

TSE M1 – Semester 1

September 2016

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# Understanding Real World Organizations

## Week 4:

What's special about firms? Part I



# What's special about firms: Part I

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- In law
- In organization and incentives
- In values



# What's special about firms? Outline:

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- Trust, mutual benefit, and delegated trust
- The separation of ownership and control
- Three ideas that define the modern corporation: legal personhood, tradable shares, limited liability
- The prehistory and history of the corporation: technology, size, risk
- Communication, values and the modern corporation

# The problem of economic exchange

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- Trust in bilateral contexts

- Delegated trust



# The separation of ownership and control


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- Has been a management buzz-phrase since the 1940s but the underlying predicament is ancient
- Ideas need to work with resources, but those who have ideas do not necessarily own resources
- Why can't they simply sell their ideas?
- Managerial talent is as hard to transfer as ideas



# Three ideas that define the modern corporation

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- Legal personhood – the concept goes back at least to Roman times
  - Tradable shares - we have evidence of this from around 1250 (Bazacle in Toulouse)
  - Limited liability – consolidated by UK Companies Acts of the 19<sup>th</sup> century and rapidly copied in other jurisdictions
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# The prehistory of the modern firm

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- Families, Gangs, Armies, Traders
  - Temples, Kingdoms, Imperial works
  - Roman *societates*
  - Medieval guilds
  - The first shareholding enterprises
  - Chartered trading companies
  - Royal manufactures
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## The East India Company's ships....





# The East India Company's troops....



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# Villeneuve



# The history of the modern firm (I)

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- Proto-industrialisation
  - The industrial revolution in Europe
  - The invention of the limited liability joint-stock company (JSC Acts of 1844, 1856, Companies Act of 1862)
  - The large American firm in the 20<sup>th</sup> century
  - The outsourcing revolution from Toyota to tech support
  - Non-joint-stock firms: cooperatives and partnerships
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# The history of the modern firm (II)

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- First industrial revolution (steam, textile machinery, steel) favored size because
  - Raised returns to precision engineering
  - Allowed energy efficiency of large machines to be harnessed
- Second industrial revolution (electricity, telephones, automobiles) more ambiguous because
  - Freed firms from need to produce close to the customer
  - Also diminished need to produce close to suppliers or rivals



# The history of the modern firm (III)

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- Third industrial revolution (IT, internet) is ambiguous again – the firm's boundaries are becoming more fluid in any event
  - The trucking industry in the early 2000s
  - Platforms and Uberisation



# Conclusions

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- The modern firm has grown out of a history of evolving non-market means of managing economic transactions, but it has taken a very particular legal form
- This evolution is the result both of technological change and institutional innovation
- Next week we will consider why the institutional innovations have been necessary, and why firms continue to exist at all in a world of rapid communication between individuals



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