FIRMS AS SOCIAL ACTORS

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August 2008

ABSTRACT: This essay considers firms as collective social actors from three perspectives associated with individualism. Ontologically, it describes firms as constantly changing relational contracts that define roles and relationships among the participants, and argues that the characteristic routines and capabilities of firms emerge in time from human performance in these roles and relationships. Methodologically, it shows that by introducing the entrepreneur more explicitly into the account of the firm's origin and emphasizing human performance within the routines as the ongoing manifestation of the relational contract itself, theories of firms as relational contracts can be grounded solely in the interactive behavior of individuals. Normatively, it briefly considers the problem of granting rights and powers to firms as collective actors and suggests that firms are poor candidates for rights but plausible candidates for responsibly exercised powers. A short conclusion offers directions for future work.

KEYWORDS: theories of the firm, relational contracts, organizational capabilities, collective actors, individualism

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1. Introduction

Scholars and jurists have long puzzled over how to think about organizations, associations of individuals characterized by one or a very few governing objectives and, generally, some sort of central plan designed to achieve them. The problem invokes the opposition of individualism to collectivism in all three of the senses identified by Anthony Quinton (1982). *Ontologically*, it asks what these social objects actually are, whether and in what sense they can be called 'real' actors in the social world; *methodologically*, it asks whether their behaviors and effects can ultimately be traced without remainder to the actions of living human beings in the here and now or, contrarily, whether there is some irreducible aspect of their existence or operation that can only be attributed to the organization itself; and *ethically* or normatively, it opposes the putative interests and purposes of the organization itself to those of the men and women who populate or otherwise come into contact with it, and asks whether organizations can legitimately exercise power or bear rights in their own names. My purpose here is to consider these questions in the particular case of business firms, organizations dedicated to the production and sale of goods for profit.

Before the Civil War, when almost every American firm was either a sole proprietorship or small partnership, these questions were essentially moot. Business relations were governed by contract law, individual owners and partners bore unlimited liability for the obligations of their enterprises, and the forms within which business was conducted were understood as convenient legal artifacts, transparent, insubstantial masks behind which easily identifiable human beings who could be held personally responsible for the conduct of their firms did business. This began to change in mid-century, when the right to incorporate with limited liability was generally extended by the states to any lawful business, and with the explosive growth of large-scale enterprises built on new technologies of mass production and distribution after 1870, the emerging industrial giants seemed to take on lives of their own, especially when they adopted the corporate form. Incorporation offered not only limited liability to owners but perpetuity to the corporation itself, legal life that extended beyond the participation of any individual in the enterprise, however important he might be, and a legal personality that enabled the firm to own property, make contracts, and appear in court in its own name, independently of the human beings who at any moment might own, operate or work for it. In 1886, the United States Supreme Court declared that corporations had the same constitutional rights to due process and equal protection of the laws that living men and women did, though as Morton Horwitz (1985: 176-178) has shown, this was meant to protect the rights of individual shareholders acting in concert through the artifice of the corporation rather than to recognize the latter as an independent, rights-bearing entity ontologically distinct from its human constituents.

But by 1910, many legal scholars, impressed by the undeniable social presence of the new industrial corporations and influenced by the organic notion of collective personality advanced by the German theorist Otto Gierke, had embraced what Horwitz calls the 'natural entity' theory, in which the corporation is fully reified, treated as a real and purposeful social actor separate in principle from its participants and endowed with economic interests identical to those of human beings. In this perspective, the corporation is an 'autonomous, self-sufficient, self-renewing body' (Davis, 1897: 294), 'an organic whole…which cannot be analyzed into the mere sum of its parts' (Brown, 1905: 379). It is, as F. W. Maitland put it in his introduction to Gierke's treatise in 1900 (Gierke, 1987: xxvi), 'no fiction, no symbol [but] a living organism and a real person, with body and members and a will of its own…. It is not a fictitious person [but] a group-person, and its will is a group-will'. Developments in the economic theory of the firm through the twentieth century have produced a compelling contractual alternative to this dubious organicism, but in recent years, a new *capabilities* theory has revived the image of the firm as an emergent, ontologically autonomous social actor without resort to claims that firms are, or are like, living organisms. In the same spirit, David Gindis (2007; *cf*. Blair, 2004) has breathed new life into the natural entity theory as well, arguing persuasively that a firm's 'power to cause, power to stay unified, power to avoid dissolution' demonstrate its reality as a social actor, and that its organizational unity or coherence, the cohesiveness of the bonds it creates among its participants, and its persistence through time combine to create an emergent 'whole which can no longer be viewed as reducible to any of its constituent parts or members' (Gindis 2007: 18, 24).

Gandis and the capabilities theorists are certainly right: modern firms, corporations or otherwise, are social objects whose operational characteristics do not arise from any aggregation of the qualities of their participants but emerge from the interactions among them, and they are undeniably 'real' social actors, in that they do cause events, and political actors, insofar as they subject some participants to the limited authority of others. But neither he nor they say exactly what these active social objects *are*, a failure to resolve the ontological aspect of Quinton's trichotomy that makes it difficult to address the remaining methodological and ethical questions. I will try here to say precisely what firms are and how they act, and on this basis briefly consider Quinton's methodological and ethical issues in turn. In part two, I draw on several strands of recent work to argue that firms are constantly changing, multilateral relational contracts from whose operation, that is, from performance over time by specific men and women in the roles and relationships defined by the contract, emerge the firm's idiosyncratic capabilities. As such, firms are real in Gindis's sense, but incorporeal -- they exist as *ideas* in the minds of human beings both within and without their borders, and exert power over human affairs solely through the actions of individual human beings whose intentions are influenced by them.

I then turn to Quinton's remaining questions. In part three, I sketch a methodologically individualist theory of firms as relational contracts with emergent capabilities and note its points of contact with Alfred Chandler's (1977, 1990) influential account of the birth and growth of the great American industrial enterprises. I stress the role of the entrepreneur in the creation of firms and the close dependence of organizational capabilities on human performance, and argue that it is possible to ground even emergent collective capabilities firmly in the behavior of individuals. In part four, I draw on suggestive work by Philip Pettit (2002) to consider whether firms might be deserving bearers of legal rights and powers. Part five concludes with directions for future research.

2. Firms as Contracts

A principal foil for Gindis's argument is the 'nexus of contracts' depiction of the firm, introduced by Alchian and Demsetz (1972) and Jensen and Meckling (1976). In this view, firms are coalitions of individuals linked through a set of contracts, either with one another directly or with a fictitious central party called 'the firm,' understood merely as a common signatory of these agreements, 'no more than a name' for what are in essence a potentially large number of individual contracts between workers, managers and contributors of capital (Easterbrook and Fischel, 1985: 89). In either case, the firm itself '*is not an individual*. It is a legal fiction which serves as a focus for a complex process in which the conflicting objectives of individuals…are brought into equilibrium within a framework of contractual relations' (Jensen and Meckling, 1976: 311, emphasis in original). Firms are thus not themselves contracts, nor are they 'real' social actors. They are no more than placeholders, convenient linguistic shorthand for the conceptual site of a set of individual contracts that govern relations among people in some sphere of productive activity. Gindis (2007: 1) is right to reject this view in favor of the alternative that the firm 'is a real integrated entity and a dynamic causal system', but he errs in suggesting that this is inconsistent with all contractual portrayals of the firm.

Firms are not nothing, ontologically empty boxes within which individual contracts are said to be located. They are distinct social objects constituted by what Ian Macneil (1978; *cf*. Goldberg, 1980) calls *relational contracts*. Macneil depicts the exchange environment as a continuum in two dimensions, one measuring the ability of bargainers to *presentiate*, to foresee and bring the relevant future to bear on negotiations in the present, the other identifying transactions as *discrete*, like the paradigmatic neoclassical exchange between strangers in their substantive isolation from other transactions, or *relational*, embedded in what John R. Commons (1968: 143-153) called a 'going concern' that all sides have an interest in preserving beyond the single transaction at hand. Relational transactions take place within a larger, continuing network of personal bonds that create a context for the transaction and affect the terms of future negotiations, just as they are affected by other transactions in the past. Macneil argues that both the degree of uncertainty that surrounds a transaction and the intensity and duration of the parties' pre-existing relationship influence the way they choose to organize their relations with one another. Where the degree of discreteness is high and the parties can presentiate effectively, contracts are easily made and rescinded and their precise terms can generally be fully elaborated. But as transactions become more relational, or as contractors find it harder to characterize adequate performance at the moment the contract is made because the circumstances under which it might have to take place cannot be anticipated, or both, the parties are likely to account for the possibility of conflict in the future by leaving such details unspecified in a relational contract and agreeing instead to procedures for taking decisions and resolving disputes as they arise without terminating the relationship itself.

Relational contracts thus focus on the going concern rather than the instant transaction, replacing the easy 'in-and-out' of discrete contracts with periodic renegotiation of terms by the parties intended to preserve the relationship, and because both past and future outcomes matter to the parties, they are subject to gradual, conservative change intended to institutionalize successful adaptations and reduce conflict. They are truly social contracts in a way that contracts governing discrete transactions, even those with many parties, are not. The very idea that firms are nothing, fictions without substance, seems to imply that the individual contracts of which such a firm is the 'nexus' govern very discrete transactions, in which resources are highly mobile and short-term price fluctuations are more important than durable personal or collective relationships. Were it otherwise, and long-term contractual relationships more important than short-term advantage, the parties would see the contracts themselves as having real value to them, something to be preserved, and thus not nothing. But every ongoing firm has this quality to some degree. When participants say they are loyal to a firm, or that they aren't, they mean that the roles and relationships through which they interact at work are or are not satisfying to them, things to be preserved or left behind. It is the roles and relationships expressed in the relational contract, the substance of the contract itself, as it is and has been manifested in the actual operation of the firm during each participant's experience, that *is* 'the firm' in their (and others') minds, the something to which they do or do not feel attachment.

As in a successful marriage, the archtypical relational contract, daily negotiations in successful firms are undertaken with the intention and expectation of maintaining a valuable larger relationship. The past matters, loyalty is evoked, and the relationship itself is constantly adapted by the parties of the moment to changing conditions within the firm, such as turnover of personnel or the introduction of new technology, and in the competitive environment outside it. At any moment, the activity of the firm manifests the terms of the agreement among its participants at that moment, and adaptive change in its organization and operation is made possible by, and reflected in, concurrent change in the terms of the contract and the identities of the contractors. As firms, relational contracts may encompass large numbers of people intent on preserving the relationship among them, and take on a broader social character. Often, Macneil observes, they create 'a minisociety with a vast array of norms beyond those centered on' immediate transactions that can survive the eventual replacement of every founding participant. Given its adaptive history, such a contract 'may or may not include an "original agreement;" and if it does, may or may not result in great deference being given it' (1978: 901, 890).

A firm, then, is not a nexus of many contracts but a single, constantly changing relational contract among individuals whose goods and services must be combined over time to create the firm's product. Its subject is the precise terms under which this combination is to take place at the present moment, and agreement to it creates an obligation in every constituent to perform in more or less well-specified ways in concert with the others for as long as they choose to remain bound by the contract. Like the constitution of a contractarian state, the contract that constitutes the firm governs production within it at the same time. That is, it codifies the consensual relationships and obligations of the firm's participants to one another in the particular process of production they agree to undertake together, though the explicitness of its terms and the prevalence of unspoken working rules ('organizational culture') that are part of it vary from firm to firm. As a social contract, a 'meeting of the minds' of the individual contractors, the firm as such resides precisely in the agreement and obligations of the parties expressed in the contract, just as a contractarian state resides precisely in the agreement and obligations represented by the social contract. Observing all the factories and offices of a modern corporation, an anthropologist from another planet, able to see what humans do but unable to read their thoughts, could see almost everything the firm does, but could not see the firm itself. Like a state, a firm is an *idea*, a mental construction, not a tangible object or a living being. But ideas are 'real', and like states, firms clearly are social actors, affecting human affairs through the attitudes, intentions and behavior of living men and women who bear them in mind.

Oliver Williamson (1979: 235-239) acknowledged Macneil's important contribution to his own contractual model of the firm, and the production contracts that Williamson posits as adaptive responses to transaction costs in markets are clearly relational in character. Williamson cites three critical dimensions of production transactions that combine with the guileful, opportunistic behavior and bounded rationality of 'contractual man' (Williamson, 1985: 43-67) to drive transactions from the flexibility of competitive markets to the reciprocal obligation of contracts: imperfect knowledge of the present and future, the frequency with which transactions recur and, most importantly, *asset specificity*, the extent to which particular human and material resources become significantly more valuable in some uses than in others. Where costly assets are specific and substantial investments of time and money have left particular buyers and sellers little choice but to deal with one another, the time and effort needed to negotiate terms of trade and the opportunities they present for strategic behavior and exploitation are potent inducements to contract for both sides. If these bilateral monopolists must deal at arm's length with one another on a regular basis, the pressure to replace the cost and acrimony of recurrent bargaining with the 'once-and-for-all' negotiation of a long-term relational contract will be stronger still. In this way, Williamson argues, the typical business enterprise extends itself backward and forward along the production chain by offering the free agents who provide its inputs and purchase its outputs the chance to renounce their independence and join the contract themselves. Where the relationship between the firm and a still independent trading partner is a recurrent bilateral monopoly, the contract is likely to expand to bring that partner into the firm. But when the goods or services traded across the firm's boundary become sufficiently generic to support effective competition on one side or the other, the pressure to expand the contract subsides and the firm stops growing.

For Williamson, asset specificity is a problem to which firms are the solution. The parties seek the security of a long-term relationship as a way to avoid the costs of recurrent bargaining over the deployment of specific assets; the relationship itself has little value to them beyond the transaction costs it obviates. Markets are seen as the nonpareil of efficient organization, and firms as second-best alternatives in exchange environments that cannot support markets. The sources of transaction cost, bounded rationality, opportunism, asset specificity and the rest, are static and conditioned by technologies and ways of doing things as they exist at a particular moment in time. In this light, as William Lazonick (1991: 213-227; *cf.* Langlois, 1992: 102-105) points out, firms are adaptive rather than innovative. They take the exchange environment as given and try to optimize within it, rather than envisioning new, constraint-relaxing responses to the environment and introducing the new technological and managerial strategies these require. The nineteenth-century enterprises chronicled by Chandler, in contrast, were Schumpeterian innovators, radical disturbers of the established order. In Chandler's 'strategy-structure' framework, entrepreneurs envision an innovation, such as deployment of a new mass production technology, formulate a strategy to profit by investing in the technology, and then invest in the new organizational structures and managerial talent needed to realize the productive potential of the technology. Entrepreneurs thus innovate twice, investing first in the technology and then in the organization, and it is the two together that enable the firm to sustain itself and create new value. The second investment includes more than just purchasing the skill to coordinate the movement of people and materials through a complex production process. It also means gaining the willing cooperation of owners, managers and workers with the governing objectives of the enterprise through tolerable working conditions and a mutually agreeable division of the surplus created by the technology.

Human asset specificity, the greater value of one's labor in one firm than in any other, takes on a very different character for Lazonick than for Williamson. As the founding participants of a new firm work together to solve the myriad of context-specific, practical problems involved in actually building and operating, say, a nineteenth-century railroad or steel mill, working relationships are negotiated, formally and informally, at the same time that vast amounts of practical information, about furnaces and locomotives but also about productively integrating men and machines in satisfactory ways, are acquired and put to use through those relationships. These working relationships, the substance of the relational contract, are thus both the means by which new knowledge is created and, in the actual operation of the production process they make possible, the principal repository of the knowledge itself. In time, these initial relationships become the firm's idiosyncratic routines and procedures, gradually changing working rules that assign roles and delineate relationships among human actors that, when put into practice, constitute the firm's powers to see, think, decide and act. The existing knowledge distilled in these routines, and the new problem-solving knowledge they produce in turn, are not held by, or accessible to, any one participant, nor are they the aggregate of what all the participants, past or present, knew and know. They are 'possessed', that is, manifested and put to use, by the firm itself in its daily operation, and often the collective sensory and cognitive powers possessed by firms far exceed the similar powers of any man or woman (*cf*. Nelson and Winter, 1982: 59-65, 99-107). Far from a problem, for Lazonick human asset specificity achieved by consent is highly valuable, for two reasons. Because it represents greater experience and more nuanced communication and cooperation within the routines, it 'unbounds' human rationality by supplementing it with a more expansive collective rationality. And because sustained cooperation in a mutually agreeable relational contract fosters cordiality, teamwork and trust within firms, it relaxes the constraint of opportunism by leavening it with goodwill and loyalty. Asset specificity 'is not a cause of "market failure," as Williamson has contended, but an outcome of "organizational success"' (Lazonick, 1991: 218; *cf*. Foss, 1993: 130-132).

Lazonick's work is an early venture into the still-emerging capabilities theory of the firm, built on the view that internal routines and procedures, 'habitual pattern[s] of behavior embodying knowledge that is often tacit and skill-like' (Langlois and Robertson, 1995: 1), are the key to understanding the origin and development of firms. A firm's capabilities, the skills, experience and knowledge it demonstrates in its daily operation, 'consist largely of the ability to perform and sustain a set of routines' (Nelson and Winter 1982: 142) and, along with the routines themselves, change over time as new participants bring new knowledge and skills to the contract and the firm 'learns by doing' in a competitive environment. Firms as such are understood as *de facto* 'truces' or 'treaties' (*ibid*: 107-112) that mediate divergent individual interests and induce participants to do their part in the routines despite their differing interests. Repeated performance of the routines builds trust and reinforces the truce, which itself becomes an aspect of the firm that simultaneously enables it to operate and inhibits change in its established routines, the latter in time reducing the firm's ability to respond flexibly to new profit opportunities (Langlois and Robertson, 1995: 101-108).

In this perspective, firms arise to create and coordinate the capabilities needed to exploit new opportunities, and expand or contract as necessary to align capabilities with opportunities in changing environments. Their boundaries are determined primarily by the relative costs of developing needed capabilities internally, which turn largely on technology, existing capabilities and the flexibility of routines, or, if possible, contracting to buy them from other firms, which generates Williamsonian, 'static' transaction costs. Because the latter diminish as firms gain experience dealing with them, they are eventually eclipsed by the 'dynamic' transaction costs of a firm's not having the capabilities it needs when it needs them, so that, in the long run, the firm's scope of operations depends almost entirely on the relationship between its own capabilities and those of other firms.

> If a profit opportunity requires a configuration of capabilities different from what already exists in the economy, then a Schumpeterian process of creative destruction may be set in motion. If the old configuration of capabilities is decentralized into what we may loosely call markets, then a reorganization within a single organization -- vertical integration -- may most cheaply bring about the necessary redeployment. If, by contrast, the old configuration of capabilities lies within large, vertically integrated organizations, creative destruction may well take the form of markets superseding firms. History offers many examples of both (Langlois and Foss, 1999: 210).

In time, as knowledge diffuses and new technologies are assimilated, all firms become 'more capable', so there is generally flux in the organization of industries as capabilities shift among old and new firms (Langlois and Robertson, 1995: 20-45). Indeed, one of the virtues of the capabilities approach is that, unlike Williamson's, it suggests not just why firms expand, but also why they contract (*cf.* Langlois, 2003).

Joined to the complementary contractual theory of Macneil and Williamson, the capabilities approach is a powerful analytical tool for understanding the historical development of firms. Like the contractualists, it maintains that the firm's working rules *are* the firm, and like Friedrich Hayek (1945) and his Austrian successors, it emphasizes the production and use of knowledge in social orders and expands their cognitive perspective from the individual to the firm itself as a sensing, deliberating and acting agent. It advances the evolutionary program of both traditions by making clearer exactly what is evolving and how the selection mechanism works. And it plausibly suggests why existing firms grow, shrink or stand pat in imperfect markets and how they evolve the internal procedures and routines that enable them to make the decisions and take the actions that this requires. But it does not explain the firm's origins, how human decisionmakers might come to take the risk of creating the firm in the first place. For at the moment the firm is first created, before anyone has had a chance to see how it actually functions, how it performs in competition, or to what kinds of situations it might have to respond, it is very hard for potential contractors to see clearly enough what the properties of the various alternatives are to make the organizational choices that both Williamson and the capabilities theorists demand of them. Given this inevitable uncertainty, the decision of the founding participants to surrender their autonomy and commit themselves to a relational contract must turn on factors other than their confident knowledge of the consequences for them in the future of choosing between market and contract now.

The final piece to the puzzle lies in the Austrian theory of entrepreneurship, particularly the idea of *cognitive leadership* proposed by Ulrich Witt (1999; *cf.* Yu, 1999: 29-31). Following Israel Kirzner (1973), Austrians link the emergence of firms to the entrepreneurial *discovery* of new profit opportunities and the entrepreneur's need for the close cooperation of other people to exploit them. Discovery is not simply stumbling upon objective information that already exists 'out there', waiting to be found. It is the product of active imagination and personal judgment, of seeing how purposes that are not being served by the existing deployment of resources or ways of organizing production might be served, and profits for the entrepreneur and her associates earned as a result, by doing things differently. As the conditional language of Langlois and Foss quoted above seems to recognize, judgment about the existence of such opportunities and the best way to exploit them may not be forthcoming at all, and where it is, it often proves mistaken, a situation competition exposes soon enough. But the willingness of entrepreneurs and their associates to assume the risk of acting on their vision of how things might be done and suffer the consequences of error is an indispensable element of the market process. Whether her new enterprise succeeds or fails, every entrepreneur contributes through the results of her experiment to the creation of new knowledge about how (or how not) to advance human interests by reorganizing the way production is carried out, knowledge that would not otherwise be available to anyone and whose dispersion through the market enables production to be adapted quickly and effectively to changing conditions.

The capabilities model skirts dangerously close to reifying the firm as an organismic entity that possesses knowledge, makes decisions and acts in the market through the operation of its routines. But in identifying the entrepreneur's personal leadership as the vital force that gives birth to the relational contract I have described, the Austrians enable a richer *contract-capabilities* model to be constructed on a firmly individualist foundation. They depict the firm as a consensual, planned production order that comes about when an entrepreneur succeeds in persuading others to cast their lot with her new way of conceiving the production of some good, so that abandoning free agency and associating in the firm to execute the entrepreneur's plan serves their interests as well as hers (Adelstein, 2005). The novelty of the entrepreneur's proposal and the unknowability of its fate in the market means that those who take this risk do so more as an act of faith than a rational choice, a belief in the person of the entrepreneur and the 'rightness', for them, of joining their interests to hers in the contract she envisions. So it is the entrepreneur's act of cognitive leadership, offering a persuasive, inspiring vision of a new way to produce, that provides a provisional sketch of how the new firm will work, induces agreement to the relational contract that constitutes it, and sets the evolution of its collectively defined capabilities in motion. Once a group of people consent to join an entrepreneur in a relational contract to organize production according to her plan, what had once been the entrepreneur's necessarily vague, speculative vision of how a hypothetical firm might work becomes a real firm that must mobilize people to act and compete under its name. The founding contractors cannot anticipate all, or even most, of the circumstances to which the agreement will have to apply, though the character of the relationships they establish at the outset will strongly condition the future development of the contract. But from the first day of operations, daily interactions within the firm begin to create the distinctive, constantly changing routines, procedures and organizational culture that are embodied at every moment in the behavior of the changing roster of contractors.

This is the sense in which firms have an existence of their own, independent of their transient participants and indefinitely sustainable as new parties to the contract replace the old. When we say that a firm 'acts' in a certain way, we mean that specific individuals do specific things through the contract that constitutes their firm that the contractors (and others) come to describe as the actions of the firm. A firm that is active in this sense can indeed adjust its internal organization and its operations as it adapts more or less successfully to circumstances in pursuit of the interests of its participants of the moment.

3. Firms and People

The theory of the firm implied by all this is easily sketched. A relational production contract is proposed to potential associates by an entrepreneur able to visualize, at least in large part, how the contract might actually operate in the future, and if the associates can be persuaded to withdraw their resources from their current uses and commit them to the entrepreneur's plan, a firm is born. At this founding moment, the particular way the original contractors agree to organize and govern the enterprise is the substantive content of the contract itself and the first and most important of the new firm's idiosyncratic capabilities. But from the outset, as participants gain experience with the day-to-day operation of the contract, its terms are continuously subject to revision as contractors come and go and conditions change. Over time, the distilled experience and contributions of all the firm's transient participants are registered in the changing terms of whatever formal or explicit contract the parties have agreed to and, less formally, in the firm's characteristic operating routines and organizational culture. These routines are the firm's mind and hand, and the particular tasks and problems they enable the firm to perform and solve comprise the firm's distinctive capabilities. Through them, the firm senses conditions within itself and in the external environment, considers the appropriate response to whatever problems these pose to the firm, and takes whatever action is deemed necessary to address them. In the market, the ability of these changing contracts to create an internal *modus operandi* that the participants of the moment believe serves their personal interests in production and allows the firm to adapt successfully to changing conditions is constantly put to the test. Under competitive pressure, innovative experiments in organizing production are continuously conducted by new and existing firms and evaluated in the market. The relative success of some in enabling their participants to advance their own interests through the firm is observed;

these are imitated or adapted by others and survive to become the raw material for organizational variants yet to come, while those that fail are dissolved by their participants in their own interests, a process that generates the great variety of organizational forms and cultures that are the visible outcomes of selection in the market.

An essential aspect of the firm's constituent routines is that they are emergent phenomena: they arise not from the actions or qualities of the contractors as isolated individuals, but from the interactions between them structured by the relational contract. They entail novelty, in that the routines display properties that cannot be inferred or predicted solely from the isolated behavior of the people who populate them, and what Geoffrey Hodgson (2003: 164-165) calls *reconstitutive downward causation*, in that they simultaneously result from the behavior of the firm's human participants and in part cause that behavior through the effects they have on the perceptions and intentions of the participants. But none of this implies that firms are ontologically collective entities or that the contract-capabilities model runs afoul of the methodologically individualist insistence that all social phenomena be ultimately traceable without remainder to the actions of living human beings. As Hodgson (2007) points out, social phenomena are social precisely because they involve interactive relations among individuals, so that no explanation of such phenomena can be based solely on the behavior of individuals in isolation. Methodological individualism thus cannot demand that social phenomena be explained entirely in terms of individuals *alone*, only that they be explained entirely in terms of individuals *and* the interactions among them, a formulation that leaves ample room for emergent phenomena without the need to treat them as reified beings able to act and cause events independently of the living people whose behavior gives rise to them.

The contract-capabilities model clearly meets this methodological requirement despite the emergent nature of the social object at its heart. The indispensable role of the entrepreneur in inducing the relational contract in the first instance means that a firm cannot come into existence other than through the interaction of the entrepreneur and the other founding participants, though in appropriate circumstances, firms may play both these roles, as when a consortium of existing firms contracts to create a new one. Every firm's existence at every moment requires the ongoing consent of its human participants of that moment to the roles and relationships created by the contract and manifested in the firm's routines, and performance of those routines is nothing more or less than performance of the human participants in those roles and relationships. Were all the firm's participants to disappear in a flash, the firm would disappear with them, even if its buildings and machines remained behind. Firms cannot act, or exist, independently of living human beings, and there is neither need nor good reason to reify them (or any kind of organization) as 'irreducible' social objects with human-like abilities to sense, think and act. They exist solely in the minds of living people, and act in the world solely through the intentions and actions of living people who are influenced by their beliefs about and attitudes toward firms and by the structure that firms lend to their relationships with other people.

And yet, despite this straightforward demystification, the image of the firm as a reified social actor 'with a life of its own' remains powerful and widespread. A major objective of both Williamson and the capabilities theorists has been to square their theories with Alfred Chandler's portrayal of the origins of the great American industrial enterprises in the late nineteenth century and their development through World War II; indeed, Williamson's 'misuse' of Chandler's history is a recurring theme in Lazonick (1991: 213-227, 265-267), and Langlois (2003) extends Chandler's story by examining the decline of the great firms later in the twentieth century. Chandler's subject is the rapid transformation of the American economy from *personal capitalism*, a decentralized economy of small proprietorships and partnerships, to *managerial capitalism*, an industrial system dominated by large enterprises operated by hierarchies of salaried managers. This was led by the *capital-intensive* industries, in which new technologies and reconceived production methods permitted far greater economies of scale and scope than were possible in traditional industries. The new technologies enabled vast quantities of output to be manufactured at very low unit cost, but realizing these efficiencies required high levels of *throughput*, a constant, high-volume stream of inputs flowing through the production process to ensure that expensive equipment and facilities operated near full capacity.

Maintaining this flow of resources through complex, closely scheduled production processes subjected capital-intensive firms to two kinds of centralizing forces. One was a need for detailed administration and coordination that could only be provided by an extensive managerial hierarchy with authority over all aspects of production, which moved big firms to tighten horizontal combinations into integration by absorbing smaller, independent competitors. The other was a need for stable sources of inputs and reliable outlets for high volumes of continuously produced output, which drove them to integrate vertically by merging with existing suppliers and distributors or creating internal substitutes for them. The first of these forces determined which of the ubiquitous horizontal combinations of the 1870s would survive and tighten, and the second made asset specificity at the boundaries of the horizontally integrated firms a source of high transaction cost and drove large manufacturers to integrate forward into distribution and marketing and backward into supply of their inputs (Chandler, 1984: 479-492).

Hence the need for three critical investments (not Lazonick's two) by entrepreneurs in the capital-intensive industries: in technology and production facilities, in large-scale marketing and distribution systems, and in management and organization. Chandler was much impressed by the performance of the new managerial hierarchies. The ability to manage production in large firms called for new skills and aptitudes that were not 'out there' to be purchased; they had to be learned on the job by the men, primarily engineers with experience in the technical aspects of the new processes (Adelstein, 2005: 71-79), who built and occupied these hierarchies. As they did, they created the routines and capabilities that allowed their firms to grow and prosper. These

> resulted from solving problems of scaling up the processes of production, from acquiring knowledge of customers' needs and altering product and process to service needs, coming to know the availabilities of supplies and the reliability of suppliers, and in becoming knowledgeable in the ways of recruiting and training workers and managers. Such learned knowledge manifested itself in the firms' facilities for production and distribution [and was] developed through trial and error, feedback and evaluation; thus the skills of individuals depended on the organizational setting in which they were developed and used. Such learned skills and knowledge were company-specific and industry-specific [and] difficult to transfer from one industry to another, or even from one company to another, precisely because they had been learned within a very specific organizational context (Chandler, 1992: 84).

Where Williamson, like Commons, had focused on the transaction as the basic unit of analysis, for Chandler,

> it is the firm and its specific physical and human assets. If the firm is the unit of analysis, instead of the transaction, then the specific nature of the firm's facilities and skills becomes the most significant factor in determining what will be done in the firm and what by the market.… [O]rganizational capabilities permit the enterprise to be more than the sum of its parts. They give it a life of its own above and beyond those of the individuals involved. The individuals come and go, the organization remains (*ibid*: 85-86, 86-87).

I have emphasized the role of the entrepreneur in envisioning and creating new production contracts, persuading others to join in her vision, taking responsibility for conducting the organizational experiments that allow more efficient forms to be identified in the market, and bearing the consequences of the results. But Chandler's embrace of capabilities theory leads him to subtly efface the entrepreneurial role from his history. We see the faces of the famous entrepreneurs who built the great firms in his work, but they seem incidental to his story, which is about larger forces like the development of technology and the organizational imperatives it imposed on production. Little is said about the perspicacity and leadership that actual entrepreneurship entails, or the stroke of insight about how specifically to achieve the imagined future that leads to a new or new kind of production contract, perhaps because, beyond that, there is little more that can be said about them analytically. But when performance of the entrepreneurial function is brought to the fore, a third, intermediate stage of historical development must be placed between Chandler's personal and managerial capitalisms.

This was the time of *entrepreneurial expansion*, a brief period lasting roughly from 1870 to 1900 during which the great entrepreneurs (or robber barons, as one prefers) first imagined and built the giant firms that outlived them and dominated the industrial economy for decades. In this transitional phase, we can see their ideas and what they contributed, and judge the moral quality of what their firms did, because it was primarily *they* who did it or caused it to be done. When their burgeoning firms were the vehicles of these men's personal ambitions, they were, like Carnegie Steel, often partnerships rather than corporations, so there was no legal personality (or responsibility) inserted between the firm's behavior and the person or people who made it behave that way. By 1910, the original entrepreneurs were all but gone, replaced not by visionary, aggressive, sometimes flamboyant men like themselves presiding over closely held fiefdoms, but by professional managers providing an increasingly homogeneous input to production in a much more impersonal production contract. No longer did their firms do what they did because a commanding personality wanted it done and others agreed to help him do it. A firm's actions were now the outcomes of its routines, which replaced personal association with the entrepreneur as the 'ontological glue' (Gindis, 2007: 19-21) holding what were now very large, publicly traded corporations together.

4. Firms as Persons

Should firms have rights to such things as free speech, due process and equal protection of the laws, as living men and women do? From one perspective, the answer is simple and conclusive: rights like this are given by God or nature only to natural persons, and not to any artifacts they might construct as they exercise them. But the contract-capabilities model demands more nuance than this. Insofar as firms entail the agreement of participants to subordinate, as necessary and to a limited extent, their own interests of the moment to the organization's governing objective of producing goods for profit (*cf*. Adelstein, 2005: 67-69), they are *individuals* in the sense described by Elias Khalil (1997: 534-540). And insofar as they represent agreement to associate in pursuit of this objective that is made openly and conditioned on the willingness of others to act similarly, they are *plural subjects* as defined by Margaret Gilbert (1989: 204-236). Firms exist in the minds of human beings and are real social actors, ontologically distinct from their human participants, able to see, think and act in their own right through the capabilities that emerge from their constitutive relational contracts. How can their powers be legitimated? What constitutional respect are they due?

Philip Pettit (2002) offers a useful way of thinking about the problem. He asks what properties groups and their actions must display before we can call them *institutional persons*, credible candidates for powers or rights. His answer centers on the *discursive dilemma* that is posed in a wide variety of common settings to social groups that aspire to deliberative, reasoned judgments. Suppose a conclusion X requires that both premise A and premise B be true. A group can decide on X in two ways: it could have each member decide for himself on A and B and then vote only on the conclusion this implies for X, a *conclusion-centered procedure* (CCP), or it could poll the members only on the individual premises and let those decisions dictate the logical

X, a *premise-centered procedure* (PCP). The dilemma arises because in many plausible circumstances, the two procedures will lead to different conclusions by the group regarding X, and because PCPs can reach conclusions on X that are not shared by even a single member. So choosing which kind of decisionmaking procedure to adopt, a choice that Pettit argues must be made by every group in one way or another, means choosing what kind of group its members want it to be: CCPs make it simply an instrument of the current desires of its members, while PCPs enable it to defy its membership on the question at hand to preserve logical consistency with other decisions. Juries typically face this dilemma in synchronous form, evaluating A, B and X in the context of a single verdict, but for most groups, including appellate courts, it is posed diachronically, where the premises are collective decisions previously made by the group and logically related to X. In this case, the group may choose to determine X by CCP, letting the decision of the group respond directly to the views of members on X but risking collective decisions that are inconsistent with earlier positions, or by PCP, ensuring that the group's decision is 'collectively rational' over time even where this produces results that are contrary to the views of members on X (*ibid*: 446-454). This latter possibility, that the collective decision on X may not reflect the conclusion of any of the members, suggests the sense in which Pettit claims that PCPs 'collectivize reason'. A group that can defy its members in pursuit of consistency with its own, previously expressed values does indeed seem to have a mind of its own.

Pettit argues that 'purposive groups', among which he counts business corporations, 'will almost inevitably confront…the discursive dilemma and that, short of resorting to deception, they will be under enormous pressure to collectivize reason and usually, though not inevitably', to do this by employing PCPs rather than CCPs (*ibid*: 452). This, he says, is because they want to be taken seriously, by their members and others, as rational, effective public advocates of their purpose. Producing inconsistent decisions over time, especially if this occurs frequently and little effort is made to reconcile the inconsistency, makes the group 'a laughingstock among its followers and the [public] at large; it could no longer claim to be seriously committed to its alleged purpose' or to be credible promoters of it (454). He goes on to define groups that do collectivize reason by adopting PCPs as *social integrates*, and argues first that, unlike non-PCP groups, mere 'aggregations of people', social integrates are capable of forming autonomous intentions (455-460), and then that, because they 'can avow their intentional states and the actions they perform in words -- or in signs of some other sort -- [and] can then be held to the associated expectations', social integrates deserve to be treated as institutional persons, again unlike other groups, which 'will not be answerable in the same way to words previously authorized or deeds previously performed' (461). Only such institutional persons, he concludes, should be allowed to exercise coercive power, and to constrain its arbitrary use, all bodies that possess it should behave as persons, responsible to the avowed pursuit of the common good (463-468).

This last normative turn makes clear that Pettit is more interested in the granting of powers to coercive state agencies than the granting of rights to consensual institutional persons. But his analysis is nonetheless usefully turned to firms, and cuts in different directions when different aspects of a firm's operation are considered. Thus, while Pettit recognizes (*ibid*: 449) that not all groups can or will engage in formal decisionmaking procedures that fit the simple CCP or PCP models, it seems clear that, in the broad range of short- and long-term operating decisions they typically face, profit-seeking business firms will generally not adopt premise-centered decisionmaking, explicitly or implicitly. Precedent does play an important role in the operation and evolution of every firm's decisionmaking routines, limiting the range of feasible alternatives presented for decision and structuring the way choices between them are made, but where profit is the firm's governing objective, there is no analogue to *stare decisis* in the firm that attaches special weight to decisions made in the past and motivates the adoption of a PCP. Suppose that, in 1985, an American firm was forced to choose between purchasing an input from an American supplier or a foreign one, and concluded that buying from the American supplier was more profitable. When a similar problem arose in 1995, the conclusion was the same, and the firm again chose to deal with the American supplier, establishing an informal precedent of 'buying American'. If the problem arises a third time, in 2005, but this time conditions have changed such that dealing with the foreign supplier is now more profitable for the firm, the weight of the precedent becomes an issue.

Perhaps a small firm operated by patriotic Americans might find it worth bearing the competitive disadvantage that would result from following the precedent, though its ability to sustain this preference in the face of market competition may be short-lived. But for larger firms, especially those whose shares are traded publicly, it is very difficult to sustain any governing objective that does not comport with profit-maximization, and the precedent is very likely to give way to the needs of the moment. Profit in the present will dominate loyalty to the past, and pressures for consistent advocacy of any particular set of organizational policies will typically be dwarfed by the imperatives of pursuing profit in the present. A firm, perhaps unlike other kinds of purposive groups, looks 'serious' or 'credible' to its participants and the public only insofar as it is able to achieve the governing objective of earning profit, whatever ancillary purposes it might choose to pursue and whether or not the pursuit of profit requires it to change its collective mind frequently or unpredictably. Contrary to Pettit's strong assertion, firms are purposive groups, and perhaps even intentional subjects, that generally do not adopt PCPs and face no strong pressure from any constituency to do so. As a result, in making most kinds of operating decisions, profit-seeking firms cannot be institutional persons, and thus should not be potential bearers of constitutional rights.

There are, however, some areas of a firm's operations where this may not be the case. As Macneil (1978: 898) points out, as relational contracts come to encompass larger numbers of people and control more assets, the resources and power of the organization become far greater than those of most of its participants, and the contracts themselves take on some of the qualities of states. Where this is so, the field of relevant subjects for negotiation expands to include such things as distributive and procedural justice, human dignity and social equality. In areas such as hiring, firing and promotions, where the firm must confer benefits or impose costs on some individuals but not on others, predictability and even-handedness are highly valuable properties of collective decisions, and firms will often find it in their interest, or be required by law, to adopt decisionmaking procedures in which clear expectations are established and *stare decisis* plays a greater role than it does in other aspects of the firm's operation. Where the firm is large and the individual small, firms may exercise significant private power over individual participants and thus derive considerable competitive advantage from the kind of public legitimacy conferred by PCPs that minimize the incidence of seemingly arbitrary decisions and are broadly seen both within and without the organization as fair and impartial. In these cases, Pettit's analysis applies more directly. Firms that *do* behave as institutional persons by establishing and enforcing internal decisionmaking procedures based on precedent that consistently respect widely shared norms of due process and fair play can in this sense be said to have legitimated the private power they exercise in the eyes of potential trading partners and the public. And contrarily, firms that do not act as responsible institutional persons deserve to be held to account, privately in the market and publicly through the law, for their failure.

V. Conclusion

I have argued here that firms are real social actors, ongoing relational contracts from whose performance arise the firm's distinctive routines and capabilities, that this depiction can be firmly grounded solely in the behavior of individual men and women in the here and now, and that there are good reasons to deny firms the protection of constitutional rights but hold them responsible for treating their participants and others in accord with widely shared notions of due process and fair play. These last two points each suggest productive directions for future work. As Nicolai Foss (2003: 196) points out, capabilities theorists have generally failed to specify clear logical links between the motivation and behavior of individuals within a firm's routines and the operation and evolution of the routines themselves, which has led some to postulate 'somewhat crude causal relations between capabilities and economic organization [with] little attention being paid to the microanalytic issues involved'. The production of more sharply defined testable hypotheses about the organization and operation of firms within a methodologically individualist framework seems to depend on the development of just such microanalytic linkages. And this in turn might lead theorists to look more closely at how routines and procedures actually work in practice, how they structure working relationships among a firm's participants and the effects these structures have on the incentives and performance of the participants and others, and what political or moral qualities they might possess as a result.

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