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Good governance, bad governance: a refinement and application of key governance concepts

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Abstract: Understanding what makes governance 'good' or 'bad' has been impeded by construct ambiguity. Contemporary governance research has struggled to define 'governance' and related constructs such as 'ownership', 'agency', and 'management' in a way that clearly separates and distinguishes them. Often, the line between governance and management is so blurred that it is impossible to say what is good or bad 'governance' versus 'management'. Here we provide a systematic classification of key governance concepts in terms of their distinct economic functions. 'Governance', for instance, is the economic function of behavioural constraint. This allows us to state what 'good' governance is and how it might be assessed. We conclude that goodness of governance is idiosyncratic to each organisation, or even to each owner. Thus, while objective measures of good governance are possible, broadly utilised criteria for measuring governance are unlikely to capture whether governance is actually good or bad.

Keywords: corporate governance; agency theory; ownership; management; good governance; bad governance; misconduct; economics of governance; ownership; governance constructs.

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1 Introduction

There are many tendrils of governance research, from strategic decision making to oversight to crime and misconduct. Generally, these research streams are oriented around their practical implications – i.e., enacting better governance. For example, what Board of Directors characteristics facilitate better decision making (e.g., Baysinger and Butler, 1985; Johnson et al., 2013; Van Der Zahn and Tower, 2004; Van Ees et al., 2009)? What factors engender higher risks of mis-conduct (e.g., Beasley, 1996; Schnatterly, 2003; Schnatterly et al., 2018; Smulowitz and Almandoz, 2021)? When and why might directors succeed or fail in their assigned roles and responsibilities (e.g., Fedaseyeu et al., 2018; Petrovic, 2008)? In short, the field seeks to understand what makes for good (better) or bad (worse) governance (Van den Berghe and Levrau, 2004). We mean here, of course, a *positive* distinction between good versus bad governance, and not a *normative* one, which would be an ethical question.

The 'goodness' of governance has long been assessed and even measured by governance ratings services, such as Institutional Shareholder Services. Such metrics are held up as key market signals of precautionary propriety. But such metrics, which score firms' public records on various supposedly predictive criteria, are notoriously unreliable (Daines et al., 2010; Epps and Cereola, 2008). Their unreliability, Sonnenfeld (2004, p.108) argues, is due to persistent 'Wall Street superstitions' about what constitutes 'good governance'. Such ratings merely encourage investment in satisfying the measured observables (i.e., 'institutional decoupling'; Meyer and Rowan, 1977; Westphal and Zajac, 2001). As Donaldson (2003) put it, "such a 'check the box' approach to good corporate governance will not inspire a true sense of ethical obligation" [quoted in Sonnenfeld, (2004), p.112].

Underneath such lines of inquiry, however, lie a vast array of concepts and assumptions that are, upon closer inspection, far more ambiguous and ill-defined than behoves the field. As a result, it remains unclear what constitutes 'good' versus 'bad' governance. Governance assessments today either pertain to the mere legality of activities (good governance is that which prevents illegal misconduct) or else they are determined by subjective and moralistic claims (it is good/bad governance because it resulted in outcomes that the assessor considers morally good/bad). While the former proffers some objectivity in governance assessments, such criteria are problematic for several reasons. First, preventing theft, fraud, or other such misbehaviours is hardly the only or even most important function of governance. Second, even if a Board did everything 'right' – if it kept to all best practices – it is certainly possible for misconduct to still occur under its watch. And third, such judgement would, *ex ante*, render governance 'good' regardless of the actual appropriateness of the governance *in situ*, so long as no misconduct is detected by those who would render judgement upon it. The latter approach to judgement over governance's 'goodness'– i.e., rendering judgements according to subjective and moralistic criteria – is also clearly unsatisfactory. While there may be grounds to make such judgements against a strong cultural tide of moral preferences, many moral claims are highly subjective and heterogeneous (Eabrasu, 2012; Graham et al., 2009). In short, we still lack clear criteria for what constitutes good and effective governance.

Part of the problem may be that modern governance theories (and corresponding practices) are themselves flawed (Ghoshal, 2005). Indeed, deeper inspection of such questions reveals that the problem is, at least in part, *definitional* as 'governance' itself has not yet been well-defined. Often, governance is used synonymously with management, supervision, oversight, and the like, and it becomes unclear what is the essence of governance *per se*. These ambiguities render a determination of what constitutes good governance impossible.

In this paper we make two primary contributions. First, we produce clear and systematic definitions of governance and other adjacent constructs (e.g., management, ownership, agency). We show that governance research has so far been greatly impeded by imprecise and overly broad definitions. To remedy this, we leverage market process theory (Mises, 1998), which distils the general set of all economic actions into subsets of specific action types or *economic functions*. We introduce *governance* as a key economic function, overlooked in the standard economic framework, and define it as the conscription and constraining of economic activities to certain strategic and ethical parameters. Rather than a subfunction of the ownership function, as has hitherto been understood (Fama and Jensen, 1983), we distinguish governance from ownership – while owners (or their representatives) often perform the governance function, it can also be performed, in large or small part, by various other stakeholders (e.g., governments, employees, outside stakeholders).

Second, we apply our revised definitions toward elaborating how we should understand 'good' versus 'bad' governance. To preview our conclusions, we argue that the 'goodness' of governance ought to be understood as subjective – i.e., its effectiveness *depends on the aims of the organisation*. It follows from this that there are no universal standards for 'good' governance, but the effectiveness of governance must be made on a case-by-case basis. Whereas institutional pressures promote isomorphy toward specific governance practices, such isomorphic standardisation may promote governance inefficiencies to the extent that they are designed without due consideration of the specific needs and goals of the organisation.

In all, we build new theoretical foundations for governance theory in the hopes of laying the groundwork for better governance theory and practices (Ghoshal, 2005). We explore some of the theoretical and practical implications of these revisions in conclusion.

2 What governance is (and is not)

Much of the confusion surrounding the goodness of governance practices is underpinned by significant conceptual ambiguity in the various terms employed to reference specific organisational leadership practices. As Levi-Faur (2012, p.3) put it, "governance is said to be many things, including a buzzword, a fad, a framing device, a bridging concept, an umbrella concept, a descriptive concept, a slippery concept, an empty signifier, a weasel word, a fetish, a field, an approach, a theory and a perspective". In fact, Peters (2012, p.19) ascribes the popularity of governance theory in large part to its conceptual ambiguity, as 'it can be shaped to conform to the intellectual preferences of the individual author'.

Broadly, the governance literature conceives of governance largely as 'what the board of a company does' [Tihanyi et al., (2014), p.1535]. This is true of the economic governance literature (Fama and Jensen, 1983; Jensen and Meckling, 1976) as well as the behavioural theory of governance (Van Ees et al., 2009). But this conception, while simple and convenient, hardly offers the precision necessary for a foundational scientific construct. Thus, the literature on governance, despite many years of work, finds itself in a state very similar to that of systems research decades ago, which Ackoff (1971, p.671) confronted:

> "Defining concepts is frequently treated by scientists as an annoying necessity to be completed as quickly and thoughtlessly as possible. A consequence of this disinclination to define is often research carried out like surgery performed with dull instruments. The surgeon has to work harder, the patient has to suffer more, and the chances for success are decreased."

Construct definition sets the boundary conditions of a theory – "its description… indicate[s] the market whose presence definitely and unambiguously determines class membership" [Mises, (1998), p.60]. Several key governance constructs are severely entangled, which has led to some important confusion. Here we demarcate these constructs clearly and completely as necessary foundations for our theorising. In this section, we set out to clearly define the various constructs underpinning governance theory, including:

- the economic functions of governance, management, and operations
- perspectives of ownership and agency
- organisational structures of boards, executives, managers, supervisors, and staff.

Table 1 shows the general conceptual hierarchy that we will use to guide the discussion. Of note, our approach here is theoretical, with only peripheral regard to the legal definitions of these terms. While the legal definitions are important considerations, we are interested in the *economic* functions that these terms reference.

Table 1 Definitions of key governance constructs

Parent function	*Subfunction*			*Responsibilities*
	1st level	*2nd level*	*3rd level*	
Governance				Conscribe the ownership function
	Oversight			Enforce governance conscriptions
Ownership				Control over resources
	Entrepreneur			Judgement over the optimal use of resources
		Manager		Enactment of entrepreneurial plans
			Labourer	Performance of production activities
	Consumer			Expend resources for increases in well-being

2.1 The economic functions of governance theory

In Mises's (1998) classical treatise, he subsumes all human activities within the framework of economics (or 'praxeology') in that purposeful action[1] is always and necessarily an attempt at (re)directing scarce resources to bring about a higher-valued state than would otherwise have been attained had no action been taken. In this broad sense, he then attempts to distil the different mechanics of action into categorical *functions* – Weberian ideal types of the set of all human actions that have a particular causal role within the economic system of human welfare maximisation. He names five specific functions: entrepreneur, capitalist, landowner, worker, and consumer [Mises, (1998), p.252]. But because Mises's goal in distinguishing these types was to unpack the market process, they are incomplete and unsatisfactory to our specified aims. For example, we find *governance* in none of these five functions singularly, but it seems to overarch them all. Thus, let us start the analysis anew with governance as a *parent function*. In fact, there are two core parent functions that the governance literature has identified: *ownership* and *governance*. These parent functions (see Table 1) can be further refined by dissecting various subtypes or subfunctions. Subfunctions are instigated, overseen, and directed by its parent function. A subfunction can be performed by the parent actor but can also be delegated to agents who act on and under the parent actor's authority. Here we briefly introduce these various functions and sub-functions before elaborating further on each.

First, the *ownership* function encompasses the central task of controlling valued resources, which manifests in two distinct activities: production and consumption (Hutt, 1990). Production or, in Mises's (1998) language, *entrepreneurship* entails resource allocation and organisation processes for value production and protection of owned resources (Bruyat and Julien, 2001; Lyons, 2021). *Consumption*, in contrast, is the expenditure of owned resources toward attaining the owner's subjective ends, i.e., a (subjectively) higher value state.

The *entrepreneur* subfunction of the ownership parent function, for Mises (1998, p.297), entails 'the striving after profits', where 'profits' are defined broadly.

Entrepreneurship is the engine of economic progress, the source of economic growth (Kirzner, 1985, 1997; Schumpeter, 1942). This function, then, entails judgement (Foss, and Klein, 2012), planning, and coordination (Lachmann, 1986) over the employment of owned resources – the placing such resources to better, i.e., more economically efficient, use. As such, the entrepreneur subfunction implies necessary control over such resources (Fama and Jensen, 1983; Foss, and Klein, 2012). *Managers* are delegated limited decision authority to direct and enact the entrepreneur's plans. The *labour* sub-function is created and directed by the managerial function to perform specific tasks required of the plans. Each of these tasks are the owner's to pursue him or herself or else delegate to others who may be willing to do those tasks via employment contract.

The *consumer* subfunction of ownership has responsibilities toward the determining and attaining of the subjective ends of the owner through the actual and efficient use of resources (i.e., via consumption). Because attainment of preferred subjective ends is the primary and ultimate aim of ownership, this consumer subfunction is primary and sovereign over the entrepreneur (producer) subfunction (Hutt, 1990). "[Consumers'] buying and their abstention from buying decides… precisely what should be produced, in what quality, and in what quantities" [Mises, (1998), p.270]. Despite the sovereignty of the consumer in the economic system, the consumer function only has indirect power over the use of economic resources. In other words, while consumers tell entrepreneurs what they want, entrepreneurs *choose* which consumer demands to listen to (or whether to listen to consumers at all), and it is the entrepreneurs' choices, and ultimately their success or failure in persuading consumers to purchase their products, which determines their economic success or failure. Thus, consumers have influence, but not control, over entrepreneurial production activities. This distinction is critical to governance theory.

Of note, consumer and entrepreneur are subfunctions that cannot be (fully) delegated to others. The owner cannot delegate their consumption to another, or else the other would become the beneficiary. Similarly, the entrepreneurship function ultimately resides with the owner, who has the residual control over the resources (Foss and Klein, 2012). While specific decisions can be delegated to sub-entrepreneurs, managers, and labourers, the owner has ultimate authority over those decisions. Let us elaborate somewhat on this notion of delegation, which is central in modern governance theory, next.

2.2 Ownership and agency

Given the economic framework just laid out, let us elaborate the core subfunctions that are commonly invoked by corporate governance theories. To begin, one problematic distinction is between the *owner* or *principal* versus the *agent* in an organisation and, specifically, what rights these distinct actors have in relation to a firm's resources.

2.2.1 Ownership

The *ownership* construct is entangled in political philosophy in such a way as to prohibit clear agreement across academic and ideological domains (e.g., Bell and Parchomovsky, 2004; Underkuffler, 2003). Some, for example, regard ownership to be altogether immoral on the grounds that it is exclusionary and prohibitive (e.g., Arneson, 2013; Cohen, 1995). However, the dominant view of ownership, worldwide and particularly within Western cultures is equivalent to or at least based on the Lockean theory of homesteading (Locke, 1689), as reflected in Holmes's [1991 (1881), p.246] classical legal definition:

> "But what are the rights of ownership? They are substantially the same as those incident to possession. Within the limits prescribed by policy, the owner is allowed to exercise his natural powers over the subject-matter uninterfered with, and is more or less protected in excluding other people from such interference. The owner is allowed to exclude all, and is accountable to no one."

The purpose of ownership is attainment of particular, subjectively chosen ends, generally the sustenance of the owner's well-being (or that of those within the owner's care), which is achieved through consumption (Packard, 2019). But to sustain such consumption, production must first occur, which means that resources must be procured and then put to beneficial use. Said differently, to achieve their own subjective ends, owners must 'invest' their properties in value-producing and consumption activities. This implies a risk-bearing investment function (Fama, and Jensen, 1983).

> "[Owners] are compelled to employ their property for the best possible satisfaction of the consumers. If they are slow and inept in the performance of their duties, they are penalized by losses. If they do not learn the lesson and do not reform their conduct of affairs, they lose their wealth. No investment is safe forever. He who does not use his property in serving the consumers in the most efficient way is doomed to failure. There is no room left for people who would like to enjoy their fortunes in idleness and thoughtlessness." [Mises, (1998), p.308]

It is this conception, generally, that underlies the property-rights theoretic foundations of modern agency theory (Alchian, 1965; Alchian and Demsetz, 1972; Demsetz, 1988). This foundation, however, has been complicated by the vast panoply of ownership configurations that the modern legal structure has enabled (Boyd and Solarino, 2016). Scholars generally adopt one of two common definitions of ownership in the governance literature: 'The first is a claim over the earnings of a firm and the second are control rights over the governance of a firm that extend beyond those of other parties to the firm' [Mayer, (2020), p.225].

These two definitions reflect the agency theoretic versus incomplete contract theoretic approaches to property-rights economics. Incomplete contract theory defines ownership as 'the residual rights of control of that asset that is the right to control all aspects of the asset that have not been explicitly given away by contract' [Grossman and Hart, (1986), p.695; Hart and Moore, 1990]. In contrast, agency theory explicitly distinguishes and separates ownership from control, defining ownership in terms of residual risk-bearing and control in terms of decision rights (Fama, and Jensen, 1983; Jensen, and Meckling, 1976). In essence, agency theorists observe the distinction Mises (1998) made between the ownership and entrepreneurial functions which are often, but need not be, performed by the same person. Where they are not, owners yield their residual claims over the control of resources to contracted others to perform the entrepreneurial function, maintaining only the residual risk, i.e., 'the risk of the difference between stochastic inflows of resources and promised payments to agents' [Fama and Jensen, (1983), p.302].

Foss et al. (2007) attempt to reconcile these perspectives in clarifying that the performance of the entrepreneurial function (which they aptly depict as entrepreneurial judgement) in such situations is merely *delegated* – it is not relinquished. Thus, they side with incomplete contract theorists in maintaining that ownership implies control, which control can only be truly relinquished through contract or sale.

In line with this conclusion, we define ownership as *ultimate* control over a specific resource such that they have exclusionary rights to its use. Any other must, ethically and legally, first obtain the permission of the owner in order to use the resource – use without such permission is theft. *De facto* control may be delegated to others, but the control ultimately remains with the owner, who can override or retake any delegated control.

While this definition of ownership as control over resources is clear-cut in certain cases, it becomes convoluted in modern cases of 'shared' ownership, such as the case of stockholder ownership. In particular, it is challenged by the existence of, e.g., passive share classes, which are considered owners with no residual claim on the firm's resources and, thus, no control or decision authority (Lan and Heracleous, 2010; Stout, 2001).

This confusion can, perhaps, be resolved by an appeal to basic intuition – passive share-holders' rights can quite readily be characterised not as 'ownership', but as a contractual claim on future earnings. Granting the term 'owner' to such shareholders who have no real control over the firm's resources and are wholly reliant on other controllers for their future earnings, runs against intuition and, more importantly, against our formal logic.

To clarify somewhat, we side with incomplete contract theorists' arguments that ownership *necessarily* implies ultimate control over the owned. To explain the commonly observed 'separation' of ownership and control, then, we must be careful to not confuse 'original' control with 'derived' or delegated control (Foss et al., 2007). But further, we should not accept *legal* definitions and concepts as necessarily accurate reflections of the *economic* processes they describe. For example, while passive shareholders are *legally* partial owners of the firm, these do not perform the *economic function* of ownership over the firm. Instead, we would more precisely depict this investor as an owner of a contract with the firm, with certain limited rights outlined therein. Economic ownership of the firm falls only to *active* investors, who have control, full or shared, over the firm's use of its resources.

2.2.2 Agency

While the concept of ownership has attracted significant attention, *agency* in this context – despite its titular status – has received far less, is measured in a large variety of ways (e.g., Hassan, 2018), and is almost never formally defined. For Jensen and Meckling (1976, p.308), agency is specifically related to the contractual delegation of control over assets owned by another 'to perform some service on their behalf'. More formally, we define agency as delegated control over resources not (fully) owned. Agency, then, is essentially a fiduciary function of contingent degree, depending on the extent of control contractually ceded by the owner.

The line between ownership and agency can blur in relationships where ownership is divided and where decision rights and control over resources are not made explicit. For example, in a public corporation, active shareholders have certain voting rights over corporate leadership and certain strategic decisions, but do not have 'control' over the corporation's resources. In these cases, partial ownership is reflected in partial or indirect control. For example, a partial controlling stake in a firm might manifest as voting rights over who performs the agent function for the firm. Said differently, because active shareholders often do not have a sufficient stake in a firm to directly control the use of its resources, they instead collectively delegate their individual share of control to one or more agents, which agents then have sufficient control to make operative decisions. In a sense, then, the agent can have greater *de facto* control over the firm's resources than the individual owners. However, it ultimately remains only delegated control, and can be withdrawn if the owners collectively agree to revoke that control.

2.3 Governance versus management

Within the economic system we have defined above, the functional roles of *governance* and *management* are adjacent but distinct. These are very often confounded and used inter-changeably, (e.g., Badia et al., 2019), and can often be performed (at least to some extent) by the same person, but they are not the same. In fact, a failure to clearly demarcate these foundational constructs has been, we argue, a primary impediment to governance research. Here we attempt to remedy this confusion.

2.3.1 Governance

The most widely used definition of governance comes from the Cadbury S.A. (1992) Report, which defines it (*corporate* governance, specifically) as the 'system by which companies are directed and controlled'. In this sense, it is clearly related to ownership, as owners would also be governors by definition. Tihanyi et al. (2014, p.1535) elaborate this definition to reference 'leadership systems, managerial control protocols, property rights, decision rights, and other practices that give organisations their authority and mandates for action'. Hambrick et al. (2008, p.381) similarly define corporate governance as 'the formal structures, informal structures, and processes that exist in oversight roles and responsibilities in the corporate context'.

While popular, these definitions miss the mark in at least two consequential ways. First, governance references an economic *function*, and not the *system* or *structure* that provides that function. It does not matter, strictly, who or what enacts the function, as it is the function itself and its effects that matters for governance theory. And second, the function of resource control, as we have just reviewed, belongs to the *ownership* function. If governance is direction and control over economic resources, then the economic functions of ownership and governance are redundant.

But what economic function is (or ought to be) the *governance* function, if different from the ownership function? In the corporate setting, many understand governance as 'what the board of a company does' [Tihanyi et al., (2014), p.1535], which encompasses an array of economic functions, i.e., 'setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business, and reporting to shareholders on their stewardship'. But defining the governance function by *who does it* is, again, necessarily imprecise – appointed directors can perform economic functions other than governance and it must be possible for governance to occur without a board, else there could be no governance of firms without a board, such as many private firms. Instead, precision demands that we ascribe the term governance a single and specific economic function, which can be performed by any number of actors or entities.

One solution is to adapt the Cadbury Report's definition to reference the function described, i.e., direction and control of an entity (e.g., an organisation). But it is arguably such a conception that makes the governance function indistinguishable from ownership and, in particular, the entrepreneurship and management subfunctions, which are tasked with the same. Other recent work describes governance as ‘a legal responsibility to ensure that the company is managed in a way that provides the best value for shareholders’ [Klarner et al., (2021), p.123]. That is, governance is the management of the managerial function. The flaw in this definition is that it again overlaps completely with the entrepreneurial function – it differentiates governance from management only in hierarchical level. The matter of governance versus entrepreneurship and management is merely semantical, an arbitrary and often fuzzy boundary drawn between two levels of economic organisation.

To resolve this question, we must distil the defining purpose of governance – the essence of what governance is. The governance function operates *outside* of the ownership function as a separate and distinctive function. Whereas the ownership function maintains control over resources, and its entrepreneurial subfunction actively determines how to allocate those resources to their presumed best uses, the *governance* function determines the boundaries within which these ownership functions operate. Whereas entrepreneurship often looks to experiment and innovate, it is the function of governance to constrain, conscribe, and regulate. Governance may also conscribe the consumption function, regulating and prioritising what resources to consume or not and when. Thus, governance establishes norms and values, defines and prioritises purposes and aims, and sets the operative rules within which the ownership functions must operate. It also *oversees*, (i.e., polices) these regulatory boundaries.

The boundary constraints imposed by governance on an economic entity include both voluntary (self-imposed) and involuntary (externally, e.g., institutionally imposed) constraints. Voluntary constraints are self-imposed by owners and their agents, and include commitments, values, contractual obligations, and other rules and norms set or adopted by the entity itself to govern its own behaviours. Involuntary governance constraints are imposed by non-owners – laws, regulations, social norms and expectations, and other such behavioural inhibitors imposed on the entity by others, such as governments – which may then be accepted or skirted by the owner (Bylund and McCaffrey, 2017). This choice of acceptance (or not) by owners is also a governance function. Governors then oversee compliance to the regulations they have accepted, or else delegate this oversight function. Poor oversight will tend to lead to more regulatory avoidance (Buell, 2010; Carrier and Minniti, 2018) – even when the restrictions are voluntarily self-imposed (DeMarzo et al., 2005).

Governance, then, entails both the identification and acceptance (or not) of involuntary boundaries as well as the determination of what voluntary boundaries to impose on themselves. Such boundary-setting circumscribes entrepreneurial, managerial, operational, and even consumption activities within certain limits to facilitate coordination, effective operations, and coherence with the established vision and purpose, but comes at a cost of limiting innovativeness and, perhaps, participation within the entity.

Because economic valuation is an evolutionary process (Bylund and Packard, 2022; Packard, 2019), governance is also a temporal and often dynamic process, monitoring and adjusting the boundaries of economic operations to fit the shifting needs and values of owners and of society. To wit, society may perform governance functions via government (laws and regulation) and non-government (media pressure and activism) coercion.

2.3.2 Entrepreneurship

The entrepreneurial function has specific responsibility over production. *Production* refers to the activities involved in generating new value, i.e., in reorganising resources in such a way as to attain or facilitate preferred subjective ends. 'Production of any kind requires the complex integration of multiple types of knowledge' [Elert and Henrekson, (2019), p.300] including knowledge of idiosyncratic needs (Packard, 2019), of resource affordances and technologies (Kirzner, 1979; Schumpeter, 1934), and 'of the particular circumstances of time and place' [Hayek, (1945), p.521]. Thus, entrepreneurship entails the direction of available knowledge and resources – their own and others' under their leadership – toward attaining the owner's subjective ends.

The entrepreneurial function, as the source and origination of newness and of norm-breaking, is the counterbalance to governance. The entrepreneurial function, dissatisfied with the status quo, seeks innovation and optimisation within the boundaries set by the governance function and, when necessary, challenges those boundaries (Lucas et al., 2022). Often, the entrepreneur will test the boundaries of governance to assess their necessity and value. Thus, there is a natural tension between the governance and entrepreneurial functions, the governance function placing constraints upon the entrepreneur and the entrepreneurial function challenging the validity and justification of such boundaries. Because control ultimately belongs to the owner (Foss et al., 2007), the entrepreneurial function's judgement or determination of resource allocation must be endorsed by the owner, whether explicitly or by delegated authority (agency).

2.3.3 Management

The *management* function is a subfunction of entrepreneurship, 'a junior partner of the entrepreneur' [Mises, (1998), p.301], and attends to carrying out the plans of the entrepreneur by assigning, supervising, and correcting labour activities. Managers are agents, delegated their responsibilities contractually by and from the entrepreneur, whose authority is derived from the owner, who maintains ultimate control. Thus, we define *management* as the delegated responsibilities of the direction of resources in production, as determined by the entrepreneurial function and endorsed by the owner. An economic actor acts as a *manager* when directing knowledge and resources in pre-defined productive activities. Because of strategic uncertainty, this often means adjusting strategic plans, or even strategic visions, in the face of unanticipated outcomes and change. Management activities, thus, include strategising, planning, organising, leading, and supervising production processes. These activities can be performed by one or many managers, including the entrepreneur. Thus, we accept the common distinction between *executives* (leaders and strategists) and *managers* (planners, organisers, and supervisors) as a useful distinction, (e.g., Keenan, 2000), although both perform the management function.

Because it is a contractual responsibility, the managerial function is supervised by the entrepreneurial function, which has residual rights to judgement over the strategic activities and their implementation, which function is overseen by the ownership function. The entrepreneur may perform the managerial function themselves or may, instead, delegate some or all of the function to others. If the managerial function is not performed well, the entrepreneur (actor who performs the entrepreneurial function) has power to dismiss and replace the manager (actor who is assigned the managerial function) at their discretion, which may also include the entrepreneur hiring another to replace themselves as manager.

2.3.4 Labour

The tasks of *labour* or operations refer to the specific tasks and responsibilities defined and assigned by management corresponding to the entrepreneur's plans and by which those plans are functionally enacted. The labour subfunction is typically performed by contractually employed staff of the organisation, although it may be noted that managers can also perform the labour subfunction by engaging directly in such tasks of operations.

2.3.5 Strategy

The governance function interacts with the ownership function in various ways, including in the strategising process. Strategy is a liminal artefact that represents the purpose and identity of the organisational entity, determined in the interaction of the governance and entrepreneurship functions and translated into a policy and/or business model to be enacted by the management function, with supervision both from ownership and governance (or their delegates). Labourers may also contribute to the strategising process but cannot make any decisive directives.

2.4 Possible configurations of the economic functions

Having now formally defined the core constructs, let us briefly do some initial ground-work in theoretically connecting them. The thrust of our argument is that the economic functions just outlined are *theoretically distinctive* and, as such, can be performed by different economic actors. In a simple society (e.g., Robinson Crusoe), all of these functions may be performed by a single person. In complex socio-economic systems, however, the functions may be divvied up in various possible ways. Our task, and the fundamental tasks of organisation theory, then turns to understanding the benefits and drawbacks of different possible configurations. While many of these foundations have already been laid in organisation theory, our definitional refinements allow us to refine some key theoretical foundations.

One key determinant of the preferred configuration of these functions is the politico-economic structure. Broadly, the classic governance literature has explicitly adopted a property-rights view of political economy, which is only somewhat or partially reflective of most modern political economies. In a purely free market, the governance function is maintained by the owner, who determines the values, boundaries, and constraints within which the entrepreneurial function will operate in deploying their owned resources. In a highly regulated market, much of this governance function is performed by outside regulators, typically operatives of a state. Most modern societies, which have been generally characterised as *state capitalism* (Musacchio et al., 2015), are of the latter type. Within such societies, the owner maintains governance over whatever the state has not yet arrogated. In socialist (or communist) societies, the principle of ownership is mostly or entirely rejected. In such societies, both the governance and ownership functions are performed by the State apparatus. In communism, for example, the governance function is performed collectively or democratically. This has various implications that have not yet been explored due to the general confusion of these definitions.

In market-based societies – by which we mean any socio-economic system of private property and private business ownership – the possible configurations of these functions are broader. For example, ownership implies the management function, but not necessarily the governance function. Governance may be performed by owners but can also be performed by agents of the owner(s) (such as a Board of Directors) or by governments. Top management teams (TMTs) often perform the entrepreneurial function, but also management and sometimes governance also. However, such functional tasks may be retained by the functional parent or may also be delegated to some greater or lesser extent to other subfunctional agents.

However, not all subfunctionaries, such as labourers, are agents. *Agency* is only ascribed a subfunctionary (e.g., labourer) if and to the extent that the owner(s) or their representative trusts that subfunctionary to effect good judgement over the use of the owner's resources. A labourer with no delegated control whatsoever over the owner's resources – if, for example, s/he is employed to provide a service that requires none of the owner's resources – is not an agent. There can be agency within both the ownership and the governance parent functions. Managers, and overseers (or policers), if their functions are not done by the parent owners or governors (respectively) themselves, are agents.

In short, while organisational theory has outlined various organisational configurations to enact economic production (e.g., Makadok and Coff, 2009) – what we are here calling the *entrepreneurship function* – this same configurational logic can be extended to corporate governance theory. Let us briefly advance what this means and might look like in the following.

2.4.1 Revising the economic system framework

In Fama and Jensen's (1983, p.303) classic work, they break the governance process into four steps:

1 *initiation* or ideation of resource uses

2 *ratification* or selection of a particular initiative

3 *implementation* of the initiative

4 *monitoring* its implementation and performance.

Then, 'because the initiation and implementation of decisions typically are allocated to the same agents' and, likewise, 'the ratification and monitoring of decisions' [Fama and Jensen, (1983), pp.303–304], they then collapse these four distinct functions into two: *decision management* and *decision control*.

According to our definitional work, there are several problems with this characterisation. First is that these are processes of *ownership*, and not of *governance*. Governance merely sets (and polices) the boundaries within which these production processes may operate. But this is merely an issue of semantics. The much more critical issue here is that this collapsing of the ownership subfunctions was a mistake that has caused important confusions and misguided theorising. While we agree that it is common for initiation and implementation to be performed by the same person, such is not so foregone that they can be collapsed into a single function. Nor should ratification and monitoring be so conflated. These are *distinct* economic functions that can be performed by different actors.

Again, while it is not uncommon for owners themselves to also perform the entrepreneurial and managerial functions – i.e., effect entrepreneurial judgement over, and form entrepreneurial plans for, the allocation of resources (Foss and Klein, 2012) and to also enact and oversee the implementation of those entrepreneurial plans – it need not be so. Often, owners delegate the entrepreneurial function by investing in others who perform the entrepreneurial function with the owner's investment. Furthermore, many of the managerial tasks of ownership control are delegated to hired managers and employees. Public firms also engage in entrepreneurship, and it is generally not the active shareholders (the owners) who are performing this entrepreneurial function. The owners' (shareholders') task is merely ratification, while the entrepreneurial and managerial functions are delegated to agents.

The governance function has been similarly conflated. For example, while it is common for a Board of Directors to both establish corporate policy *and* oversee its implementation, these are distinct functions and may be performed by distinct actors. In fact, it is often misleading to speak of a Board of Directors as a unified entity, as the tasks of the Board are divided and each member has distinct roles and interests, such as work on board sub-committees, where the majority of board tasks are accomplished (Kesner, 1988; Kolev et al., 2019). Furthermore, there is delegation of tasks, but not agency, within the governance function also. For example, board members assigned the oversight of corporate policy are typically unable to keep sufficiently close tabs on the firm's daily activities and must either delegate the oversight function to others or else forego such oversight and use auditing techniques to assess compliance instead, the latter approach being the more common (as it is often mandated by government regulators).

We argue that a host of theoretical confusions and errors have arisen from the conflation of these distinct economic subfunctions under the distinct ownership and the governance parent functions, which themselves have often been conflated.

2.4.2 Agency problems

Another relevant implication of this work is that the well-known agency problem is not one of *governance* but of *ownership*. The governance function has no direct control over resources and, so, does not pertain directly to the principal-agent problem, which concerns issues of control over the productive transformation of those resources. It is the ownership function which concerns maximising value from resources, and the agent function – defined as delegated control over resources – at issue is created and delegated by the controller of those resources, the owner. The principal-agent problem arises because the contracted obligations of agent managers and labourers to implement the strategic vision of the owner are necessarily incomplete (Grossman, and Hart, 1986; Hart, 1995) and costly to generate and enforce (Fama, and Jensen, 1983). Employing agent managers as fiduciaries over resources thus necessarily confronts economic risks and misgivings over the agent's competence and moral stature in filling those duties honestly and fully despite self-interested incentives to do otherwise.

Although it is an ownership (control) issue, there is a key role that governance plays in this principal-agent relationship. In particular, internal governance – the voluntary governance concerns left to the owner to determine (or to delegate) – has strong bearing on the structure of this relationship. What constraints must the agent operate within while performing owner-delegated production activities? How will those constraints be enforced? These are governance decisions that are determined by the owner, delegated to a governance agent, or decided between them.

External governance (regulation) can also play a role in shaping the principal-agent relationship. For example, formal regulations, such as Sarbanes-Oxley and Dodd-Frank in the USA and the Companies Act 2006 in the UK, can partially dictate the structure and interaction of this relationship. Public US firms are required to have a Board of Directors, with at least compensation, audit, and nominating committees, with a specified number or ratio of 'inside' versus 'out-side' board members. Thus, the managerial oversight interactions between principal (shareholders) and agent (e.g., TMT) are wrought in part by external governance.

3 Good governance, bad governance

Having now formally defined and distinguished governance from other key economic functions, we return to our original task of clarifying good and bad governance. To briefly reiterate, scholars, consultants, and practitioners alike have tended to judge governance either on performance *ex post facto* or else moralistically rather than formalistically, based on the personal values of the arbiter more than on any objective criteria. Those scholars and firms that have tried to objectify good governance *ex ante* have done so with dubious criteria.

This is a critical problem for practitioners who seek to implement 'good' governance. Because of these scholarship failures, instead of creating good governance, firms are often merely steering their performance toward the specific items on the governance rating checklists, either incapable of or uninterested in developing truly good governance for their organisation.

As our review highlights, the bulk of the issue is in onerous confusion over the actual nature and scope of 'governance'. Our refinement of these terms thus affords us an opportunity to revisit the criteria of 'good' versus 'bad' governance.

3.1 What makes governance good?

Because governance references the constraining function of bounding the entrepreneurial function to particular values, norms, and rules, the *economic* role of governance is to provide such constraints that will engender the highest value-states over time. While constraints engender efficiency, they also inhibit exploration and creativity. Thus, the governance function walks a tight line between under-and over-constraining.

Good governance might be understood through the lens of Pareto efficiency, which requires any improvement to make all equal or better, and none worse. In this sense, good governance constrains only to the extent that, by so doing, the entire economic system, (i.e., all stake-holders) attains a higher idiosyncratic value-state. Under Pareto optimality requirements, no governance constraints could be made that were not universally valued. Because value is subjective and idiosyncratic (Bylund and Packard, 2022), such requirements would in essence curtail the purview of governance only to the curbing of general malfeasance, such as theft, fraud, and such, leaving the task of value-state optimisation to the entrepreneurial function. *Only* the curtailing of inherently destructive activities would fall within such a narrow, Pareto optimality conception. This is, we note, the standard view of prevailing attempts to assess governance, i.e., how effective organisations are in curtailing malfeasance.

But such a narrow approach to governance assessment may overlook important *positive*, (i.e., value productive) effects of constraining that are, or ought to be, the purview of corporate (and other) governance. For example, creativity research has found that overly open choice sets can inhibit rather than facilitate creative solution-finding (Amabile et al., 2002; Smith et al., 1993). Thus, the constraining role of governance might not be optimised as a mere policer of malfeasance. There may be a value-facilitating role in its conscribing and focusing of productive activities to narrow value areas. Such value-focusing can engender superior specialisation and expertise that generates greater overall economic value. In a corporate setting, this may entail defining and circumscribing the aims and mission of the organisation to particular values and activities, proscribing ambiguities and mission creep that can lead to scoping inefficiencies.

Of course, too narrow a focus can lead to myopia and curtail potentially higher-value entrepreneurship that might occur under less restrictive norms. For example, Starbucks governance infamously refused the iced coffee drinks that a particular branch manager had put forward as an innovation, maintaining that the Starbucks brand was to be constrained to hot drinks only. Eventually, it was the branch manager's entrepreneurial persistence that pushed Starbucks's corporate governance to relax its strategic conscription to hot drinks only and permit the launch of its Frappuccino drinks, which proved enormously popular.

Thus, good governance is not merely the circumscribing of destructive activities but is also value enhancing through purpose scoping without being value inhibitive due to unnecessary prohibitions. It enables and facilitates *because* of its constraints. To the extent that its constraints become a value stumbling block, governance has overgrown its optimality and becomes decreasingly 'good'.

To summarise, we define *good governance* as the optimisation of economic (owners') value via the conscription of destructive, unproductive, and/or distractive activities that decrease overall economic efficiency and value productivity. The goodness of governance, then, is idiosyncratic to each organisation or, more narrowly, to each owner. What is 'good' for one firm, or to one owner, may be inefficient toward or even incompatible with the values of another. There is no objective, generic template for 'good' governance. While there may be some values that are culturally universal, their ranking within the vast panoply of all values is always subjective and idiosyncratic. Thus, because all value pursuits entail trade-offs of other value pursuits, even standard best-practices for maximising universal values – such as auditing practices to prevent theft and fraud – may not be the idiosyncratically 'optimal' use of resources within the value structure of individual owners.

3.2 Assessing governance

Our revision of what it means to have 'good governance' suggests that attempts at objective, generic assessment of governance is problematic. If governance is good insofar as its constraints are idiosyncratically value-facilitative for the owners of particular resources, can such governance be assessed objectively as 'better' or 'worse' *ex ante*? What factors can we look to as indicators of good or bad governance?

A careful and scientific answer to these questions must be premised upon the admission that every productive organisation is distinct and necessarily has different subjective value assessments (Bylund and Packard, 2022). Said differently, because value is subjective, the 'good-ness' or efficacy of governance toward those subjectively chosen ends is necessarily idiosyncratic and must be assessed as such. Governance must be assessed with respect to the terms of the subjective values of the owners (or prospective owners) of the resources in question.

Governance assessment, then, should be done with careful and explicit admission that the assessment is respective of either a presumed objective or else in reference to the assessors' own subjective ends. This is, of course, acceptable in the case of an employee's assessment of their own fit within the organisation or in an investor's determination of whether the firm, and its governance, is worthy of investment. But external assessments are only valid insofar as the subjective ends assessed cohere with those who would use those assessments in judgement. The value of an external assessment, such as the Institutional Shareholder Services, is only valuable insofar as the user of the assessment also prioritises those values that are assessed (assuming the assessment captures those values effectively).

3.3 Governance entrepreneurship

A second key implication of this reassessment of the economic governance function is that it can be performed by various mechanisms – an organisation's constraints need not be determined or enforced through some standard, accepted practice. Per institutional theory (DiMaggio, 1988; DiMaggio and Powell, 1983), isomorphism toward particular standards can be useful, for example, in signalling to external observers (e.g. investors) effectiveness. However, market process theory (Mises, 1998) implies that it would be foolish to presume that such standards represent some universal optimum for such governance, and that no innovative alternative might be superior. The value of meticulous bookkeeping and regular auditing may not, to a certain owner, be worth the extensive time and costs it requires, compared to allocating those resources to, e.g., sales and marketing. This does not mean that the owner does not value accurate books or fraud prevention, but the state of the organisation might be such that some of those scarce resources are more productively allocated elsewhere. However, because good bookkeeping is still valued, the owner might employ an alternative solution – their own 'system' – to keep her books accurate and balanced. Such governance innovations are entrepreneurial in the sense that they are value creative – they innovatively achieve valued ends through an efficient reallocation of scarce resources.

In this way, governance practices expected by society or required by law or regulation may be inhibitive of advancing governance practices (Bylund, 2016). There have been very few governance innovations in recent decades, which lends to questions about whether there may be inhibitive external governance constraints surrounding corporate governance. For example, although the ownership subfunctions – entrepreneurship, management, and labour – have been increasingly trending toward decentralisation for more efficient use of dispersed knowledge, this trend has not been mimicked by governance, largely because regulations prohibit it within the large, public firms that might benefit most from innovative approaches.

We are not claiming that one governance approach is 'better' or 'worse' than another – as we have just remarked. Such an assessment is subjective and is determined, foremost, by the owner. However, our research implies that universal standards for specific corporate governance practices are not ideal. While such standards can be highly beneficial, their isomorphic adoption is optimally voluntary and not mandated by external governance. Certainly, the concern that a lack of such standards may allow malfeasance is a valid consideration. We proffer two points in response. First, the data suggest that such standards as have already been mandated have made little or no real impact on corporate malfeasance (Schnatterly et al., 2018). Perhaps standardisation, rather than diffusing indefeasible oversight, instead propagates weaknesses, the exploitations of which are just as easily diffused as the standards themselves. Whatever the explanation, increased governance standards and regulations have not altered the rates of corporate misconduct. And second, as we have explained, the prohibition of malfeasance is not the only consideration of good governance, and mandated standards may inhibit the innovation of new and better practices.

4 Implications

We now summarise what we think to be our main theoretical contributions and also to extrapolate some practical implications. These specified implications are hardly comprehensive. This project is a reconstruction of core theoretical foundations and so the implications (both theoretical and practical) are extensive. However, we will summarise and advance some of these to provide a general sense of how and why these refinements matter.

4.1 Theoretical implications

The importance of good governance is well understood among scholars and practitioners. Yet, the fundamental concept of governance has long been problematic and ambiguous, which has inhibited the advancement of governance theory and its practice.

To illustrate these concerns, governance mandates have evolved significantly over the past decades, with significant developments to common governance practices that have included large government regulation restructurings [e.g., Sarbanes-Oxley (USA), the Cadbury Code (UK), the Cromme Code (Germany), and the Provisional Code of Corporate Governance for Securities Companies (China)], institutionalised practices derived from scholarly advances, (e.g., compensation as stock options to reduce agency problems), and isomorphic governance restructurings to align with best practices and assessment metrics (Daines et al., 2010; Sonnenfeld, 2004). Yet, despite these advancements, corporate losses due to fraud and misconduct have remained generally unchanged over time (Schnatterly et al., 2018). Perhaps this is merely a case of malefactors increasing in skill and complexity to match the increasing detection technologies. However, it would be a dereliction of our responsibilities as scholars to not consider the possibility that our own failures to truly understand governance phenomena may be partly at fault.

One likely explanation for this lack of real progress is that the revisions to corporate governance have been merely cosmetic, addressing superficial symptoms while leaving the root causes unaddressed. Another possibility is that there remains a fundamental misunderstanding, both among academics and practitioners, of what constitutes good and effective governance, which has led to inapt and ineffective policy and practice.

Both of these explanations are, we contend, underpinned by a more fundamental issue, one that has pervaded theories of governance from the beginning – a pernicious ambiguity surrounding the conceptual nature of governance. What is governance, and what is it not? What are its boundaries? Who does governance? And how is this key economic function different from other related economic functions, such as ownership and management? These questions have so far evaded careful academic scrutiny, which we argue has led to the proliferation of confusions, misunderstandings, and theoretical errors.

In an effort to address these fundamental confusions, and to finally make substantive progress toward understanding truly *good* governance, we have carefully unpacked and distinguished the governance function (the conscribing of the ownership function to particular operational boundaries) from the ownership function (control and judgement over the use of resources), with which it has been almost universally confounded. It is true that owners, and the entrepreneurs beneath them, very often also perform the governance that conscribes the production that the owners and their agents pursue. This owner-generated governance pertains, in particular, to establishing a corporate mission, values, and culture. However, much of the governance function is, in fact, performed by external governors, e.g., government regulators. Even social institutions can rightly be understood to effect governance over entrepreneurial judgement, conscribing value creation efforts to within cultural and institutional boundaries of social values, norms, and beliefs. Thus, we significantly refine, advance, and broaden corporate governance theory toward a superior understanding of who performs the governance function, how and why it is performed, and what shape that governance takes vis-à-vis the goals of the organisation's stakeholders.

4.2 Practical implications

By carefully distinguishing governance from the economic functions of ownership *per se*, the nature of effective governance starts to come into focus for practitioners as well. First, good governance is, of course, far broader than the narrow subfunction of preventing fraud, theft, cheating, and other misbehaviours. Certainly, conscribing such malfeasance falls within the purview of good governance. But the ultimate aim of good governance is the optimisation of subjective aims – maximising (subjective) value. Such an end of good governance is far more than curtailing malfeasance, but also includes scoping productive activities to effective boundaries that will maximise entrepreneurial efforts, enabling the entrepreneurial subfunction of ownership to thrive by neither over-nor under-regulating.

Extrapolating from these theoretical refinements, we can offer several important implications for practitioners. First, we can infer from our theorising that firms should reconsider their commitment to industry standards of 'good' governance. While such standards may be appropriate for some firms and their specific economic and moral objectives, they will be comparatively inappropriate and inefficient for other firms. This is particularly problematic when external stakeholders seek to assess and rank governance practices. Managers should take care in considering the appropriate governance and oversight mechanisms to achieve the firm's idiosyncratic values and strategic objectives. Thus, rather than conformity toward some universal standard, we should expect governance practices to be as different as their strategic purposes and objectives. This will generally entail aligning internal and external stakeholders in such a way that progress toward those objectives can be transparently assessed and assured.

While the unpacking of specific governance practices for disparate organisational aims is beyond the scope of our work here, we propose that firms must start to think and act entrepreneurially in their governance practices to innovate new and better initiatives that better comport to their specific and, perhaps, unique aims. For example, our argument that the governance function is not an ownership subfunction but can be performed by other stakeholders, and that it can be delegated, implies that the governance function might be *decentralised* within an organisation, i.e., performed in part by its employees (Mitchell et al., 2022). Traditional governance theory implicitly supposes that governance is necessarily the task of supervisors. While supervision is predominantly a governance mechanism, other governance mechanisms have emerged that abjure supervision. For example, decentralised autonomous organisations *self-govern* through 'smart contracts' (Morrison et al., 2020; Murray et al., 2021). Our theoretical refinement of governance processes allows us to understand, explain, and support these types of alternative governance mechanisms, facilitating effective scholarship of new governance innovations.

Our research also has important policy implications. We note that the boundary between effective scoping and overly constrictive restrictions is not a clear line and can be very difficult to judge. There is no 'right' boundary and, so, governance can never be said to be objectively 'good' or 'bad', at least not from the outside. This boundary is ultimately determined by the owner and/or the governor. Thus, there is certainly better or worse implementation and policing of governance-chosen boundaries. The 'goodness' of the boundaries themselves are a subjective judgement, but once determined by the owner and/or governor, it may be possible to assess its 'goodness' more-or-less objectively.

For this reason, external governance regulations can very easily become problematic because they impose an objective value judgement over the appropriate boundaries for all productive activities within the regulators' jurisdiction. While it may be true that some conscription are universally 'good', such as the prohibition of coercive force, violence, or fraud, history shows that regulators are quick to depart from such universal values and into more selective value judgements. In fact, many modern democracies enforce a majority rule that allows temporally unstable socio-cultural preferences to dictate such operational norms. Such regulations, even when intuitively good in purpose and nature, can easily become onerous and prohibitive of entrepreneurial innovations (Bylund, 2016) because their requirements prohibit ingenuity in allocating the governance mechanisms in different ways. Thus, by requiring, through external governance mandate, that governance be performed in a particular fashion, whatever weaknesses in that governance structure are propagated and can be widely exploited, while entrepreneurial solutions are inhibited or even prohibited. In other words, the utilitarian 'goodness' of external governance is a key concern for corporate governance theory.

4.3 Conclusions

In conclusion, we reflect on Ghoshal's (2005) call for better (and less pessimistic) governance theories as well as Tihanyi et al.'s (2014) call for new and broadened conceptualisations of governance. Heeding these calls, we suggest, must begin with reconceptualising governance more carefully and precisely. Even very small mistakes at the foundational level tend to balloon into large misunderstandings at higher theoretical and practical levels. We believe that this has been the case for governance research. Thus, our efforts herein to clearly define what governance is and what makes it good are, we think, a vital step toward good governance theory and more rapidly advancing governance practices. A true shake-up in governance theory starts at the foundations.

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Notes

1 Mises (1998, pp.11–13) distinguishes action from reaction in that action is purposeful whereas animalistic reaction is not.