CORPORATE GOVERNANCE

Agency and Shareholder Theory

Berle & Means · Jensen & Meckling · Fama · Manne

PAPER 01 / 03

A Furtherance reference compendium on the intellectual traditions behind organisational design, leadership, execution, and culture.

IN THIS PAPER

This paper opens the Corporate Governance series in Furtherance's reference library. It covers the agency and shareholder tradition — the theory that frames the public company as a problem of aligning managers with owners. The question it answers: when those who run a company are not those who own it, what keeps managers accountable?

Berle and Means named the founding problem — the separation of ownership and control. Jensen and Meckling turned it into agency theory; Fama showed how markets discipline managers; Manne cast the takeover as the ultimate check.

Berle & Means The Modern Corporation and Private Property, 1932

The founding governance problem

CORE THESIS

In the modern public corporation, **ownership is separated from control**: shareholders are dispersed and passive, while professional managers hold real power. This separation is the foundational problem of corporate governance.

FRAMEWORK

Idea	Meaning
Separation of ownership and control	Owners own; managers control
Dispersed shareholders	No single owner has the power or incentive to monitor
Managerial power	Control accrues to executives, not owners

METHODOLOGY

An empirical and legal study of the ownership structure of large US corporations.

SIGNIFICANCE AND CRITIQUE

The founding text of corporate governance, framing the question everything since has answered. The critique: it is descriptive, predating the formal theory that followed.

Jensen & Meckling Theory of the Firm, 1976

Agency theory · the nexus of contracts

CORE THESIS

The firm is a **nexus of contracts**, and the separation of ownership and control creates **agency costs**: managers (agents) may not act in owners' (principals') interests. Governance and incentives exist to align the two and minimise those costs.

FRAMEWORK

Agency cost	Meaning
Monitoring costs	What owners spend to observe and constrain managers
Bonding costs	What managers spend to signal commitment
Residual loss	The remaining loss from imperfect alignment
Alignment levers	Equity ownership, debt discipline, incentives

METHODOLOGY
Economic theory of the firm built on contracts and incentives.

SIGNIFICANCE AND CRITIQUE
The dominant theoretical frame in governance and corporate finance. The critique: it is shareholder-centric, assumes narrow self-interest, and downplays other stakeholders – the tension the third paper takes up.

Eugene Fama Agency Problems and the Theory of the Firm, 1980

Market discipline · Nobel laureate

CORE THESIS
Separation of ownership and control can be **efficient**, because **markets discipline managers**: the managerial labour market prices reputation, and decision management can be separated from decision control so that no one both proposes and ratifies.

FRAMEWORK

Mechanism	How it disciplines
Managerial labour market	Reputation and future pay depend on performance
Decision management vs control	Split initiating from ratifying and monitoring
Market pricing of information	Efficient markets reflect available information

METHODOLOGY
Financial economics, extending agency theory with the logic of efficient markets.

SIGNIFICANCE AND CRITIQUE
Refined agency theory and showed why the separation can persist efficiently. The critique: the efficient-markets assumptions underpinning it are themselves contested.

Henry Manne Mergers and the Market for Corporate Control, 1965

Takeovers as discipline

CORE THESIS
The **takeover** is a governance mechanism. A “market for corporate control” disciplines poor managers: underperforming firms trade at low share prices, invite acquisition, and see their management replaced.

FRAMEWORK

Idea	Meaning
Market for corporate control	Control changes hands to raise value
Takeover as discipline	The threat of acquisition checks managers
Share price as signal	Low prices flag underperformance and invite bids

METHODOLOGY

Law-and-economics analysis of mergers and managerial accountability.

SIGNIFICANCE AND CRITIQUE

Foundational for viewing takeovers as a disciplining force. The critique: it is contested — takeover threat can encourage short-termism, defences blunt it, and some of Manne's related positions remain controversial.

> **A NOTE ON EVIDENCE**
>
> A note on stance: this tradition is both descriptive and normative — it does not merely describe the agency problem but tends to prescribe shareholder primacy as the answer. That prescription is contested, and the third paper presents the stakeholder and purpose counter-tradition. Read this paper as the rigorous case for one pole of an unresolved debate, not as settled doctrine.

Synthesis

Contribution	Role	Key idea	Register
Berle & Means	The problem	Separation of ownership and control	Founding study
Jensen & Meckling	The theory	Agency costs; nexus of contracts	Economic theory
Fama	Market discipline	Labour market; decision control	Financial economics
Manne	The takeover	Market for corporate control	Law and economics

> **FOR THE OPERATOR**
>
> The agency tradition frames the company as a problem of aligning managers with owners — the separation of ownership and control (Berle & Means), the agency costs it creates (Jensen & Meckling), and the market mechanisms that discipline managers (Fama, Manne). For the operator: incentives, monitoring and accountability structures exist to close the gap between those who run the firm and those who own it. The next paper turns from theory to the board — where accountability is meant to live in practice.