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## UNPLUGGED

# Management & Law: The Forgotten Contribution of P. Selznick

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Decisions made by corporate leaders have a huge impact on business, society and the environment. However, how are their decision-making power governed? And to what extent are the rights of those it affects preserved? The question of the responsibility of corporate leaders has long been discussed by management studies. But most of the time, scholars in management sciences do not question the legal framework, they rather import the 'view from law' (Lan & Heracleous, 2010). Today, however, questions about the legal status and governance of managerial power are gaining new momentum. Corporate law and its capacity to hold managers accountable become important issues in the field (Battilana et al., 2020; Ciepley, 2018; Veldman & Willmott, 2019). And new changes in the law, such as the introduction in a number of countries of new legal forms of purpose-driven corporations (Hemphill & Cullari, 2014; Hiller, 2013; Segrestin et al., 2020), raise the question of what management research could bring to law.

In this essay, we look into the past and review a book by Philip Selznick that provides a critical key to address this question. As one of the pioneers of the institutional field, Selznick is a renowned author (Selznick, 1949, 1957). He views institutionalisation as a process by which an organisation acquires its own identity and develops values and inter-dependences with those who contribute to perpetuating it (Besharov & Khurana, 2015; Desreumaux, 2009; Krygier, 2012). His conceptualisation has inspired an entire stream of research on institutions and institutionalism (Hinings et al., 2018; Kraatz, 2015; Kraatz & Block, 2008). Despite insightful, the book we review here, *Law, Society and Industrial Justice* (hereinafter LSJ), has gone relatively unnoticed since its publication in 1969 (Selznick, 1969). It was even severely received by sociologists, who dismissed it as a 'contribution in "sociological jurisprudence"' rather than in the sociology of

law' (Black, 1972, p. 709).<sup>1</sup> We think it is time to restore the real contribution of the book, which offers an original thesis about the contemporary question of the governance of managerial power. Indeed, in this book, he shows that one of the Achilles heels of corporate law is precisely the conceptualisation of the foundations of managerial authority. And management scholars can precisely play an important role in addressing this legal gap.

More specifically, we see three main reasons why the book should interest management and organisation studies.

First, Selznick has an atypical – and inspiring – way of looking at the law.<sup>2</sup> He seeks to capture on what basis the private power has been institutionalised. In doing so, he studies 'legality' rather than law from an organisational point of view, and he is able to point out those issues that existing law leaves unresolved.

Second, Selznick proposes a way to reappraise corporate governance and corporate law from what we know about management. Selznick's analysis is that managerial power has not been sufficiently conceptualised in law, and that the enterprise is still 'a legal order struggling to be born' (Selznick, 1969, p. 52). The power to manage is, indeed, largely institutionalised. This means that it is officially recognised and based on an established and partially accepted order. However, what are the foundations of this power and how is it governed? Scrutinising both the legal theoretical resources and the actual processes of legitimation, Selznick comes to the conclusion that managerial authority is not grounded in law: it does neither come from the legal categories of property or contract nor derive from

<sup>1</sup> Different reviews can be found, see Fisk (1970), Black (1972) or Krygier (2008, 2015).

<sup>2</sup> In 1961, he created the Center for the Study of Law and Society (CSLS) at UC Berkeley, and later in 1977, the Jurisprudence and Social Policy PhD program.

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the legal concept of the corporation: corporate law has little to say about the inner relationships between managers and employees. Managerial authority could be at the outset grounded in scientific approaches and administrative competencies, but it lacks legal recognition. In the late 1960s, Selznick considered that such recognition could come from the then emerging labour law.

Third, the historical view of Selznick helps us to inform the most recent legal developments. By characterising what has so far been missing in the law, Selznick's work allows management scholars to discuss recent reforms in corporate law, such as purpose-driven corporations, using precise criteria: do they allow the constitution of free enterprises, with an acceptable and legitimate managerial authority? And do they lay the foundations for a legal order for the enterprise and for 'industrial justice'?

In this essay, we, thus, present a detailed review of an important but forgotten book to show how Selznick's view of management challenges the law and points out a gap in the foundation of managerial authority. We then suggest different avenues the book opens up to address today the question of sustainable and fair corporate governance.

### In search of a law of enterprises

Before we present the arguments set out in the book, let us clarify what Selznick means by 'enterprise'. While Selznick does not precisely define the term, he uses it, by contrast to the term *corporation*, to designate the large 'administrative organization' that emerged in the early 20th century. This organisation generally has distinctive features, such as a 'sizable administrative staff' and 'dependent constituencies'. In what follows, the enterprise will be assimilated to the modern form of business organisation, where managers have become professional and separate from the shareholders. As we will see, Selznick emphasises that the enterprise should not be confused with the corporation. He sees the corporation as a structuring legal tool and recognises that corporate laws play a critical role in business matters. However, when he studies a business organisation, such as Ford, he looks at the enterprise and especially at the managerial prerogatives with respect to different parties, especially employees, for which corporate bylaws have little to say. Selznick (1969, p. 41) describes the enterprise as 'a locus of authority, commitment, dependency and power'. Even more importantly, he also recognises that the modern enterprise is a major social institution. This idea is also conveyed by others, such as Drucker (1946) cited by Selznick, who described the large enterprise as the 'representative social institution' of modern life.

Considering the enterprise as an institution has two implications.

The first can be expressed as the idea that institutionalisation implies legality. Selznick does not mean legality only from

the legal point of view however. He wrote: 'we should see law as endemic in all institutions that rely for social control on formal authority and rule-making' (1969, p. 7). The enterprise, therefore, encompasses a form of 'legality'. In it, the managerial power is institutionalised and partially accepted. It is not a personal discretionary power, or an authority founded on 'brute' power relations. Instead, institutionalisation goes hand-in-hand with the diffusion of a 'rule of law' that frames the exercise of authority and limits arbitrariness. Within the modern institution, the enterprise 'has brought with it new modes of belonging and dependency' (1969, p. 36). Managerial power has been rationalised and partially bureaucratized (Weber, 1922). More generally, relations tend to be arranged in a more ordered, organised way, as in the case of union representation.

The second implication is that the existence of an institution with its own legality cannot remain outside the law. An institution hypothetically connects multiple concerns and interests, in a social life with its own dynamic. This dynamic is fundamentally positive but still requires formal acknowledgement in law. As a result of institutionalisation, the enterprise generates expectations among stakeholders. It raises the questions of responsibility and 'public accountability'. The private order of the enterprise should be consistent with the law, to avoid creating an excessive amount of uncertainty and confusion.

How can we understand this private order of the enterprise however? How can a private authority be accepted? How can freedom and authority be reconciled? According to Selznick (1969, p. 37), a law of associations or a law of enterprises must fulfil three functions: '(1) to sustain the vitality of the group structure of society; (2) to regulate group action in the interests of the community as a whole; (3) to protect the rights of individuals who encounter the power of the organized group'.

Does such a law exist? In practice, can we find principles that could already constitute a law of associations? If not, where are the foundations for constructing this law? These are the central questions of the book. To answer them, Selznick first looks at the classical concepts available in law, before investigating the conceptual resources provided by administrative sciences, and finally scrutinising how the emergent labour law introduced new (in the 60's) but fragile foundations for the legal basis of managerial authority.

### Legal resources

First of all, what resources does the law provide for thinking about the enterprise? When Selznick wrote in his book, there was no branch of law that would cover associations. Instead, the law provides different concepts. Selznick examined three of them, the corporation, the contract and property, to see whether they provide a basis for a law of associations.

## The corporation

The first concept is the 'corporation'. This is clearly an important resource, and the idea is not to underestimate the role of charters and the corporation, including its accountability toolkit, in practice. However, Selznick points out that the idea of a corporation can be misleading when studying the institutional reality of enterprises:

- The concept of the corporation emphasises the moment of incorporation. It focuses on the shareholders as the 'members' of the corporation because they are the parties to the contract. As a result, legal experts tend not to look at the multipartite reality of business organisations. To move out of this tropism, Chester Barnard, for example, looked at dimensions that were missing from the legal framework. He saw organisations as 'systems of cooperative activities' (Selznick, 1969, p. 51). This led him to create a theory of contributors—and not only 'members'—by looking at their relationship to the activity as opposed to their formal belonging to the corporation (Barnard, 1938).
- Theories of the corporation contained in law are focused on well-known debates. These include whether a corporation is created by the government (concession theory) or the result of private initiative, and whether a corporation is a fiction (fiction theory) or a fully fledged legal entity (for an overview of these debates, see Avi-Yonah 2005; Millon, 1990). The corporation, therefore, polarises legal research toward subjects that are far from the social realities of organisations. This detracts from the consideration of the internal organisation of power.

In the end, and this is key, Selznick highlights the considerable gap between corporate law and the institution that the enterprise has become, even though legal experts have long proposed that corporations are a 'special legal entity' (Selznick, 1969, p. 49), superseding the interest of constituencies. This view was shared by Dodd, for example, in his famous debate with Berle (Dodd, 1932).<sup>3</sup> Selznick is aware of these developments but believes that highlighting the (long-term) interests of the corporation presumes first looking at the institution:

For our purposes, the important point is that decision-making in the light of long-run benefits presumes a concept of the institution. The enterprise as a going concern, as a relational entity, becomes the focus of policy and strategy. This has nothing to do with formal incorporation. (Selznick, 1969, p. 47)

<sup>3</sup> The theory would also later be taken up by the team production theory (Blair & Stout, 1999, pp. 751–807).

The enterprise as a going concern must, therefore, not be confused with the corporation in the legal sense of the term. Corporate law and bylaws offer few affordances to analyse the legal order of the enterprise. An enterprise is not necessarily incorporated in the form of a corporation, even if the benefits of corporate status are evident, especially for large enterprises. Above all, corporate status says nothing about 'the structure of the enterprise and its role in the community':

These questions, and the legal answers they evoke, do not depend on recognized corporate status. They reflect the existence of a system-in-being with respect to which legal rules and policies need to be framed. (Selznick, 1969, p. 78)

The enterprise is, therefore, potentially a profoundly institutionalised legal order, but it is also a 'legal order struggling to be born' (Selznick, 1969, p. 81).

## The contract

The second legal concept examined by Selznick is the contract. He identifies several criticisms:

- A contract implies free will, and consent must generally be verified at all times. Like an association, it requires 'commitment'.
- A contract is based on an exchange or reciprocity, with well-defined mutual obligations. Once fulfilled, the parties are released. An association, however, is based on mutuality, with a common end.
- A contract is grounded in an individualistic or even atomistic approach to the corporation. An association, however, involves third parties and multiple beneficiaries. It creates expectations and responsibilities for directors.
- Above all, contracts are incapable of providing a basis for authority or government. When the fundamental attributes of an association are taken into account, especially membership and the division of labour and authority, 'then the need for a new model, going beyond contract, becomes acute' (Selznick, 1969, p. 60).

## Property

The final concept that Selznick examines is property. This concept plays a central role in the law. However, once again, it offers few clear ways to consider the private government of enterprises because the concept is oriented towards material objects and individuals. It initially gave an absolute right (*dominium*) over the owned thing. Revised doctrines see the owner as a trustee, playing the role of a steward responsible for managing the property in the common interest. This doctrine is appealing, but Selznick finds it unrealistic.

In practice, in the enterprise, the concept of property has hidden a bias: a transition has taken place from property, as an exclusive right over an asset, to power over individuals. In other words, there is a transition from *dominium* to *imperium*. This shift is neither grounded nor legitimate. For instance, ownership of a house does not give the right to order the people entering it. The legitimacy of managerial authority cannot be founded on domination. Property cannot be a basis to establish rights that are recognised today, such as seniority rights or the right of unions to assign jobs. The concept of property is of no use for analysing membership, for example.

The foundations of legality peculiar to the institution of the enterprise are, therefore, not contained in the regular doctrines of the law. Selznick, therefore, turns to management theories. And here, the book becomes fascinating as Selznick looks for legality within management studies.

### **Administrative foundations**

Selznick delves into management theories and practices to study the workings of private government, or the 'legal worth' of administration (Selznick, 1969, p. 121). From a methodological point of view, he combines theoretical frameworks (for example, bureaucratic rationalisation, the human relations movement) with the study of management practices, administrative literature and field studies. This makes his book extraordinarily rich, and we cannot account for this breadth in a few lines. However, schematically speaking, the book shows that managerial practices are fashioned by administrative principles that are important bases of legitimacy. Managerial power is not based on property but rather, to a greater extent, on bureaucratic and scientific rationality.

The phenomenon of bureaucratisation characteristic of the early 20th century in organisations was theorised by Weber (1922). In his model, Weber related rationality to the legality of bureaucracy. Rationality ensures the alignment of the means with the ends (although Selznick notes that these ends were not further discussed by Weber). Legality is derived because decisions are justified on the basis of rules and can, therefore, be called into question using the same rules. Selznick emphasised that Weber's conception of the law is relatively disheartening. He associated the law with discipline and obedience. However, the empirical reality of the bureaucratic phenomenon is undeniable. Selznick identifies many elements at the level of business policies, testimonials or surveys, which demonstrate the increasingly systematic use of formal procedures or criteria, a trend that structures power and creates 'expectations regarding the consistency and fairness of official action' (Selznick, 1969, p. 84).

However, the bureaucratic model does not fully account for administrative legality and, indeed, is far from doing so. Faced

with the fairly rigid bureaucratic system, the operation of enterprises remains fundamentally tied to leadership. Leadership enables more flexibility and is more open to initiatives at all levels. It also means that goals can be creative and changing. Recognising the role of leadership is not returning to a pre-bureaucratic model founded on the personal authority of the leader. Selznick argues that modern enterprises offer an unprecedented synthesis of bureaucratic rules and leadership. This is made possible by the new scientific approaches to management.

The other fundamental lever of legality is scientific management and the strategic human resources movement. Managing people like 'resources' can seem an offense to personality, but it is necessary to avoid caricatures. The concern of scientific management is fundamentally objective inquiry. It, therefore, aims to inform managerial decision-making by studying the facts. In other words, a decision is not arbitrary when it is backed on rigorous knowledge. The scientific management movement aims to replace conflict with a consensus built around the rigorous information provided by science, in order to create 'a new era of productivity and fairness' (Selznick, 1969, p. 86).

The scientific management movement quickly integrated the need to consider motivational aspects. At a fundamental level, management authority has a few founding principles: (1) respect for human beings; (2) the 'poverty of power': in organisations, power is useless if it cannot mobilise and (3) the inseparability of consent and control (Selznick, 1969, p. 101). These principles may seem evident, but Selznick showed that the ethos of modern management has appropriated them, and that they become truly structural in enterprises, even those that were traditionally 'considered inescapably authoritarian in spirit and practice' (Selznick, 1969, p. 102).

The rules and approaches of scientific investigation can, therefore, be argued to be essential pillars of legality in the enterprise. However, irrespective of how well demonstrated and convincing they may be, these two dimensions are not sufficient. It would be wrong to disregard conflicts within the enterprise. In reality, it is possible for an enterprise to have a complete and sustainable legal order only if the scientific management movement incorporates a political dimension. The human resources movement has provided impetus to curb authority and safeguard respect. But, 'the impulse is not a guarantee, and without a guarantee the employee remains dependent on the goodwill or self-interest of others' (Selznick, 1969, p. 120).

### **The incomplete status of management in labour law**

While the classic law has few resources for understanding managerial authority, significant progress was made during the

20th century in terms of labour law. However, there are various doctrinal and jurisprudential movements, which are heterogeneous and difficult to characterise. Selznick set out to decipher the changes underway, adopting a historical perspective. Once again, his book demonstrates exceptional erudition, combining the work of historians, legal doctrines and cases (court decisions).

*A priori*, in terms of labour law, the contract formally remains the basic instrument, and no change can be perceived in the general framework of relations. A contract is supposed to be signed between two people of their own free will. The law does not interfere in the content of contracts. However, Selznick proposes taking a closer look at the nature of the employment contract and denounces the 'prerogative contract'. Behind the appearance of being a free contract, he claims that this establishes an exorbitant discretionary space for employers.

### **From a prerogative contract...**

To understand this, it is necessary to go back in time to the 18th century, when master and servant relations prevailed, particularly in households. The authority of the master was considered natural and legal (as long as the exercise of power remained moderate) and pertained more to customs and public law than the free will of the parties. It came with several obligations. For example, it went hand-in-hand with a 'long-lasting relationship and personal services (not the sale of goods)' and was not 'terminable at will'. Moreover, even though this was not always explicit, the norm was that the master was responsible for the 'general welfare' of the servant.

With the increasing influence of free-market political and economic theories, this type of relationship gave way to a 'truly contractual theory of employment'. The contract then became the preferred instrument for organising labour relations. This had two consequences. The first was that labour relations were 'legally unsupervised relations': the law existed to structure the creation of the contract, but not to weigh in on the balance of the relationship. The second consequence was that there was no longer a concept of authority in labour relations. This was a striking change in the 19th century.

The contract implied mutual consent, even if it granted one party the right to exercise authority over the other. From this point, the contract became terminable at will, without any obligation on duration, because it was more focused on organising a transaction than establishing a relationship. However, paradoxically, contractual theory authorised a form of sovereign and absolute authority of managers because they were not bound by rules beyond breaking the contract. Selznick, therefore, considers that the law created

an unbalanced relationship based on a type of contract that he describes as the 'prerogative contract'. In reality, it was a mode of 'submission' whenever the contract did not establish the participation of the employee in the rule making or management process:

The contract of employment inevitably becomes a prerogative contract, a mode of submission, if provision is not made for employee participation in the continuing process of rule making and administration. With control of that process reserved to the employer, contract can only fade to a shadow of its potential as an instrument of self-government. This lack of machinery for handling the continuity of membership and decision-making was the most radical defect of the individual employment contract. (Selznick, 1969, p. 137)

Contracting may have been between equals in theory. However, in reality, the law maintains master and servant relations without explicitly stating so, and '[t]he result was a marriage of old master-servant notions to an apparently uncompromising contractualism' (Selznick, 1969, p. 136).

However, labour law did not stop there. It underwent a decisive shift during the *New Deal* period. Selznick shows that during this period, the 'prerogative contract' was replaced by a new device, which he calls a 'constitutive contract'. The obligation to engage in collective bargaining henceforth constitutes the basis of a law of association between workers and employers.

### **... To a 'constitutive contract'**

Selznick's in-depth analysis of jurisprudence goes well beyond the scope of this paper. His aim is to identify the fundamental transformation taking place in labour law reforms, particularly with the regulations set in place during the very progressive period of the *New Deal*:

And taken together they delineate what is really fundamental in the collective bargain: the fashioning of a new set of roles and relationships; commitment to the ensuing system of order; affirmation of a new principle of legitimacy. (Selznick, 1969, p. 152)

To understand this substantial change, Selznick's analysis can be summarised in three propositions.

### **The emergence of a 'constitutive contract'**

The National Labor Relations Act of 1935 (also known as the Wagner Act) played a key role. During the *New Deal* period, it limited the authority to oppose union action, established protected union representation, and most importantly, established 'collective bargaining' as an obligation. Selznick views collective bargaining as the preferred method for achieving 'industrial peace'. In appearance, collective bargaining remained in the realm of contractualism. However, contractualism was

profoundly reinvented in three main ways. First, free will was maintained, but the law required an explicit commitment from the parties to negotiate. It also encouraged them to come to an agreement, to better preserve freedom in the employment contract. Second, the commitments adopted in contracts had to remain limited and could be lifted, but the contract could subsequently be invoked during any eventuality. The terms of the contract were not the only source of rights and duties. The act introduced a 'sphere of institutional responsibility' (Selznick, 1969, p. 147) and principles for guiding decisions in the field. Third, a contract involved a limited scope, that is, the concept of boundedness or privacy. By contrast, a collective agreement applied across the board to all employees, and its scope was by definition open. The notion of privacy was also largely extended here. In reality, collective bargaining was a contract in appearance only.

The law actually established a particular type of legal document: a unilateral collective commitment, 'a pledge of continuing cooperation' that resembled the models of the 'collective act' proposed by authors such as Gierke or Duguit (1918). 'Collective bargaining is constitutive in that it creates new and continuing institutions, new and irreversible commitments' (Selznick, 1969, p. 151). Selznick sees this new legal framework as an innovative instrument of 'industrial self-government' (1969, p. 156).

### **'Creative arbitration', a new justice institution**

The second component of the creation of a judicial institution is the use of arbitration in the event of a disagreement on the application of the contract. Selznick emphasises that this device does not run counter to the principle of private free enterprise: 'The arbitration is an integral part of the system of self-government' (Selznick, 1969, p. 157). It is the condition of free enterprise that makes it possible to keep the lawyers, or at the very least the law, at a distance.

In exercising their duties, arbitrators are led to make 'interstitial' decisions in a creative way in the empty spaces left by the contract. Analysing the corpus of these decisions reveals a core of fundamental principles for industrial justice. These include that decisions must not undermine the legitimate objective of the firm. It is, therefore, necessary to be able to prohibit absenteeism and preserve respect for authority. Conversely, extra-professional activities must not be included in the field of managerial control. In addition, 'a skilled or professional employee may assert a claim to the protection of his occupational identity' (Selznick, 1969, p. 171). Ultimately, this creates a 'code' for the enterprise.

### **From prerogative to policy: Responsible management**

The third proposition is truly innovative. Selznick argues that collective bargaining and the use of arbitration were a radical

departure from the idea that the employer benefitted from 'reserved rights' or a discretionary space. This is because all decisions could now be questioned. If an employer suddenly changed the starting hour of employees from one day to the next, this might be legitimate or abusive. In theory, this is not clear. In practice, however, the possibility of challenging the decision calls for it to be justified, for example, by a particularly urgent situation. As soon as the employer's authority goes hand-in-hand with the possibility that unions can dissent from a company decision and file a grievance, power can no longer be arbitrary. Arbitrators also do not consider absolute discretion *a priori*, instead looking at the legitimate interests of the parties. The result is a new model of the responsible employer as more than just one who avoids power abuse: 'to be reasonable and non-arbitrary is to act with appropriate regard for the rights of employees, whether formalized or inchoate' (Selznick, 1969, p. 180).

Selznick continues his inquiry by analysing the other component of labour law, 'employment law'. The progress made in this respect during the 1960s was significant, but we do not wish to dwell on this subject. Selznick shows how and via which techniques, rights such as minority rights, were introduced, always under the condition of not directly undermining the freedom of enterprise. For our purposes, namely, the emergence of a framework of legitimacy for private government, we prefer to skip straight to the third section of the book, a highly programmatic conclusion titled *The Emergent Law*.

### **The call for a new law of enterprises**

As a researcher and observer of social and legal transformations, Selznick records and models a profound change: the institutionalisation of the enterprise, which went hand-in-hand with the beginnings of innovative industrial justice. In *Law, Society, and Industrial Justice*, he sets out to conceptualise the principles of this justice. However, it is up to the law to grant legal recognition and solid legal foundations to the enterprise. This is the reason for 'new and urgent demands for appropriate responses in legal policy and cognition' (Selznick, 1969, p. 274). The third section of the book is, therefore, a programmatic call for the law to take these changes into account. In other words, according to Selznick, there is a historical opportunity for the law.

It is impossible to see private enterprises as islands of power in society. However, it is possible to conceive that they may be legitimately privately governed. When private governance follows the same fundamental principles as public governance, it can become acceptable and legitimate. Under public law, the concern had historically been to enable the intervention of the state (and its immunity) without compromising individual freedom, and therefore ensuring the responsibility of the state. It was fundamentally the model of 'due process' that made this possible. This model is a standard calling for the respect for human rights, for

every law to explicitly state its motives, and for everyone to have the right to a fair trial. This standard is fundamentally applicable to private settings. It, therefore, becomes possible to recognise that private institutions can have their own governance as long as it respects the constitutional rules of due process.

In 1969, the world was in the middle of a transition. Labour law contains the seeds of a 'law of associations', and legal acknowledgement is foreseeable. However, it has yet to materialise. The law has not yet explicitly recognised either the institutionalisation of the enterprise or the foundations of managerial authority:

In the contemporary American setting, the law of employment remains weakly developed. Labor law shows great strength, but the legal bases of managerial authority-in-property and in the employment contract have not been reconstructed. This will not occur until corporation law itself is remade to take account of the enterprise as a social unit, face up to the realities of authority and the separation of ownership and control, and assert the rights of employees as members. (Selznick, 1969, p. 275)

Selznick, therefore, argues that the establishment of a legitimate framework for enterprises requires acknowledgement of the status of responsible management, and a revision of corporate law.

## **The gap in the law: Implications for management research**

Selznick's book, therefore, has deep implications for contemporary management scholars. Our reading of the book invites first to return to the theory to distinguish the enterprise from the corporation. It also invites us to reread our recent history by considering the possible effects of the absence of a law of the enterprise, or we could say, of responsible management. Third, and above all, this book challenges us to work on the design of legal frameworks that are more appropriate to the nature of enterprises.

## ***Distinguishing enterprises from corporations***

The organisational phenomenon studied by Selznick is not captured by either economic theories or the law. Legal theories are problematic. As we have seen, Selznick criticised the theories of corporations because he believed that they biased debates and focused on particular stakeholders to the detriment of others. These theories clearly disregarded the basis of managerial authority. Legal experts have since admitted that the enterprise was overlooked by the law. For example, Robé (1999, 2011) considered that the law ignores enterprises, and the corporation is no more than the legal cloth of the enterprise. The law has remained divided into labour law and corporate law, failing to offer an integrated theory of the enterprise (Segrestin et al., 2020).

Economic theories are equally problematic. They conflate the enterprise and the corporation under a single generic term: the firm. A firm is seen as an alternative coordination mode to the market. However, this view makes it difficult to account for the organisational and institutional phenomena identified by Selznick. Two theories for understanding firms have dominated the field (Alvarez & Barney, 2005): transaction cost theory (Williamson, 1985) and incomplete contract theory (Grossman & Hart, 1986). These two approaches look at firms from the very specific angle of transactions and contracts. They do not clearly analyse labour relations or the relations between shareholders and directors, either as agency relations or in light of the transaction costs that they generate. In a sense, these theories see firms through the lenses of property rights and contracts. However, Selznick demonstrates very clearly that those concepts were no longer relevant for understanding modern enterprises. The contractualist view tends to overlook both the 'association' and the institutional nature of the enterprise.

Building on Selznick's approach, we suggest that enterprises are not a generic form of economic organisation, but a historical phenomenon that emerged in the late 19th century in western countries, with distinctive features. They are administered organisations, managerial authorities with leadership (Barnard, 1938; Selznick, 1957) and therefore require both consideration of the various legitimate interests concerned, and a purpose both in and for society. Selznick, therefore, invites us to further theorise the enterprise, as an entity distinct from the corporation.

## ***The gap in law: At the root of the contemporary crisis***

Selznick's work also provides a key to understanding the changes that took place in business organisations from the 1980s to the 2000s. He suggests that the law has created ambiguity: managers are seen as holding management authority, but the basis of this authority is not explicitly defined by law, if it cannot be legitimately justified by the ownership of shares. On the other hand, in corporate law, the manager is a corporate representative. CEOs are appointed and dismissed by boards and ultimately the shareholders. They are, therefore, potentially agents. As a result, the rise of agency theory in the 1970s meant that corporate law has been mobilised to strengthen shareholders' control over directors. Selznick considers that responsible management implies 'appropriate regard for the rights of employees', but the principles of corporate governance set out that:

The shareholders as owners of the company select the directors to run the business on their behalf and hold them accountable for its progress. (Cadbury report, 1992)

Ultimately, managerial authority remains subject to shareholder control (Kaufman & Englander, 2005). The law gives



shareholders considerable power of influence over directors (Greenfield, 2008; Greenwood, 2005; Mayer, 2013). Changes in governance during the 1980s and 1990s created an imbalance and a management crisis (Bower & Paine, 2017). The absence of a clear conceptualisation of the enterprise has allowed corporate governance to destabilise and disempower managerial authority (Segrestin & Hatchuel, 2011). Agency theory has effectively denied the leadership role of management by assuming managers were agents. We might say that the corporation turned against the enterprise (Hatchuel & Segrestin, 2007).

Today, the question is not whether things could have been different if Selznick's work had received more attention in the 1970s. A re-examination of this work invites us to recognise the important role of theories for the future of enterprises and corporations. The lack of conceptualisation of the enterprise, in theory and in law, has created a real trap. The question now is how to get out of it.

### **Filling the gap: Purpose-driven corporations?**

Selznick saw in labour law the possible constitutive contract for enterprises, even if he warned that a change in corporate law would also be required. Today, however, we can see that progress in labour law has proved insufficient. First, as already mentioned, management authority remained ultimately under the sole control of shareholders. Second, responsibility issues have grown considerably since 1969. Today, the private power of enterprises is not only exerted over employees. In the case of multinational corporations and very innovative enterprises, in particular, it affects entire populations and the environment. The question of the basis of authority can, therefore, no longer be raised exclusively at the employee group level. The need for a law of associations is more acute than ever.

Research is needed in many directions, but the recent changes in corporate law can be viewed through this prism: do they in themselves constitute the basis of a 'law of enterprises'? Several states have introduced new forms of corporation, especially purpose-driven corporations. Profit-with-purpose corporations can take several forms, depending on the state, with different missions and evaluation or enforcement mechanisms. However, the general framework is relatively fixed (Clark & Babson, 2012; Hemphill & Cullari, 2014; Hiller, 2013; Rawhouser et al., 2015). These organisations adopt:

- (i) a corporate purpose to create a material positive impact on society and the environment; (ii) expanded fiduciary duties of the directors requiring the consideration of non financial interests; and (iii) an obligation for the corporation to report on its overall social and environmental performance. (Hemphill & Cullari, 2014, p. 520)

To date, the most complete model is probably the French one (Segrestin et al., 2020). In France, the new form of *société à mission* is a corporation that includes both a *raison d'être* (purpose) and more detailed social and environmental goals in

its bylaws. These goals then become binding. Special governance arrangements are also set up to control the purpose. A board, separate from the board of directors, is in charge of evaluating the organisation against its purpose; and inspection by an independent third party is also planned to verify compliance with all commitments at least every 2 years.

For example, GRT Gaz, a gas transportation company, adopted a *raison d'être* with multiple commitments. GRT's purpose is: (1) to provide a reliable, safe and efficient gas supply service; (2) to contribute to energy transition by opening its network to all types of gases (including renewable gases) while maintaining the best standards of quality and reliability; (3) to ensure the personal development of its employees; (4) to act as a steward of territories by providing neutral and objective advice and (5) to ensure transparency (...).

In our view, purpose-driven corporations potentially gather all three of the ingredients that Selznick identified for a law of enterprises: (1) a 'constitutive contract', to lay the foundations of the co-operative group; (2) a 'management policy', which denies the possibility of arbitrary power but requires managerial decisions to be justified and (3) a mechanism for 'creative arbitration', allowing dispute resolution and a form of jurisprudence.

By setting out a purpose, the bylaws of purpose-driven corporations expose the enterprise. The purpose defines both the fundamental motive (*raison d'être*) and the goal of the collective activities. The corporate bylaws, thus, constitute the community of the enterprise, beyond the shareholders. As with GRT, the purpose can mention shareholders, but it may also highlight other groups such as employees, territories and the environment. Here, therefore, the law has introduced a 'constitutive contract' for enterprises.

Second, the purpose provides an evaluation and accountability framework for managers. In law, directors already have fiduciary duties. These duties are not limited to the shareholders' interests and can also include the 'best interest of the corporation'. However, this leaves space for interpretation at board level. The new law goes further. Each corporation is free to define its purpose, but once it has been set out in bylaws, the purpose becomes binding for management and those in charge of management control. It, therefore, guarantees the stability of the mandate and what Selznick calls the institutional 'integrity'<sup>4</sup> (Goodstein, 2015). The law covering purpose-driven corporations, therefore, makes explicit 'management policy' and what managers are accountable for. It also makes management accountable to the different constituencies of the enterprise and not solely to shareholders.

Finally, the new corporate law does not introduce arbitration as such. However, it does introduce new governance bodies. In France, for example, it introduces a new board

<sup>4</sup> Selznick (1957, p. 119) defined institutional integrity as 'the persistence of an organization's distinctive values, competence, and role'.

responsible for verifying that commitments have been met. It also requires an external audit. In future, it will be important to study how these new bodies work and to what extent they challenge management decisions. At this stage, however, we can only note that the law on purpose-driven corporations introduces new governance bodies and the possibility of new jurisprudence for enterprises.

This provides an interesting twist to the narrative of law, society and business that we have examined in relation to Selznick's classic study. It is ultimately through corporate law that enterprises could be reborn in law. However, we can, and should, continue to explore other possible endings to the story.

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