with the challenging task of governing an organization. I acknowledge that corporate governance scholarship has access to empirical work. But I have found that the work done in the corporate governance literature is rarely as nuanced and fine-grained as the work done in the best social inquiries into governance structures.

Consider, for example, Elinor Ostrom’s superbly crafted work on the governance of common-pool resources. Common-pool resources theoretically face many of the same types of informational, agency, and enforcement issues that are theoretically associated with corporate governance. There is much to commend in Ostrom’s work, but let me note in particular her ability to observe

what actually happens without falling under the sway of the prevailing
orthodoxy of high theory. By doing rigorous empirical fieldwork into how
people actually solve the difficult problems of governing common-pool and
community resources in Africa, Asia, and Latin America, Ostrom has
questioned the applicability of formal modeling for establishing widespread
policy about governance of resources. Where non-cooperative game theory
would suggest the need for prescriptive central actor solutions, Ostrom has
found in the field, time and time again, that local groups have created a wide
diversity of institutional arrangements for community cooperation over
common-pool resources that outperform central-actor solutions. She has also
found numerous cases where resource users fail to self-organize. Therefore, the
central question in Ostrom’s work becomes why self-organization is
successfully undertaken in some cases and not in others.5

Much of the contemporary approach to the theory of corporate governance
derives from non-cooperative game theory. I contend that without rigorous
fieldwork into the actual workings of corporate governance, the assumptions
that drive rigorous modeling may lead us to provide solutions in instances
where there are no problems. Before wading into the issues of what Klein calls
public fairness, socio-legal scholars need to do rigorous fieldwork into actual
governance so that they can understand how contemporary business practice
deals with issues of private governance. This empirical inquiry can make use of
Klein’s many criteria associated with private fairness, such as how
organizations actually allocate risk and loss, what rights they provide to
shareholders, how they prevent the abuse of power within the organization, and
so on.

III. POLITICAL ECONOMY OF BUSINESS ASSOCIATIONS

Of course, Klein’s concern about public fairness is entirely appropriate for
empirical inquiry. This is what I would call institutional analysis. I would
suggest, however, that instead of invoking the normative language of fairness,
that socio-legal scholars should recast this inquiry into the language and
methods of political economy.6 Corporations derive their unique legal status
and benefits from their state-granted charters. Business associations working
within highly regulated fields (e.g., pharmaceuticals or telecommunications)
gain or lose competitive advantage depending upon the scale and scope of the

5. See Elinor Ostrom, Institutional Arrangements and the Commons Dilemma, in RETHINKING
INSTITUTIONAL ANALYSIS AND DEVELOPMENT (Vincent Ostrom et al. eds., 1988).
6. See, e.g., Jagdish N. Bhagwati, Directly Unproductive Profit-Seeking (DUP) Activities, 90 J.
POL. ECON. 988 (1982); Robert D. Tollison & Richard E. Wagner, Romance, Realism and Economic
Reform, 44 KYKLOS 57 (1991); Gordon Tullock, The Welfare Costs Of Tariffs, Monopolies, and Theft, 5
W. ECON. J. 224 (1967).
regulatory regime. And because of the scale of modern multinational corporations, along limited margins business associations can actually rival states. The resulting strategic game played between business associations and relevant state actors is of enormous importance for public fairness. And Klein’s public fairness criteria can become useful guides for empirical inquiry. For example, to what extent does the political economy of business associations attempt to redistribute wealth? How objective and stable are the laws of business association? Who are the weak and the strong in the system, and how are their interests protected? Nonetheless, let us strive to understand the strategic parameters first.

IV. FACILITATION OF ENTREPRENEURSHIP

One can imagine a world with effective corporate governance (for example where conflicts and agency problems are minimized), with a sound political economy for business associations (such as where rent-seeking and expropriation are minimized), but without significant innovation. It is notable that implicit in many of Klein’s Criteria is a concern that we create the proper incentives to encourage innovation, both organizationally and within product markets. And this makes sense given what we know about innovation within a market system. How well our institutional framework facilitates entrepreneurship is an important empirical question that socio-legal scholars should attend to as they look at the institutional function of business association law.

I use the term entrepreneurship here broadly to identify the practice of effectively identifying and responding to social and economic change, especially where there are profit opportunities, by bringing together talent and resources to add value to the lives of customers. Obviously, any study of entrepreneurship implicates governance and political economy concerns, but among Klein’s Criteria are significant variables to consider, such as the maximization of individual freedom, the enforcement of private bargains, and limiting the costs of private compliance.

V. APPLICATION

Thankfully, Klein himself has provided us with a fine example of how good socio-legal scholarship can enhance our understanding of private governance. In his work with Mitu Gulati on the organization of the construction industry,
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we are provided with a detailed exploration of how productive activity actually takes place among business organizations in a significant construction project. Like the work of Elinor Ostrom and her students on governance, this close study requires us to rethink some of our guiding assumptions, in particular the Coasian and Williamsonian assumptions about governance and transaction costs.

So how would my three-pronged approach supplement what Gulati and Klein have already provided? In addition to inducing the organizational analysis, I would recommend that they provide a richer account of the institutional setting for the construction industry—and that they approach that study with the jaundiced eye of an investigative journalist, inasmuch as they do with the eye of a scholar. With that perspective, I suspect that they might uncover a very interesting story of how the local, state, and national political structures undergird construction enterprises. This is mere suspicion, but one aroused by the fact that the construction industry was one of the major political contributors in the 2004 elections. Individuals and political action committees related to the construction industry gave close to $60 billion in contributions—more than four times the amount that came from defense-related industries and nearly 40% more than from energy-related industries. What is it that members of the construction industry, who, according to Klein and Gulati, effectively organize their projects with little attention to hierarchy or firm boundaries and with light-handed lawyering, expect to gain from sowing influence with elected officials?

My three-pronged approach would also ask them to teach us more about entrepreneurship within the curious, decentralized environment that they describe. Who specifically within their sprawling network identifies how to profit from changes in the economic landscape? There is apparent freedom and flexibility; is that freedom and flexibility garnering value-enhancing innovations for the customers of construction projects? A more focused look at how these arrangements take advantage of dispersed information and tacit knowledge in order to add value to customers’ lives and profit to the participants would help us better understand the value (or lack of value) to associate with this more fluid way of organizing productive activity under uncertainty.

VI. CONCLUSION

Bill Klein’s Criteria Project, like so much of his work, asks us to look closely at the assumptions and foundations of our legal scholarship—and like so much of his work, it can point the way to a robust empirical agenda for

scholars who are intent on better understanding the actual workings of the institutions that govern business associations. I have suggested a way to reframe Klein’s normative Criteria that lays out an empirical agenda that uses analytical fieldwork to study the actual governance of business organizations, the actual political economy in which business associations operate, and the role of business association law in facilitating entrepreneurship. Such empirical work could inform the normative debates that will no doubt be sharpened by Klein’s Criteria Project.