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**Article**

# "Corporate Scene Investigation": A Praxeological Attempt to Sketch the Profile of the Entrepreneur in Modern Business

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ESSAY

# "CORPORATE SCENE INVESTIGATION": A PRAXEOLOGICAL ATTEMPT TO SKETCH THE PROFILE OF THE ENTREPRENEUR IN MODERN BUSINESS

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**Abstract**
Mature capitalism and market economy realities become intelligible also by scrutinizing their "prodigal children": modern business corporations. But these are not some undivided entities. Beyond the place in the global division of labour, they are fiefs of in-built specialization among the corporate governance stakeholders, each of them representing individual-based aggregations of pure catallactic functions. With an atomized, anonymous, asymmetrical and amalgamated ownership in a globalized capital market, with the multi-level directorship, delegated to harmonize profit-orientated investment interests, with creditors, but also with other suppliers of factors of production, modern corporations seem to have overshadowed both the real entrepreneurs-actors as well as the pure corresponding function. Our article is a (praxeo)logical exercise to pinpoint and reveal the realistic field of definition of the "entrepreneurship function" within the modern corporate spectrum, delimiting and portraying the entrepreneurial aspect out of the real characters that inhabit the corporate entourage (precisely said, of shareholders, managers, creditors). It seems that the modern literature on the law and economics of the firm has lost sight of the entrepreneur(ship), whose presence is felt but rarely positively identified. The endeavour to locate and isolate this, along with the associated incentives and logic of action is a task with some analytical merits. A thorough discrimination of the entrepreneurs' position inside the corporate field and, respectively, of the "natural" vs. "allowed" decision spheres can generate sounder judgments about the well-structured and poorly-structured companies (good vs. poor corporate governance) or about institutions found to be business (un)friendly (good vs. poor corporate law-making). We define "good governance" at the level of the corporate form the situation when incentives are aligned with rights and obligations, and the "good law" the norm which does not alter the common sense of property rights and freedom of contracting. Without knowing them, any legal organization of the corporate form will be fraught with problems.

**Keywords:** entrepreneur, capitalist, shareholder, creditor, corporation, praxeology, catallactics.

**JEL Classification:** B53, D23, F44, K20, L26, M14, P12.

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**Introduction (to "the praxeological theory of the firm")**

The briefest and most condensed answer offered by an economist or a lawyer to the question "what is, essentially, a *corporation*[1]?" would be: "a *firm*, an *enterprise*!". Such a simplified, but not simplistic answer cannot be avoided. And it cannot be simplistic, since to clarify the concept of the "firm" is itself a process with a particular degree of complexity, which, once clarified, would make sensibly easier to explain the corporation's both internal and external modus vivendi and modus operandi, as well as broader scale, macroeconomic/societal good/poor impact.

What mainstream literature – firstly, the *neoclassical* literature, then the one dedicated to the *agency*, *transaction costs* or *property rights* – has advocated as a "theory of the firm" still has rather many aspects of unsystematic intuitionism than blocks of (generally valid) theory or, at most, proxies partially able to explain these "objects" (Jora, 2013, p.179) which otherwise might be accepted by any theorist as "teleologically structured clusters of production factors" (Topan, 2013, p.102), though not (fully) being aware of what (exactly) keeps them united.

Although unevenly absorbed by the various schools from the pioneering literature on the firm, certain aspects of the "individual's position in the world" (as uncertainty and risk, time, information) and of the "interpersonal relations of production" (as team/associative work, cost of different types of transactions, opportunism/inclination to evading responsibility, towards shirking, or principal-agent problems) have been, however, widely accepted as heavily affecting the creation, organization, size and dissolution of firms (Langlois, Fu-Lai Yu and Robertson, 2003).

But we believe that, despite attempts to capture the substance of the reality of the firm from various angles, the mainstream analytical approaches failed to avoid leaving explanatory gaps and involuntarily resorted to conceptual sophisms. We hold in this article that a particular progress has been made by the more modest (in the spirit expressed by "Occam's razor"), and, in the same time, sensibly more realistic *praxeological theory of the entrepreneur*, as built (though unevenly among the explanatory streams) by the theorists of the *Austrian School of law and economics*.

The Austrian theory of the firm emerged, within the integrated body of economic theory this school developed in the subjective-value, marginalist and praxeological tradition, as reaction to what was inappropriate or incomplete theorizing from at least two schools[2]: *neoclassical* and *transaction costs*.

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[1] The (multinational) corporation is the most manifest type of modern large business unit. The incorporated legal form – characterized by entity status, limited liability and perpetuity – is one of the most spectacular topics to which an entrepreneurial theory could apply. For some recent accounts in this respect from the authors of this article, see also Jora (2013), Topan (2013) and Muşetescu (2009).

[2] The field of the theory of the firm includes so many somewhat overlapping and somewhat contradictory paradigms and research programs that it is not at all very clear what the field purports to explain or conceptually describe. Thus, there are knowledge-based and resource-based approaches, transaction cost approaches, managerial, property rights based or nexus of contracts ones. And this is to name only a few, while leaving aside more eccentric ones such as the organic view, or the Marxist exploitation theory based view. In the midst of this "firm theory jungle", to paraphrase Harold Koontz

- The *neoclassical* long dominant vision operated with a so-called "black box firm", internally unfathomable (perspective referred to, more or less justly, as having Marshallian origin): it was "embedded in the logic of equilibrium, mechanistic-managerial, automatic-optimizing one, and made the firm/enterprise equivalent to a production function where the managers, as price-takers, try (although what would such "trying" mean in the context is not at all clear), assisted by financial calculation, to extract maximum output from a stack of inputs)" (Jora, 2013, p.178). Immune to uncertainty, without anticipatory concerns, without acknowledging the time-dimension in their actions, without information-asymmetry experiences, the neoclassical firm remained a sort of "ghost" of real businesses. From the perspective of economic theory, such a firm was a function that transformed inputs into outputs.

- The answer based on *transaction costs*, on the Coase (1990 [1937]) - Williamson (1985) line, tries to explain the option for a certain organizational form of the production processes. It took into consideration the characteristics of the actors – bounded rationality and opportunism – and, respectively, of the transactions – uncertainty, frequency and asset specificity – by "savings in terms of transaction costs". It seemed a more realistic theory. The choice rests on "governance at the margin" (markets vs. firms as hierarchies) according to the particular attributes of the transactions. But this view remains fragile: the "transaction cost" is a biased derivate of the old "(opportunity) cost" (Topan, 2013, pp.79, 80, 99) and still "marginalizes" the very characters who make the calculated choices at those "margins" – the entrepreneurs.

The *praxeological* orientation of the theory of the firm (in the aprioristic tradition of the Austrian School), focused on the entrepreneurial function, has marked the "old" literature of the Austrian School, with Rothbard (1962), Machlup (1967), Kirzner (1973), non-explicitly announced by Mises (1949) and Hayek (1948), "renewed" by Foss (1994), Klein (1996, 1999, 2008, 2010), Fu-Lai Yu (1999) and Salerno (2008), with noticeable recent contributions in this field also from the Romanian "Austrian" community, markedly within Ph.D. research programs: Marinescu (2004), Spiridon (2005), Costea (2006), Muşetescu (2009), Topan (2009), Jora (2011), Stamate (2012), Iacob (2012), as well as by others in progress.

This article aims at touching two core issues, even if treated in a rather expedient manner. The first one is to account for the corporation "deeds and deals" by the basic theory of the firm as proposed by the Austrian School: (epistemo)logically consistent and corresponding to the reality to be explained. The second one is to discriminate, in an exercise of "conceptual forensics", among the catallactic/economic functions performed by the corporate governance actors, with a particular focus on the full entrepreneur vs. simple creditor division.

The purpose of our endeavour is to obtain a clearer map of the place and role in the corporate entourage of the different characters that populate it (focusing on shareholders and creditors). We start from the precise function they perform (entrepreneurs inside/outside the corporation), and as a corollary reveal the shortcomings and perils which the analytical and, then, legal confusion may provoke to this nexus of contracts corporate world, as the recent crisis abundantly exhibited in terms of "poor corporate governance and poor law-making".

(1980), one cannot stop feeling that the intuitive view underlining the common usage of the word "firm" has not gained too much in conceptual or theoretical clarity.

## 1. Praxeological/catallactic analysis: a note on the method

Before tackling these problems, we will briefly introduce the *praxeological method* and the *catallactic function* concept, as this will be helpful in proposing possible solutions.

The Austrian School, as established by the epistemological tradition contained in the works of Ludwig von Mises, is the school of apriorism, individualism and realism, methodologically opposed to empiricism and positivism, holism and aggregates, and to automatism and mechanics attributable to human behaviour and personal interactions, mathematically depicted and modelled. It is the school of theoretical economics (of causal relationships that are independent of time and place), methodologically separated from historical contingency (often abusively extrapolated and substituted for the generally valid theories). It is also the school of human action analysed in its inner logic (praxeologically) and not in the pseudo-logic of equilibrium and non-action (as seen by neo-classics) (Mises, 1978, 36).

The *praxeological method* resides, through strictly deductive reasoning, in the inference of logical implications out of a realist set of axioms: the core one – "human acts are oriented by purposes" –, and the auxiliary ones – "humans differ in matters of preferences and endowments"; "actions take time"; "work implies disutility"; "people use experience", etc. These axioms are, in a sense, derived from experience or "empirical", based on self-contemplation of human mind (not suitable to experiments of the sort the physical sciences allow), and deduction can offer solid principled and pragmatic insights about our real world populated by such acting/conscious/rational characters (although not at all infallible).

Mises borrowed the term *catallactics* – according to his own confession – from Whatley (1832, p.6), a nineteen-century British economist. It means "the theory of exchange" in Latin. He then coined the derived concept of *catallactic functions* to analytically describe the possible economic "roles" that individuals can fulfil in the exchange economy[3]. Thus, these functions are aspects or facets of human action and they include, in a more or less standard enumeration, the productive catallactic functions (viz. entrepreneur, capitalist, labourer, and landowner), together with the catallactic function of the consumer.

In what can be considered a development of the good contributions coming from the classical school, Mises (1998 [1949]) developed his own brand of the so-called "theory of distribution" which – following insights of his precursors, such as Fetter (1905) or Clark (1899) – evolved into a "pricing theory" of the factors of production. Thus, each function designating a productive aspect of human action is paired with a specific income share which is one and the same with the price of that production factor. Profit, interest, wages or rents become, therefore, functional incomes, under the implied principle of "one function - one income".

One can immediately notice that for Mises *catallactic functions* are not one and the same with *real persons*, nor with the *ideal types* behind the similar terms employed in business history. Every real person necessarily cumulates catallactic functions – one could even argue that every person cumulates all catallactic functions, some being more pronounced or visible than others. For example, Mr. William Henry Gates the Third, the founder, the most

[3] As aspects of man's effort to better his lot in this world, they also exist in the Crusoe model of the isolated individual, but they are (significantly) less obvious or visible.

important financer and the Chief Executive Officer for the longest period of Microsoft Corporation's existence: how was his overall income derived?; what was his most important catallactic role in this company? His gross income included three components: pure profit, interest ("normal profit", as a Ricardian would say) and marginal wage. An interesting consequence of the catallactic disambiguation is that every personal income proves to be necessarily composite. What we would call "market wage rates", for instance, or "market interest rates", or "market profits" are actually composite incomes, containing elements of wage, interest, rent and profit/loss – some part being more visible than the rest.

Below, Mises is to be quoted in this respect:

> "…[T]he classical division of the factors of production […] was invented only for the purposes of the theory of exchange. […] The classification of the factors of production is not a classification of men or groups of men, but of functions; the rationale of the division lies solely in the purpose of the theory of catallactics it is intended to serve" (Mises, 1962 [1951], p.331).

> "The entrepreneurs, capitalists, landowners, workers, and consumers of economic theory are not living men as one meets them in the reality of life and history. They are the embodiment of distinct functions in the market operations. The fact that both acting men and historical sciences apply in their reasoning the results of economics and that they construct their ideal types on the basis of and with reference to the categories of praxeological theory, does not modify the radical logical distinction between ideal type and economic category" (Mises, 1998, pp.252-253).

> "The economic categories we are concerned with refer to purely integrated functions, the ideal types refer to historical events. Living and acting man by necessity combines various functions. He is never merely a consumer. He is in addition either an entrepreneur, landowner, capitalist, or worker, or a person supported by the intake earned by such people. Moreover, the functions of the entrepreneur, the landowner, the capitalist, and the worker are very often combined by the same persons" (Mises, 1998, pp.253).

> "In the context of economic theory the meaning of the terms concerned is this: Entrepreneur means acting man in regard to the changes occurring in the data of the market. Capitalist and landowner mean acting man in regard to the changes in value and price which, even with all the market data remaining equal, are brought about by the mere passing of time as a consequence of the different valuation of present goods and of future goods. Worker means man in regard to the employment of the factor of production human labour. Thus every function is nicely integrated: the entrepreneur earns profit or suffers loss; the owners of means of production (capital goods or land) earn originary interest; the workers earn wages. In this sense we elaborate the imaginary construction of functional distribution as different from the actual historical distribution" (Mises, 1998, p.255).

Before elucidating the entrepreneurial element in the activity of shareholders and of creditors, as well as those two categories' different position in a firm, we will fleetingly revisit the functional fiefdom of the entrepreneur.

## 2. Entrepreneurs-capitalists-owners, as creators of firms

The Austrian theory of the firm distinguishes itself in the literature by its sound foundation in the basic economic categories of *entrepreneur* and *profit*.

As stated above, catallactically, the *entrepreneurial function* is not a characteristic specific to a group or class of people; it is inherent in every action and common to every individual, being only more noticeable for some. Personifying this function into an imaginary actor (as methodological artifice), we find the entrepreneur (from the catallactic theory) – cleared

from the rest of the composite interferences – as "[the] acting man exclusively seen from the aspect of the uncertainty inherent in every action" (Mises, 1998, pp.254).

Also catallactically, the *profit* is the entrepreneurs' revenue. While we will not expand on the topic, vast in the literature, we keep in mind the essence: the pure profit (in the economic sense) of a person, as entrepreneur, is what remains after deducting from his naturally composite revenue both expenses regarding the production factors purchased from other individuals, including capital externally contracted, and contributions of the person in question other than of entrepreneurial nature (capitalist, worker, landowner). This rest is the reward for skill in tackling uncertainty and it is "paid" by the gratifying consumers "with" the losses from the less proficient businessmen (Mises, 1998, pp.286ff.).

In the general market process, a *firm* is identifiable through an individual or conjoint *entrepreneurial project* (which can be translated into a productive transformation of certain resources, in the "scarcity-expectancy-uncertainty" dialectics). It requires the allocation of someone's property-means (although its current administration can be delegated). The teleological unit of the company is given by the entrepreneur/s, the one/s risking the capital of his/their firm, although he/they cohabit/s in/through the company with other stakeholders.

We build on the Misesian-Rothbardian vision of apportioning the catallactic roles in the firm: the *entrepreneurs* surmount the natural market uncertainty (where they calculatedly allocate property-resources), the ultimate source of profits (and losses); the *simple capitalists* do not endure the losses[4], they are simply "waiting" for the fruits of the savings. But, in terms of real individuals[5], every entrepreneur in the firm is also, in the nature of things, capitalist (though not the other way around): to take on the results (profits or losses) of a business project implicitly involves waiting for some time, yet the entrepreneur does much more than this. Assuming any kind of risk means necessarily having the ability, that is, the stock of capital, to incur the eventual loss.

*Competing views on entrepreneurs in the Austrian School*

In the Austrian paradigm two views regarding the entrepreneur and profit coexist. The differences have significant consequences in terms of the realist definition of the firm. One is that initiated by Kirzner (1978) – rooted less in Mises's and more in Hayek's route – while the other has Rothbard (2009 [1962]) in the centre – the most devoted intellectual follower of Mises, developed by Salerno (1995), Hoppe (1996), Hülsmann (1997).

- The *Kirznerian approach* presents the entrepreneur somehow "separated" from property/resources; he possesses the entrepreneurial alertness "gene", the one "facilitating" the discovery of entrepreneurial opportunities for profit through interspatial and inter-temporal price arbitrage.

[4] "There is a simple rule of thumb to tell entrepreneurs from non-entrepreneurs. The entrepreneurs are those on whom the incidence of losses on the capital employed falls" (Mises, 1998, p.11).

[5] In terms of real people, those designated as capitalists – as well as workers or landowners – are acting under uncertainty and therefore their income is composite, containing, besides interest, a part of the profit/loss. But this last part is due to the overlapping of functions: they are also entrepreneurs (for example, as is the case for banks, only that in the business of "capital lending").

- The *Rothbardian approach* avoids the definitional limits of such an "ethereal" entrepreneur, establishing a realistic relationship between the entrepreneurial activity and the inescapable necessity to engage scarce resources (property); for which he bears the immediate risk of losses.

The firm is, according to such a perspective, a project of a capitalist in his quality of entrepreneur, project where material resources from his private property[6], as well as material resources entrusted by simple capitalists/creditors (with respect to the said project) are calculated, configured and combined with labour-services of third parties and employed, in conditions of uncertainty[7], to achieve goals (foremost of which is consumer demand satisfaction), whose common denominator is "making profit".

The firm, as a form of explicit manifestation of entrepreneurs, requires economic calculation, which in turn has several institutional premises, the most important being the existence of private property, in general, also over the means of production, in particular (including in the form of unhampered capital markets), freedom of (domestic and international) trade and sound money. In such an elementary framework, entrepreneurs are free to set up companies, to expand them, to reconfigure them, to merge or break them up into pieces, to dissolve them, etc. – all operations being subject to economic calculation.

### 3. Corporations' shareholders, the discreet entrepreneurs

Both *methodological realism and individualism* require that analytical judgments be carried out beyond the barriers raised by certain fictions contemplated by the positive law. Despite its impersonal image, the corporation[8], definable as a legal entity, organized usually as a joint stock company[9], involving a large number of shareholders owning different numbers of shares (viz. fungible and abstract portions of the property of the corporation's equity,

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[6] By integrating the ownership, capitalist and entrepreneurial functions, Salerno (2008) builds the concept of "integral entrepreneur" (somehow, "creator of firms"): "An important sidelight of this integration of the ownership function with the capitalist and uncertainty-bearing functions is a new perspective on the nature and organization of the firm. The firm appears now as the projection of the owner's personality, with all its cognitive and temperamental idiosyncrasies, into objective reality. Each firm's organization is shaped to accommodate the unique decision-making ability of the owner and it is perpetually transformed in a dynamic world by his decisions. The firm's organization is, furthermore, the immediate source of the integral entrepreneur's decision rents. The application of these insights should lead to a much richer theory of the firm's organization." (Salerno, 2008, p.207).

[7] Uncertainty is a constant, an ultimate given, in the human action. Depending on the specific understanding of the configuration of time, place and people circumstances, the entrepreneurs can "overcome" uncertainty, process which can be validated only ex post. On the other hand, the risk is considered to be a predictable and quantifiable event, but the models and the provided figures of such calculations should be considered with caution, because forecasting and measuring in the field of future events are in turn speculative, anticipatory, and, essentially, entrepreneurial elements. For a thorough treatment of this distinction, see Mises (1998, p.105ff.) and the whole subjective value in the Austrian School tradition.

[8] For an interesting discussion on whether corporation are state-created legal formats or free market products, see van Eeghen (2005a; 2005b) and Block and Huebert (2009).

[9] While today a joint stock company is synonymous with corporation, there has been a brief period in history where these legal concepts were different. A legal battle in Great Britain in 1897 (the Salomon versus A. Salomon & Co. case) confirmed this identity.

owned undivided by the shareholders during the entire corporate lifespan, which is not limited by charter), is an enterprise, involving entrepreneurs. The entrepreneurial reading of corporations is also perfectly legitimate, although, usually, the entrepreneurial element remains associated with archetypal "small business", initiated and managed by the owner himself.

Entrepreneurship, distinguished by its role in the structure of production, involves, from the "single-associate company" to the "multinational corporation", the same considerations: the corporation is also centred around the idea of human action based on the ownership of resources (the property function), performed over time (the capitalist function) and subject to uncertainty (the entrepreneurial function itself), and circumscribed to an actual specific project, through the instrument of economic calculation in monetary terms. (The judgment regarding the secondments of managers relative to entrepreneurs is similar.) Integrating theoretically the catallactic functions and the essence of the corporation, as basically a firm/business enterprise, to explain it coherently economically, we can pinpoint several aspects.

*The shareholders, and not the managers, are entrepreneurs*

The *shareholders* are the *owners* of the corporation (although, in a certain perspective, "the corporation's assets owned by the incorporated entity itself", or, in another perspective, some dismemberments of property are somehow delegated to a much greater extent than in other business formats). The shareholders are also capitalists, because, naturally, they are waiting from their capital contribution until they receive potential dividends. The shareholders are also the ones who assume, by not receiving dividends and by the depreciation of their shares, the losses caused by "the swings" of the market, and this happens exactly in the context of the project that is the very corporation whose shareholders they are and from the performance of which they capitalize profits or suffer losses. Another notable aspect is that the shareholders are the first/only ones who (can) lose up to the entire capital invested, if the corporation goes bankrupt, so significantly more than "the loss of future opportunities for earning" (as is the case of managers and other employees). Extending "the test of loss", we can remark that the holders of privileged shares detach from the shareholding by cancelling the status of entrepreneurs from the corporation, being only capitalists, while the holders of common shares, without voting rights, remain entrepreneurs, because even if they are seemingly detached from corporate decisions, in fact they bear the possibility of loss (they take risks and let the resources to be effectively allocated by others)[10].

[10] Based on Salerno's concept of "integral entrepreneur", we could discriminate among shareholders, recognising as entrepreneurs only those most profoundly involved in corporation's activity. But, in its nature, the contribution of the "more active" shareholder (founder of corporations, market leader, and business guru) does not differ from that of the "more passive" shareholder: the firsts appear more prominently only historically. On this line of discriminating between "the integral entrepreneur" and the rest of the shareholders, the classical dualism direct investment - portfolio investment would also be enabled: the passive shareholders would be "portfolio" investors, the active one investing "directly", but the distinction remains one of degree, and not in nature.

*The managers are simple administrators, regardless of rank*

The *managers* are the vanguard of the corporate *workforce*, performing executive tasks, and only if they are, in parallel, shareholders, they can be also regarded as entrepreneurs (only in this combination). In "the test of loss", likewise, we note that even if managers (maybe even employees/workers in general) are rewarded, beyond the fixed salary remuneration, with a profit share, as long as the losses do not have the same effect on them, they are not entrepreneurs. Moreover, since Berle and Means (1935 [1932]) pioneering analysis of the separation on "ownership and control", the shareholders are seen as somehow inclined to act divergently, though those two authors miss the ultimate cause of this "divorce" (which is, arguably, the state-driven design of the corporate law) [11].

Further on, we will expand on the two implications of our functional analysis announced above: the "shareholders versus creditors" discrimination and the possibility of the "fully-borrowed entrepreneur".

## 4. The core difference between creditors and shareholders

As the terms "entrepreneur", "capitalist", "landowner", "worker" can refer both to economic function and real person or ideal type (and this even in hypothetical examples or mental experiments, as will be seen below), the possibility of inconsistent usage and of confusion arises. Moreover – and this is an important part of our thesis in this article –, consistent usage requires, and sheds light on, the concept of the business unit or firm, and therefore, on the theory of the firm. In order to illustrate this assertion, let us proceed to a discussion of shareholders/stockholders "vs." bondholders/creditors that Rothbard (2009) makes at one point (chapter 6) in his quite extensive treaty, *Man, Economy, and State*.

In sub-chapter 9, entitled "Joint-Stock Companies and the Producers' Loan Market", Rothbard (2009, pp.435ff) asserts that essentially the role of the creditors is, from an economic point of view, equivalent to that of the shareholders. He is doing this in the context of a number of sub-chapters dedicated to arguing against the Keynesian idea that there could be a hiatus between capital/savings (too much/many) and entrepreneurship/ investment (too little, due to pessimistic "animal spirits"). Coextensive with this line of argument, which stands for an essential identity between savings and investments, is the idea that the loan-market is not an independent driving force in itself but just a part – and not necessarily the more important one – of the broader time-market.

According to Rothbard:

> "We must conclude that economically and even in basic law, there is no difference between shareholders and productive creditors; both are equally suppliers of capital, both receive interest return as determined on the general time market, both own their proportionate share of the company's assets. The differences between the two are only technical and semantic. It is true that

[11] Several developments in the power balance inside the modern corporation argue that modern management has benefited from an increasingly favourable legislation that allows an apparent independence in their relationship with the owners of the corporation they manage. Politics has shaped corporate law and ultimately altered the free market, contractual relationship between the managers and the owners – through directors – of modern corporations (Roe, 1994).

our discussion has so far applied only in the evenly rotating economy[12], but we shall see that the real world of uncertainty and entrepreneurship, while complicating matters, does not change the essentials of our analysis" (Rothbard, 2009, p.439).

"It is clear that, in essence, G, the creditor on the prospective loan market, is no different from F, the man who has invested in stock. Both have saved money instead of spending it on consumption, and both wish to sell their saved capital in exchange for future goods and earn interest" (Rothbard, 2009, p.436).

"There is not essential difference between F's method of investing his capital and G's method of investing his; the difference between investing in stock and lending money to firms is mainly a technical one. The separation between saving and investment that occurs in the latter case is completely unimportant. […] Whether saved capital is channelled into investments via stocks or via loans is unimportant. The only difference is in the legal technicalities" (Rothbard, 2009, p.437; Rothbard's italics).

Analogous from Mises:

"…The moneylender is always an entrepreneur. Every grant of credit is a speculative entrepreneurial venture, the success or failure of which is uncertain. […] Debtors, guarantors, and warrantors may become insolvent, collateral and mortgages may become worthless. The creditor is always a virtual partner of the debtor or a virtual owner of the pledged and mortgaged property. […] He has linked his fate with that of the debtor or with the changes occurring in the price of the collateral […]" (Mises, 1998, p.536).

"The contracts which place the debtor and his fortune or the collateral as a buffer between the creditor and the disastrous consequences of malinvestment of the capital lent, are conditioned by laws and institutions. The creditor is less exposed to loss and failure than the debtor only in so far as this legal and institutional framework makes it possible for him to enforce his claims against refractory debtors. There is, however, no need for economics to enter into a detailed scrutiny of the legal aspects involved in bonds and debentures, preferred stock, mortgages, and other kinds of credit transactions" (Mises, 1998, p.537).

The above argument seems somewhat counterintuitive. But that would not be a problem in itself, as one more than legitimate task of economics (and of any science, for that matter) is the dispelling of intuitive errors and the shedding of light on counterintuitive truths. Nevertheless, if we were to try to tackle the problem from a different angle, it could be synthesized as follows.

The table no. 1 purports to show the inadequacy of the existing bodies of economic theory to account for the distinction between shareholders and bondholders – as this article draws heavily on the Austrian paradigm, we have singled-out sub-fields of the said paradigm, which although not similar to the mainstream perspective, they communicate significantly with this. This distinction is both intuitive and widely used by professionals, for instance, in the classical "debt vs. equity" discussion in corporate governance/finance literature.

[12] The "evenly rotating economy" concept, as introduced by Mises (1998), represents an imaginary state of "dynamic equilibrium" in which all of the basic economic functions, such as production, saving, consumption, and factor supply, are performed by some kind of automatons, meaning human beings that cessed to deliberate and proceeded to behave as specified by an inertial plan of action. Unless an economist theoretically imagines such an unrealistic state of things, he finds it impossible to understand the consequences of entrepreneurship in economic interaction, in real market processes.

**Table no. 1: The mainstream literature fails in differentiating between the catallactic categories**

| The particular theoretical viewpoints → / *Economic role* ↓ | Theory of capital | Theory of entrepre-neurship | Theory of monetary economic calculation | General theory of human action under scarcity | Theory of exchange | Theory of production |
|---|---|---|---|---|---|---|
| *Share-holder* | "Waits" inter-temporal exchange | Bears (some) uncertainty | Employs monetary calculation | Pursues chosen ends with scarce means | Inter-temporal exchange (proper/inter-personal or autistic) | Producer/ productive |
| *Bond-holder* | "Waits" inter-temporal exchange | Bears (other) uncertainty | Employs monetary calculation | Pursues chosen ends with scarce means | Inter-temporal inter-personal exchange | Producer/ productive |

*Source: Authors' own representation*

But there appears to be a problem here, and this might be clarified once we acknowledge that the focus is rightly set: either on the *macro* or on the *micro* perspective.

- If creditors are the equivalent of capitalists and shareholders of the entrepreneurs, then it follows that capitalists are equivalent to entrepreneurs. If this is contemplated or analysed in terms of catallactic functions, it is definitely problematic as it equates two distinct functions. If it is contemplated in terms of real persons, it is not wrong anymore, but is somewhat fuzzy and can be misleading. What we concede is that the thesis is appropriate only from an aggregate or macro angle. Yes, there is no capital surplus over possible entrepreneurial projects. Yes, there are no savings that cannot be channelled into profitable investments (on the free market). And yes, in an important sense all capitalists are entrepreneurs and all entrepreneurs are also capitalists.

- But should we zoom into the micro sphere, this creditor-shareholder equivalence thesis is problematic. We suggest that to make sense of the creditor-shareholder relation one needs a concept of the business unit, or the firm, such that the stockholders are considered to be "inside the firm" while the creditors as such are considered to be "outside the firm" (while the latter could very well be considered to be "inside" their own business unit – the bank, let's say). One very important difference between creditors and stockholders is that the latter are the ones who incur first any eventual losses. Or, to put it otherwise, there is a non-zero level of losses by which the shareholders are hit, but creditors are not (as they can be repaid swiftly from the capital of the first). And this proves, in a solid sense, that they are enterprising different businesses.

Thus, a person can cumulate catallactic functions in more ways than one. First, in his own firm (or simply as a private person) one is entrepreneur, capitalist (necessarily) and maybe even worker (self-employed) or landowner. In addition to that, one can be only a capitalist

("creditor") with respect to a particular firm/business unit (that is not his own or which he is not a part of).

> "The activity of the banks as negotiators of credit is characterized by the lending of other people's, i.e., of borrowed, money. […] Banking is negotiation between granters of credit and grantees of credit. Only those who lend the money of others are bankers; those who merely lend their own capital are capitalists, but not bankers" (Mises, 2009, p.262).

> "But one thing is essential: that activity of the banks that consists in lending other people's money must be sharply distinguished from all other branches of their business and subjected to separate consideration. […] It is true that a risk remains. Imprudent granting of credit is bound to prove just as ruinous to a bank as to any other merchant. That follows from the legal structure of their business; there is no legal connexion between their credit transactions and their debit transactions, and their obligation to pay back the money they have borrowed is not affected by the fate of their investments; the obligation continues even if the investments prove dead losses. But it is just the existence of this risk which makes it worthwhile for the bank to play the part of an intermediary between the granter of credit and the grantee of it. It is from the acceptance of this risk that the bank derives its profit and incurs its losses" (Mises, 2009, p.263).

Given the distinction between the two functions, it can be noticed that the supply of capital can be "outsourced" (not completely) through financing from third parties on the capital markets, but the outsourcing of the entrepreneurial function is impossible. There is no "firm" where the entrepreneurial function is bought from a third party supplier. Even in the extreme cases of modern business arrangement such as franchising and management contract where third parties seem to offer the entire body of know-how – and strategic decisions – on how to manage a business, the entrepreneurial function is still "inside" the firm. The bearer of potential loss – the ultimate owner – cannot "sell" or "buy" such a service on the market.

*The modern corporate law-making and its twilight zones*

Both Mises and Rothbard are differencing the catallactic functions, but Rothbard fails to be alert to the dilemma whether such an overlap between the functions of entrepreneurs and capitalists are a free market phenomenon or a result of *state-driven positive law*.

Here we try to assess the pertinence of one or the other of the two competing perspectives, raising questions which despite the space requirements for comprehensive answers remain important even only for showing the importance of prior *catallactic clarification*[13].

- First of all, several analysts have pointed that *modern bankruptcy law* is a legal redistribution of property rights which is incompatible with the free contract law (White, 1977, p.271). Fundamentally, it is argued that the operation of limited liability that exonerates the shareholders from their liability towards the creditors of the company make such creditors assume an increased entrepreneurial risk that they would not have borne on a free market. In other words, positive law redistributes the entrepreneurial risk from shareholders towards creditors. One possible reply is that limited liability actually involves an implied contract between shareholders and outside creditors, the second ones being warned that the first ones do not accept unlimited personal liability, so that creditors must

[13] It is precisely functional analysis which permits us to identify the problems of positive law and legislation. It is not that Mises and Rothbard are not quite right, but, to the contrary, based on their views, one can shed light on the messy reality of legislation and corporate law.

look only to the corporation's assets for satisfaction of their claims in case of the insolvency/bankruptcy of the corporate debtors. As Hessen (2008) points out that apart from the transparent acknowledgement of the limited liability status of a business unit, the creditors are free to negotiate outside pledge agreement, guaranty, endorsement, or the like so as to extract further safeguards in case of litigation.

- Second of all, *business innovation* is always in a dynamic through which private parties discover, according to contractual interests, a wide range of forms and instruments of redistribution of risk and reward among them. For example, let's take into consideration a contractual arrangement where a creditor advances capital to an entrepreneur and accepts to be compensated only and if the entrepreneur will experience a profit. Otherwise, the alleged creditor is willing to accept capital loss even if he is ready to accept only a fixed compensation for his co-entrepreneurial participation. No economist can annul such affairs on the argument that it does not fit the catallactic definitions of entrepreneurs and capitalists. The two parties purely and simply may ignore and pursue their business according to their perceived interests. But even if the abovementioned example is worth discussing, it is actually a confirmation of the possible counterintuitive results of catallactic function analysis. Specifically, in the example given, the so-called creditor is the true entrepreneur, while the so-called entrepreneur might be but an employee of the former (if he uses solely borrowed capital and externalizes losses).

- And, not finally, the *test of profit and loss* which defines the quality of an entrepreneur should be understood as both a patrimonial/legal position as well as an economic one. It should not be taken only from a real (or consequentialist) perspective. It is a frequently met in business practice that, sometimes, business partners (and other stakeholders) lose capital – not only business opportunities – as a result of a failure of a company. For example, a client that advances payments to a company may sometimes lose the money if such a supplier goes bankrupt before delivering the product. The corporate client just wanted to buy something and wasn't necessarily aware of the risk it undertook. Fundamentally, to advance capital to a supplier is a form of assumption of entrepreneurial risk. But again, the question is: what uncertainty have those creditors who lost money to bear? The specific one of the "credited firm", or the specific one of "crediting – even if ad-hoc – someone else"? Someone providing in advance – as commodity credit – timber for a furniture business is not considered, in the event of bankruptcy, of having activated in the furniture business. They are dealing with different issues.

*What is the risk? The legalizing of moral hazard habits*

Summing up, the discussion on the proper identification of entrepreneurs in modern business is major because it helps to reveal the basic function and the associated character who, in a rational calculated manner, is responsible for acquiring and originating *critical price-information* on *cross-society subjective preferences* and *technological possibilities*, confronting uncertainty and assuming risks.

The sound *nexus of relations* between entrepreneurs and other stakeholders evolving around the projects/firms created by the first is not immune to disturbance factors, even legal ones, that, unidentified and unaddressed, may transform the providential societal role of "creative destructors", "opportunity discoverers", "risk takers" entrepreneurs into "expropriators", messing-up the entire economic scenery.

For some analysts of corporate governance, such a theoretical debate may seem too scholastic. What is at stake for not advancing a strict border line between the concepts of entrepreneurs and capitalists? Our perspective is that such a distinction is useful not only for theoretical debates. It has a core impact on the *real life behaviour* of different categories of stakeholders within the realm of modern corporations.

When a particular category of holder of business interests is not protected through legal mechanisms and its interests are not matched by his exposure, such a gap will be manifested in what economists call "moral hazard" (Hülsmann, 2006, p.36)[14]. We will highlight what we consider "law failures" resulted by conflating the shareholder and creditor roles, thus *disturbing the corporate environment*.

- In the first instance, the *modern bankruptcy law transfers*, as already stated, *entrepreneurial risk from the real entrepreneurs towards the creditors*. In consequence, the entrepreneurs (ignoring, in our case, the problem of agency costs) are exposed to the incentives to assume even more risk as otherwise. In highly leveraged firms, where creditors do not succeed in imposing a voice on corporate decisions, the entrepreneurs controlling the business engage in high risks strategy (the eventual loss being borne by creditors). Examples such as the entrepreneurs-friendly bankruptcy law in the United States of America (the famous Chapter 11) point to the decision of the framers of the corporate law to throw the costs of entrepreneurial decisions towards creditors[15]. On the other hand, the same bankruptcy law redistributes in an artificial way the credit risk between initial creditors and late creditors. By putting them at the same table, irrespective of the moment when they awarded the credit, the modern bankruptcy legislation in fact encourages over-indebtedness by not penalizing late creditors (informed on the risks of over-indebtedness, but opportunistic in endorsing this dispersed fragility) at the expense of the initial ones.

- In the second instance, creditors realized that such a core moral hazard they are exposed to cannot be solved but by their *involvement in the corporate decision making process* (by assuming, in fact, the entrepreneurial function). While the mainstream literature as well as policy makers were outraged by the involvement of bankers in the corporate ownership and boards before 1933 (Simon, 1998, p.1077) as well as after 1999, along with the deregulation wave experienced by the US financial industry, a better explanation would be that such involvement was a result of the core moral hazard induced by the corporate form as shaped by the modern positive law. In consequence, an artificial separation between commercial banking and investment banking, as the Glass Steagall Act introduced for 60 years in USA – see Ramírez (1999, p.372) –, delivered as a financial market imbalance preventing mechanism, could have been avoided by a more careful discussion on the ways to limit or eliminate the endemic modern corporation moral hazard. A much more inspired focus might have been on the inbuilt vices of modern fractional reserve banking[16], which alter the traditional functions of banking enterprise and promote malivestments.

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[14] For a discussion on the legally induced moral hazard inside and outside modern business corporations, see Jora and Iacob (2012) and Jora and Iacob (2013).

[15] According to this law, any corporation can suspend payments towards its credit obligations for the period of re-organization of the business which may easily exceed 180 days.

[16] For a comprehensive discussion, see Huerta de Soto (2010).

- In the third instance, the moral hazard induced by the modern corporation also takes the form of *channelling the value of the firm "outside" the reach of the creditors* to private entities that such entrepreneurs operate effectively. Any entrepreneur who controls a business can use the mechanism of transfer pricing (non-market prices) to expropriate first of all the creditors, but also other minority shareholders. Accounting and audit cannot by themselves solve this core issue of corporate fraud, but only the economically sound corporate law, having absorbed the basic catallactic picture of the modern corporation.

**Conclusions**

A corporate law that attempts to avoid the risks of encouraging moral hazard advances legal concepts which are realist and derived from practice and from a good theoretical framework. To conclude our study: all capitalists are entrepreneurs and all entrepreneurs are capitalists, but not necessarily with respect to the same business unit. Entrepreneurs (who are also necessarily capitalists with respect to their own firm) bear specific uncertainty (associated to a specific/particular business project). Thus, in our judgment, the creditor/shareholder distinction implies the equity/debt distinction which implies the business unit or the firm concepts. The task of the theory of the firm in explaining the nature of the firm becomes one of describing the role of the persons who fulfil the entrepreneurial function (those who incur first potential losses) with regard to a stock of capital goods structured together by those same persons into what thereby becomes a business unit/firm.

As for the possible practical implications of an Austrian entrepreneurial theory of the firm – which is at the same time truly praxeological – let us briefly suggest but two. First, for business practice or corporate governance consultancy, it becomes relevant to check the following: to what extent the decision-making in the business unit resides or is directly and strongly connected with the persons who fulfil the entrepreneurial function. Along this line, one could speak of well-structured versus badly-structured firms (favouring moral hazard behaviour in governance bodies), and here a realistic theory is paramount. Second, for policy purposes, the theoretical framework suggested could be used to engage in a critique of positive legislation, for instance. Namely, to see whether corporate and business law in general unleashes or hampers the actions of those fulfilling entrepreneurial function in a business unit. And thus, everyone could distinguish between good and bad pieces of legislation.

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