Natural Law and Agency Theory

Michael LP Lower
Introduction

This article argues that natural law theory can provide a great deal of light concerning the nature and purpose of organisations such as the firm. The firm has an essentially economic purpose, it is true, and a number of important consequences result from that fact; natural law theory cannot claim to do away with the need for adequate theories of the firm. Thus, a specialised literature discusses the agency problem, the importance of the role and composition of the board (in general and in specific contexts), the contribution that institutional investors can play in corporate governance and so on. It is, indeed, quite legitimate and reasonable for much of the discussion of the theory of the firm to focus on its economic purpose.

But the firm is also a community of human persons and so natural law explanations of human action, of the nature of communities and of the fundamental principles that govern their effective functioning are as valid for firms as they are for any other human community. There is a distinct body of knowledge concerning the moral or ethical aspects of the firm (about the firm considered more generally as a human community) that operates at a higher level of importance and abstraction than the more specialised economic or managerial theories concerning the firm. Moreover, since economic analysis

1 The author would like to thank Lilian Miles of Manchester Business School and Sam Gregg, director of the Center for Economic Personalism at the Acton Institute, for their helpful comments on earlier versions of this paper. The shortcomings are the author’s responsibility.
is intended to influence practical decision-making, it has, for reasons that this article will try to make plain, to be seen as an aspect of a broader moral analysis. Economic analysis looks for the most efficient means to secure given ends and it has developed its own tools and methodology to help it in this task. Moral theory has no role to play at this technical level. But it does interact with, and to an extent govern, the work of economists since it discusses the sorts of ends that human behaviour (including human social, economic and political life) ought to pursue. Ethics is especially concerned, as will be seen, with how human well-being can successfully be pursued and efficiency is one, but only one, of its concerns.

To put it another way, any valuable or meaningful discussion of “the firm” has to operate at a number of levels. It will, no doubt, incorporate discussion of the economic aspects of the firm’s governance mechanism (the managerial hierarchy, its constitution including the system of checks and balances incorporated in it and so on). But it should also incorporate a discussion that takes place at another, prior level. It considers, for example, the purpose of “the firm” and inquires about the nature of the relationship between the members of the firm and the demands that membership imposes on the members and on those in charge of the firm. These are moral or ethical questions that impose themselves on any discussion of the firm and the way that it is run. This article is primarily concerned with these questions. It looks at them from the perspective of natural law theory and, in particular, the author’s understanding of the natural law theory of John Finnis². John Finnis is, undoubtedly, one of the leading contemporary natural law

theorists and this article tries to show that his theory makes it possible to understand the nature and purpose of the firm and corporate governance.

The first section of this article will provide a basic explanation of natural law and the ways that it can illumine discussion about the nature and purpose of the firm and about the ethical responsibilities of those in charge of it. The second section, to illustrate some of the points made in the first part, will evaluate agency theory and compare its underlying assumptions and approach with those of natural law. A number of commentators have observed that agency theory is capable of harming both the businesses that espouse it and their participants.\(^3\) This paper will offer some suggestions as to why this is the case; it will be argued that, ultimately, it is because agency theory disregards fundamental truths about the nature of the firm as a community or, put another way, about the nature and purpose of the firm and the relationship between the members of a firm.

Section one: Natural law: the firm as a community of persons

This sketch of a natural law framework for understanding the firm as a community of persons begins by looking at human action; it uses natural law theory to try to build an understanding of what motivates human activity and at the moral rules that guide it. An

understanding of what motivates people (in this case shareholders and employees\textsuperscript{4}) to act and of the purposes that underlie human action is an essential point of departure for a discussion of the nature of human communities, such as the firm. In the last analysis, the whole point of communities (such as the firm) is that they provide the means for each of their members to pursue some aspect of their life plans. Thus, an understanding of the elements of a coherent life plan, and of the role that membership of a community plays in pursuing it, is vital if one is to understand the meaning of “community” and “common good”. Since firms are human communities, there are ethical principles that apply to firms just as much as to any other human community. Natural law theory makes its contribution at this level; it explains how communities contribute to the well-being of their members and the demands that communities can make on those who form part of them. Theories of the firm, such as agency theory, are more specialised in nature but need (if they are to be helpful and enlightening) to be compatible with it. Natural law theory can provide a sort of reality-check for theories of the firm.

**Human goods**

Natural law theory dwells on practical reason\textsuperscript{5}; it looks at what reason suggests to us as being goods or goals to pursue when we decide how to act and when we form our aspirations and plans. Reason discerns that certain goods fulfil us as human beings and that there is an inner tendency or drive to desire those goods. John Finnis argues that all such goods can ultimately be reduced to one (or some mixture) of certain basic goods or

\textsuperscript{4} Shareholders and employees are the actors most likely to consider the well-being of the firm as an aspect of their own well-being and so, for reasons to be explained later to be prepared to take the good of the firm as being a substantial factor to be borne in mind in their own practical reasoning.

\textsuperscript{5} Intellectual activity directed to action rather than to the acquisition of knowledge for its own sake.
values: life, knowledge, play, aesthetic experience, sociability / friendship, practical reasonableness and “religion”. There is nothing “moral” about these goods; they are, simply, goods that a mature, sensible person would recognise as having a positive role to play in a well-rounded human life. Thus, such a person would acknowledge that it is better to be well-informed than ignorant, sociable than selfishly individualistic, and so on6.

Successful integration of these goods in a human life: practical reasonableness

Reason does not only demand that we recognise these (or some similar) goods or values as being goods or values that are fitting for us, as humans, to pursue; that can almost be taken for granted in any reasonably mature person. It goes further to discover rules that allow us to incorporate these goods into our lives in a practically reasonable (or ethical or moral or effective) way. Careful reflection allows us to see how we can successfully integrate the pursuit of the basic goods or values into our lives so as to advance towards what some natural law texts refer to as “self-constitution”, “self-realisation” or “self-fulfilment” or “human flourishing” (these and similar terms will be taken as synonyms in this article). No-one can ever hope to exhaust all of the possible ways in which the basic goods (or goods constitutive of the human person) can be integrated into a human life. We have finite time, resources and talents and so choices have to be made. Each good is capable of being lived out in an almost endless number of ways (think of all of the possible approaches to knowledge and branches of learning, for example). We can only hope to participate in the basic goods or values and to find some way of integrating them

6 Finnis, n 1 above, pp. 59 – 99.
into our lives with reasonable success. Thus, human life can be seen as a quest to participate *effectively*, and in ways that accord with our circumstances and tastes, in the goods or values that are constitutive of human persons. Practical reasonableness\(^7\), or ethics, tries to establish the ground rules for setting about this task. This paper is not the place to list or discuss every aspect of practical reasonableness but they include such considerations as; the need to have a coherent plan for one’s life, avoiding arbitrary preferences amongst the basic goods and between persons, a commitment to pursuing one’s plan of life and having reasonable concern for the consequences of one’s actions\(^8\).

**Community and the common good**

Practical reason also has to establish the relationship between one’s own efforts to achieve self-realisation or integral self-fulfilment and that of others\(^9\). Thus, the concept of “community” has to be introduced here. The term “community” incorporates a range of meanings, but its essence is common action; the creation of a community involves a deliberate choice to co-ordinate one’s own activity with that of others. One or more people can be said to be a “group” or “community” or “society” if they share some common purpose. As Finnis puts it:

> “a group, in the relevant sense, whether team, club, society, enterprise, corporation, or community, is to be said to exist whenever there is, over an

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\(^7\) The fruits of the efforts of reason directed towards action.

\(^8\) Finnis, n1 above, pp. 100 – 133.

\(^9\) Finnis, n1 above, pp. 134 – 160.
appreciable span of time, a co-ordination of activity by a number of persons in the form of interaction, and with a view to a shared objective.”

The relationship between the members of a group could have one of several bases; utility (where each member is purely self-interested), pleasure (where, as in a game, the collaboration is seen to be its own purpose) or the more thorough-going form of community based on friendship (the fullest form of community where members collaborate for the sake of concern for the well-being of the other or others). A community may belong to more than one of these categories at once and may shift from one category to another, as when a business or play relationship becomes a friendship.

Friendship, the paradigm for the most profound sense of community, involves a transformation of the internal attitudes of the friends. Each friend is prepared to act for the sake of the well-being of the other and sees the friend’s well-being as a constituent of his or her own well-being. Where there is friendship in its fullest sense, each friend adopts this attitude to the other’s well-being and there is mutual awareness of this state of affairs. Thus, a kind of shared viewpoint emerges so that a person’s own good and that of his or her friend are both seen as relevant and providing rational motives for action.

The term, “common good” (which can be used to describe this shared viewpoint) has a variety of meanings; Finnis proposes the following:

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10 Finnis, n 1 above, p. 153.
“a set of conditions which enables the members of a community to attain for themselves reasonable objectives, or to realize reasonably for themselves the value(s) for the sake of which they have reason to collaborate with each other in a community.”  

This definition of “common good” emphasises that the purpose of a community is to help its members to achieve at least some of their objectives. The purpose of any community is to play at least some part in helping its members to achieve their integral self-realisation. At the same time, membership of the community and acting for the sake of the other members is also a constituent of one’s own well-being.

Corporate governance as an element of the common good of the firm

Corporate governance can be thought of as an aspect of the common good of the firm; an arrangement that helps its participants to pursue their own self-constitution or self-realisation. The purpose of the firm’s governance mechanisms (and the board is the main governance mechanism) is to co-ordinate the interaction between the participants in the firm. Effective governance will allow the firm to meet its customers’ needs better. It will also make it possible for the firm’s participants to co-operate with each other and, by doing so, to pursue their own self-realisation. Thus, the participants in the firm have a common good in the sense that the well-being of the firm is a component of the well-being of each of them; the firm helps them to achieve their own personal goals. A form of “friendship” emerges, in the sense that the participants in the firm come to adopt the

11 Finnis, n 1 above, p. 155.
perspective of “the firm”. They see things neither exclusively from their personal perspective nor from that of the other employees and shareholders but from a kind of composite perspective (the perspective of the firm). Thus, membership of the firm is capable of effecting a change in the internal attitude of its members and a willingness to work for the good of the firm.

How the firm helps its members in their quest for self-realisation

The firm exists, in one sense, to provide its goods or services. More accurately, one might say that it allows the firm’s participants or members (notably its employees and shareholders) to offer a range and sophistication of services that they could not offer as individuals. At the same time, and at least as importantly, it allows the participants to pursue their own flourishing or self-realisation in ways that would be denied them otherwise. It helps the participants to achieve a range of basic human goods (preservation of life, work, friendships, knowledge and so on) in ways that may well be superior to anything that they could have achieved acting alone. Natural law theory suggests that it is appropriate to stress the importance of the firm as a tool for helping its participants in these ways just as much as its importance as a provider of goods and services. According to this understanding of the firm as a human community, there is no reason to stress the good of shareholders over that of employees.

12 Of course, it does so only for certain purposes since it affects only some aspects of the lives of its members.
Someone employed in a firm, for example, works for a number of reasons: salary, reputation, enjoyment of the work, to meet people, to help others and so on (it is not argued that everyone is moved by all of these reasons). But the salary is not an end in its own right. It is used to pay, amongst other things, for food and shelter; thus, it meets the need to preserve life (one’s own and that of dependents). The salary also allows other human goods to be pursued (knowledge, play and so on). In addition, the firm is a provider of jobs, of work to be done. Work, although not included in Finnis’ list of basic human goods is in fact just such a good; work is an essential aspect of the development of the human personality and is perceived by most people as a need (regardless of the need to support oneself through work). The firm, in providing work for employees, is meeting an important human need.

Shareholders participate in the firm for a range of reasons. Most obviously, investment is a way of putting capital to good use. Many of us will rely on the return on investments (which may be organised through a pension fund) to replace our salary in old age. Investing may also be associated with meeting more immediate needs (in the case of the self-employed, for example) or in finding productive uses for money that is not needed immediately. Shareholders, too, engage with the firm for reasons that can ultimately be analysed in terms of the pursuit of basic human goods and in terms of freedom or autonomy. Freedom is a vital component of human dignity since, as already explained, practical reason is directed towards our own self-constitution or self-possession. This implies that the role of common enterprises, such as the firm, is to help its individual members to help themselves. Without it, the ability to shape and pursue a life plan would
be compromised by reliance on others or by uncertainty as to whether certain basic goods had been effectively secured beyond the short term. Share ownership, and the ownership of private property in general, help to create a sphere of personal autonomy and so make it easier for us to help ourselves. Thus, human dignity, as well as efficiency or good husbandry of resources, points to the reasonableness of share ownership\textsuperscript{13}.

\textbf{Self-fulfillment is not selfishness}

The fact that we can consider action for the common good as an integral component of our own well-being is an extremely important aspect of natural law theory. The utilitarian approach that underpins the economic analysis of law and, hence, the agency theory that will be described in the next section rests on an assumption that “rational actors” are motivated by a very narrow (egoistic) form of self-interest. How does natural law theory’s talk of “self-interest” and so on differ from its utilitarian namesake? Finnis examines this question in his study of the natural law theory of St Thomas Aquinas\textsuperscript{14}. It is common, in the modern era, to think of ethics as being concerned with a search for reasons to escape egoism. But Aquinas did not think that there was a chasm between my good and that of others. Human beings are capable of being motivated by the human goods both in their own lives and in those of others; we can see the point of helping others to pursue their own self-constitution and to instantiate the goods constitutive of human persons in their own lives. It is the goods that provide us with reasons for action, not the fact that the good is “my good” (this is not to say that it is unreasonable to give

\textsuperscript{13} See Finnis, n1 above, pp. 169 – 173 (on the role of private property in assisting owners’ efforts at self-realisation and its orientation towards the common good).

priority to instantiating the basic goods in one’s own life and in those closest to one).
Acting for the good of another creates a bond of friendship that is, in its own right, a good for the persons involved. It is quite possible to decide to pursue an egoistic plan of life but this, quite simply, is irrational for it involves a decision to act in ways contrary to one’s own self-constitution and to deny the relevance of the good of friendship. Finnis explains, in terms similar to those already described above, the kind of shared perspective that prevails between friends: each friend is prepared to act for the sake of the good of the other and sees that good as a constituent of his or her own good:

“So their relationship of interest (will, choice, action and affection) is, and is directed towards, a truly common good – not simply two individuals of the same ‘common’ type, nor the sum of those goods. It is that truly common good which gives their relationship, their sharing … its intelligible ground or point. Neither person’s well-being is instrumentalized to the other’s. Self-love is, so far forth, transcended. This is the answer to the fear that my choices, even my good choices, must all be primarily and / or fundamentally for my own sake, for my own self-fulfilment.”

Summary of section one
The first section of this article has provided an overview of natural law theory. Human action is driven by a tendency to pursue self-constitution by pursuing certain goods that reason recognises as being goods that are constitutive (or fulfilling) for human persons. Practical reason (intellectual activity directed to action rather than speculative or purely

theoretical knowledge) suggests certain requirements concerning the pursuit of these goods; that is to say, it recognises that the goods have to be pursued ethically. One of these requirements is a willingness to work for the common good of one’s communities and to see the common good as a constituent element of one’s own well-being. One could say that there is an inner logic or dynamic to the concept of community; when that logic is accepted by its members, they are willing to work for the common good. The common good is not the good of an abstract collective, but rather the good of the individual members of the community; the community exists to help its members achieve their integral self-realisation. All of this can be used to understand the firm as a human community. It makes it easier for employees and shareholders to co-operate so that each of them can achieve certain aspects of their self-realisation.

This account of the firm as a human community does not do away with the need for theories of the firm (specialised theories that try to understand the role of firms in the economy and how firms work best). But theories of the firm are inadequate (or misleading) if they fail to understand that the firm is a community of persons and everything that follows from that. This section of the paper has argued that natural law theory can provide a realistic account of the essential nature of any human community such as the firm. Although the relationships within the firm rest on contract, the notion of contract and of market-place exchange do not fully explain the nature of the relationships within the firm. Effective governance needs to start with an understanding of the true nature of any human community. The next section of the paper looks at agency theory and explains how it conflicts with a realistic appreciation of the nature of a firm.
Section two: Agency theory

Agency theory\textsuperscript{16} focuses on the costs generated by the separation of ownership and control found in the largest businesses in the UK and elsewhere: shares in UK listed companies are often owned by a very large number of shareholders each having a very small fraction of the total number of issued shares. Individual shareholders lack the means and the incentive to monitor the managers who control the business. Thus, there is the risk that managers will appropriate corporate resources for themselves (contrary to the expectation that they will manage them for the sake of “the company”). UK company law has long accepted that directors might abuse the confidence placed in them and has tried to address the problem by imposing fiduciary duties and, more recently, through the more detailed rules in Part X of the Companies Act 1985. UK corporate governance practice goes still further and looks for additional mechanisms to protect absentee shareholders from the effects of managerial self-interest. It has adopted monitoring systems (the use of NEDs on corporate boards and their committees to monitor executive directors) and high-powered incentives (the use of shares and options as significant components of executive remuneration).

Adverse effects of agency theory

\textsuperscript{16} For an explanation of agency theory, see, for example, Michael Jensen and William Meckling, “Theory of the firm: managerial behaviour, agency costs and ownership structure”, (1976) 3 Journal of Financial Economics 305.
The results have not always been encouraging. Serious commentators have pointed out that the use of high-powered incentives has been both inefficient and corrupting. From the efficiency perspective, it seems that current practice in the United States and the United Kingdom actually results in a disconnection between shareholder value and executive pay. Stock options are supposed to align the interests of executives with those of shareholders. In fact, they result in efforts to manipulate share prices with a view to maximising the value of the options. And the practice of repricing out-of-the-money options does away with the performance incentives that stock options are supposed to introduce\(^\text{17}\). Furtive, excessive emphasis on monitoring can be divisive and prevent NEDs from contributing more widely to the development of corporate strategy\(^\text{18}\).

Theoretical shortcomings of agency theory

It has been argued that these problems flow from the imperfect assumptions on which agency theory (and, indeed, the economic analysis of law) is based\(^\text{19}\). The participants in the corporation are assumed to be utility-maximising and utility is understood in rather narrow and materialistic terms. Social interactions are evaluated in terms of their “efficiency” and the question is asked whether any further interaction could take place which would generate a net gain (expressed in monetary terms) for the participants. Agency theory applies these assumptions, and the search for efficiency, to the study of

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the costs associated with the separation of ownership and control. It assumes that the central problem for corporate governance to tackle is the need to constrain opportunistic behaviour on the part of senior executives; in the terminology of Transaction Cost Economics, the search is for the appropriate governance structure that will deal with the problems of opportunism and bounded rationality in the most cost-effective way\textsuperscript{20}. The “firm” is understood to be a rhetorical device used to refer to the cluster of exchanges between input providers (such as employees, shareholders and senior management). The input providers are linked by nothing more than self-interest and agency theory does not inquire into the constituents of that self-interest; it is content to assume that, for all practical purposes, self-interest and financial return are synonyms. Relations within the firm are thought of as being the same as market-place transactions and corporate governance is seen as being primarily a search for the least-cost methods of constraining managerial opportunism. Emphasis on monitoring systems and high-powered incentives are given pride of place when corporate governance is understood in these terms.

Ghoshal and Moran\textsuperscript{21} criticise Williamson’s TCE theory, and their criticisms are equally applicable to agency theory. TCE prescribes the introduction of a system of hierarchical control to deal with the problem of opportunism. Hierarchical controls induce efforts to play games with the system. Managers come to view those under their control through the prism of the controls in place. Thus, they come to develop a jaundiced view of employees. Evidence suggests that hierarchical controls send a signal to employees that they are not trusted or trustworthy. They decrease their sense of personal autonomy and

\textsuperscript{20} See, for example, Oliver Williamson, “Corporate governance”, (1984) 93 Yale Law Journal 1197.
of intrinsic motivation. Intrinsic motivation and commitment are reduced as extrinsic rewards are increased. Taking the rewards away does not restore intrinsic motivation. So reliance on hierarchical controls is likely to induce a shift from "consummate cooperation" to "perfunctory compliance".

"To summarize, available theory and evidence suggest the following very plausible scenario. For decision makers shaped by the logic of Williamson's theory, the need for "guarantees" against "the intrusion of unscreened and unpenalized opportunists" will seriously restrict the viability of alternative social controls and will induce them to turn to rational controls. As the increased use of rational controls (a) increases the organization's dependency on those controls, (b) shifts voluntary compliance and extra role behaviour to compulsory compliance and work-to-rule, and (c) encourages more difficult to detect opportunistic behaviour, the cost of removing those controls will grow until it is no longer an option for the organization. Management's options for responding to opportunistic behaviour will narrow to one of more controls that would serve only to increase opportunistic behaviour. As this self-fulfilling prophecy plays itself out, management perceptions that employees are opportunistic would become increasingly valid. An equilibrium between dishonesty and control may be reached, temporarily, when the firm exhausts its opportunities to apply rational controls. By then, the most promising individuals within the firm (ie those who
are most equipped to succeed) will more likely be those who are most skilled at furthering their own interests, with the most guile."

The self-fulfilling prophecy of opportunism increases governance costs. Ultimately, the hierarchy’s dependence on rational control (measurement and incentives) will lead it to operate in contexts in which there is a high degree of measurability. As a result, organisations that adopt TCE prescriptions will seek to minimise both internal and external measurability (so as to maximise the scope for measurability): firms will take as their ideal large-volume, mature businesses and standard products. But sophisticated markets are superior to organizations in these areas. For reasons to be explained in the next section, firms have a capacity to face uncertainty by drawing on the commitment of their members to the good of the firm. Thus, firms are likely to be superior to markets (a) when outcomes are uncertain; (b) the reputations of the parties are hard to establish; and (c) when the short-term gains for opportunism are large. But TCE will guide firms away from these activities and towards those that are catered for by sophisticated markets. Williamson's error, argue Ghoshal and Moran, is not to suggest that opportunism exists but to make opportunism the central factor that explains the existence of the organisation. The organisation of firms should not be modelled on that of markets since they survive precisely in those situations in which they are superior to markets.

Firms and markets each have a distinctive inner logic

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22 Ghoshal and Moran, n 20 above, p. 27.
Agency theory’s fears of opportunistic behaviour are sensible but they are given excessive emphasis. Like any human community, the firm’s role in the life of its participants is essentially a positive one; its purpose (as explained above) is to help them to achieve some aspects of their integral self-realisation. And, if it is working well, it will be able to count on the willingness of its members to work for the common good of the firm. Ghoshal and Moran\textsuperscript{23} reach essentially the same conclusion but without reference to natural law theory (indeed from a utilitarian perspective which is not the perspective of this paper). They point out that firms have an inner logic which is very different from that of market place exchanges. Firms, they say, have an ability to harness their members’ sense of shared purpose. This allows them to adapt to situations of high uncertainty (such as those faced by firms in innovative markets). The values and preferences of members of organisations are altered by organisational context and this creates an energy that managers can harness for the benefit both of the business and of the individuals who work in it. Organisations are capable of adapting because of the activity of the individuals who work in them and who come to see a fit between the organisation’s goals and their own. But TCE’s hierarchical controls, if applied to organisations, destroy the sense of shared purpose on which they rely.

Is there a role for agency theory?

There are very many theories of the firm. Their aim is to provide ways of thinking about the nature and purpose of the firm and to help directors, those in charge of stock markets and governments to think clearly and systematically about policy and action concerning

\textsuperscript{23} Ghoshal and Moran, n 20 above..
the firm (either firms generally or some types of firm or just one firm). Many dominant theories of the firm focus on economic aspects of the firm's existence and activity. This makes sense since so many of the firm's external and internal relationships are heavily influenced by contracts. The need to make a profit to survive and the need to participate in markets also reinforce the importance of economic analysis to inform thinking about the firm and corporate governance.

Agency theory provides the basis for much current thinking about corporate governance. It assumes that corporate governance can be reduced to a discussion of the difficulties caused by the separation of ownership and control and emphasises the use of monitoring and incentives to deal with these difficulties. But experience of the ill-advised use of options to incentivise directors and the powerful attacks on the theoretical bases of agency theory lead one to question agency theory’s usefulness. No-one doubts that opportunism and self-seeking behaviour are a real threat to the interests of shareholders; directors’ fiduciary duties and part X of the Companies Act 1985 show that the Courts and Parliament have been alive to this threat. Agency theory’s observation that diluted shareholding structures create greater opportunities for opportunistic behaviour (and therefore greater need for monitoring and a system of sticks and carrots) is valid. But the risk of managerial opportunism, while real, does not justify the creation of an elaborate “story” according to which firms are quasi-markets co-ordinating the interaction of a collection of atomistic input providers. It has been argued in this paper that the reality is quite different. Institutions such as the firm are defined by reference to the shared purpose of their constituents or members. This creates a willingness to act for the good of
the firm since this good is, and is seen to be, an element of one’s own well-being. The theoretical debate as to the nature of the firm has very practical consequences. That shared purpose or common good can have a profound impact on the reasoning of those members.

It can be argued that the best that can be said for agency theory is that it has a contribution to make to discussion of one facet of corporate governance (the raising of finance) in particular types of market. But it leaves to one side many of the central questions relating to the governance of the firm as a real, living institution. For corporate governance as a whole, it is dangerously reductionist (that is to say that it takes a partial account of the problem and assumes it to be a complete account). Agency theory’s emphasis on monitoring the effectiveness of individual directors makes perfect sense from the perspective of passive shareholders (especially if they have a very small stake in the firm); perhaps this is because passive shareholders are the sort of “members” of the firm whose attachment to its common good is likely to be weakest. But it is important to bear in mind that it makes certain radically simplifying assumptions and that, pressed too far, agency theory will be counter-productive. Thus, it cannot be relied on as an all-purpose theory of the firm. Indeed, it may be that no single theoretical story can helpfully be used to analyse every aspect of corporate governance.

Conclusion
The first part of this article presented the idea of the firm as a community of persons: it emphasised the idea that the firm is a group of people united by some common good. Fundamentally, the purpose of the firm is to help its members (employees and shareholders) to achieve certain aspects of their self-constitution. At the same time, a fully reasonable member will see the good of the other members of the community as an element of their own well-being and will be prepared to act in consequence. Thus, self-constitution is an expression of reasonable self-love rather than egoism or selfishness.

Natural law theory provides a link between economic theories of the firm and a broader understanding of human action and life in community. It is suggested that the search for a single theory of the firm (one that will adequately explain every aspect of relationships within the firm and between the firm and others) will be in vain; each theory catches just some aspect of the firm, its requirements and its relationship with the broader civic, economic and political societies of which it forms a part.

Corporate governance scholars tend to be driven by stories or images of the firm. They use these metaphors to help them to evaluate current corporate governance arrangements and to develop reform proposals. There is a danger of getting too carried away in one’s enthusiasm for a particular story; the theory may be useful in evaluating some aspects of a firm’s life and activity but become a positive burden if one sees it as capturing the whole reality of the firm. There is also a danger of getting locked into fruitless struggles between rival visions of the firm. As the second part of the article tries to show, theories of the firm that do not understand the nature of human communities can generate harmful policy and practice. As with agency theory, rival theories of the firm have to be carefully considered so that corporate governance scholars are aware of when they might be useful and where their limitations lie. It is contended that natural law theory can be a helpful part of this process. It is argued that sensible use of theories of the firm demands an
ability to draw on the partial insights that they offer without being seduced into thinking that they describe the whole.