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THE ROLE OF CORPORATE LAW IN THE THEORY OF THE FIRM*

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THE corporation is a nexus of contracts. Some scholars have argued that the contractual view of the firm implies that markets will lead managers to adopt optimal governance structures and that legal rules are irrelevant.[1] The latter claim is implausible because markets do not operate costlessly. Legal rules may reduce the costs of reaching and adhering to optimal contracts, but the particulars of optimal contracts differ from firm to firm. For example, the optimal structure for a closely held firm is not the same as that of a firm with widely scattered holdings.[2] This implies that state corporation laws also should differ and that firms will select their state of incorporation adaptively. We offer data to support this implication of agency theory.

I. The Logic of Shareholder Activism in Large Corporations

The problem of controlling agency costs is addressed by a large number of corporate governance mechanisms. Some depend on market incentives and some on political or legal influence. These two substitute methods are distinguished by the amount of governmental intrusion. Market mechanisms require only minimal intrusion of the state; political and legal mechanisms require a more elaborate system of law and the participation of some active shareholders. Firms choose particular governance structures in accordance with their circumstances. They can select among many

* The authors thank Louis De Alessi, Richard Kirk, Owen R. Phillips, and an anonymous referee for helpful comments on an earlier draft.

[1] See, for example, Michael C. Jensen & William Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. Financial Analysis 305 (1976); Eugene F. Fama, Agency Problems and the Theory of the Firm, 88 J. Pol. Econ. 288 (1980); Douglas W. Diamond & Robert E. Verrecchia, Optimum Managerial Contracts and Equilibrium Security Prices, 37 J. Finance 275 (1982).

[2] Henry G. Manne, Our Two Corporation Systems: Law and Economics, 53 Va. L. Rev. 259 (1967).

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incrementally variable devices (for example, the percentage of shareholders' votes to approve a particular action). We expect to see substitution in an incremental way among governance mechanisms, not corner solutions.

Those who have a comparative advantage at running the business become managers, but they must persuade other participants that they will not use their informational advantage to harm these participants. Managers must select governance structures that ameliorate shareholders' rational concerns.[3] Both managers and investors gain from effective governance. Managers do not want a structure that grants them "too much" autonomy, because investors who fear excessive corruption and ineptitude will bid down the price of shares. Investors do not want a structure that imposes "too much" control over managerial decision making, because it imposes excessive costs on the organization and permits other shareholders to abuse the system; again prices fall. Optimal controls bring higher prices. Thus, the control of managerial discretion in open corporations is best viewed as an incremental process, which, when brought into proper balance, yields minimum costs of equity capital.

One of the many governance decisions that managers make is the selection of the firm's state of incorporation, as firms incorporated in one state are allowed to operate in all other states. Each state's corporate law provides a basic legal framework that governs the relations of investors with senior managers, directors, and controlling shareholders. Through the law of fiduciary duties, which proscribes theft and specifies standards of care and loyalty, corporate law serves as a standard form contract that substitutes for costly, fully contingent agency contracts.[4]

[3] Managers may implicitly demand government regulation of their conduct (at least to some degree) as a means of signaling to potential investors the value of the contracts they offer. State incorporation statutes, for example, may be selected by corporate managers as market signals. The optimal strictness of a legal environment varies according to the preferences of managers with respect to constraints on their behavior, the costs and effects of such legal constraints on managerial performance, and the ability of stockholders to substitute among private (market) and governmental methods of allocating the value consequences of potential managerial discretion over investors' funds. For the development and testing of hypotheses based on this self-regulatory perspective in the market for corporate privileges, see Barry D. Baysinger, A Theory of the Efficiency of Jurisdictional Choice: The Case of Corporate Federalism (September 1978) (unpublished Ph.D. dissertation, Virginia Polytechnic Inst. & State Univ.).

[4] See Frank H. Easterbrook & Daniel R. Fischel, Corporate Control Transactions, 91 Yale L. J. 698, 702 (1982); and Daniel R. Fischel, The Corporate Governance Movement, 35 Vand. L. Rev. 1259, 1265 (1982). Fischel suggests that "[O]ptimal fiduciary duties should approximate the bargain that investors and managers would reach if transactions costs were zero." The analysis presented in this paper does not dispute that contention; it does, however, suggest that more than one type of bargain would be negotiated in the absence of transaction costs, and thus that there is more than one optimal specification of fiduciary duties.

State corporate laws vary along a continuum from strict to liberal. Strict laws provide a relatively greater scope for the involvement of shareholders in managing the firm; liberal laws reduce direct controls by shareholders and emphasize the anonymous mechanism of the stock market. In terms of Hirschman's social control dichotomy,[5] strict laws invoke the voice mechanism, while liberal laws rely on the exit option.

All firms use a mix of exit and voice mechanisms. The optimal mix varies from firm to firm in response to the relative effectiveness of each mechanism under the particular firm's circumstances. For example, as the importance of exit diminishes, the importance of voice increases. The makeup of the firm's ownership group is an important determinant of the optimal mix of governance mechanisms.

The governance role of residual claimants in the currently articulated contractual theory of the firm is limited exclusively to the exercise of the exit option. Shareholders, in general, are assumed to be rationally ignorant of the firm's internal affairs, and they exit or remain with the firm only in reaction to external and easily monitored measures of performance. Yet, for many shareholders, in both large and closely held firms, this is neither a rational pattern of behavior nor an adequate form of governance.

Concentration of shares into relatively large blocks is a common phenomenon.[6] Owners of large blocks, regardless of their motivations in making the investment, may have so much of their wealth tied up in a firm that they cannot afford to ignore the initiation and implementation of strategies. Contrary to the small shareholder bias in the legal literature, it is the larger shareholders, for whom the exit option is not viable, who generally benefit from and prefer strict laws (that is, the voice option). This provides an a priori argument for shareholder activism in the governance of corporate contracts. Since strict corporate law facilitates this activism, consideration of such laws is an important element in the modern theory of the firm.

The benefits of enhanced legal controls, however, are offset by significant organizational costs. Increases in the legal rights of shareholders potentially opposed to managerial prerogatives reduce the ability of managers to exercise delegated authority. At some point, increases in

[5] A. O. Hirschman, Exit, Voice, and Loyalty: Responses to Declines in Firms, Organizations, and States (1976).

[6] Melvin A. Eisenberg, A Larger Role for Shareholders, in Commentaries on Corporate Structure and Governance: the ALI-ABA Symposiums 1977–78 (D. Schwartz ed. 1979), at 135; Harold Demsetz, The Monitoring of Management, in Statement of the Business Roundtable on the American Law Institute's Proposed "Principles of Corporate Governance and Structure: Restatement and Recommendations" (1983).

such constraints will reduce shareholders' wealth by stifling innovation and increasing the likelihood of opportunistic behavior by individual shareholders. The provisions of a stricter corporation law, for example, allow maverick shareholders to block mergers, acquisitions, changes in the articles of incorporation and by-laws, or other major organic changes that would increase shareholders' wealth.[7] Under stricter corporate laws, the decreased risk of adverse managerial behavior is "purchased" with the currency of increased likelihood of shareholder opportunism and managerial inertia. An institutional framework that permits the selection of different mixes of governance controls is a necessary condition for optimality. Jurisdictional variety in corporation laws, however, does not necessarily flow from these considerations.

Conceivably, firms could incorporate in a liberal jurisdiction to maximize flexibility, then write an "internal constitution" that specifies the nature of the contractual relationship for any given firm. In principle, this strategy could address the unique characteristics of each firm more easily, and constitutional revision could be accomplished at lower cost. Under such a scheme, all firms would be incorporated in the most liberal state. We do not observe this because of the tremendous information costs it would impose on the securities markets. Moreover, flexibility per se is not valuable. For some shareholders, the flexibility to rewrite the internal constitution increases the uncertainty concerning the prospect of undesirable change. Monitoring and bonding costs, as well as the residual loss, would rise. We observe a variety of standard form corporate contracts across states because strict as well as liberal statutes create costs for shareholders. The choice of incorporating jurisdiction thus may be predicted from the ownership structure of the firm.

Summarizing, stricter corporation laws survive because in some instances market oriented governance mechanisms do not provide some classes of shareholders with the explicit legal controls they prefer. More liberal corporation laws survive because they allow certain firms to economize on the costs of political or legal control of managers, without interfering with the operation of market controls. Markets lead managers to adopt the optimal mix of legal and market governance structures for their firm. The optimal mix reflects the preferences of the firm's residual claim-

[7] For development of this point, see Daniel R. Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 Nw. U. L. Rev. 913, 923–45 (1982). He has pointed out that recent changes in the Delaware General Corporation Law allow a minority of shareholders to "hold up" the majority in certain circumstances, including mergers, spin-offs, and so on. Also see Kenneth E. Scott, Corporate Law and the American Law Institute Corporate Governance Project, 35 Stan. L. Rev. 927, 942–44 (1983).

ants. In contrast to much of the legal literature on this subject,[8] we conclude that jurisdictional choice is not simply a matter of unconstrained managerial discretion.

II. Empirical Analysis

A. *Hypotheses*

Two empirically testable hypotheses flow from the preceding analysis of the role of corporate law in the theory of the firm. First, there is no one universally appropriate corporation law (governance structure or specification of property rights) for all firms. Second, the efficiency and financial performance of corporations will not be lower in liberal states and higher in stricter states.

The observed geopolitical distribution of business corporations, in equilibrium, is the result of previous managerial decisions to remain incorporated in the jurisdiction where a firm's headquarters is located or to reincorporate (migrate) elsewhere. Managers select the appropriate mix of legal and market governance mechanisms contingent on organizational attributes that vary across firms. Firms with relatively more concentrated share ownership will be more likely to incorporate in stricter jurisdictions, ceteris paribus.[9] Firms incorporated in stricter jurisdictions also will be more likely to attract new owners that increase ownership concentration, ceteris paribus.[10] In more liberal states, on the other hand, incorporated firms will exhibit a less concentrated pattern of share ownership. The first hypothesis thus predicts a nonrandom distribution of business corporations among the various state incorporating jurisdictions.

Firms in strict jurisdictions with concentrated share ownership will remain there: as long as major shareholders prefer that arrangement, they will influence the choice of incorporating jurisdiction and block migration. Moreover, almost all firms begin with a relatively concentrated ownership structure (for example, a partnership) and even after going public tend to

[8] Because managers choose the state of incorporation, critics of corporate law have presumed that jurisdictional competition in the market for corporate charters—the "race for the bottom"—has led to the evolution of promanagement (that is, permissive) statutes. See, for example, William L. Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 Yale L. J. 663 (1974).

[9] Testing this hypothesis offers a partial test of the hypothesis stated by Easterbrook & Fischel, *supra* note 4, at 736–37: that more gain sharing (equivalent in our terminology to "stricter" laws) is appropriate when investment interests are more concentrated, as it is harder to spread risk by diversification.

[10] Here concentration refers to the size of holdings and other conditions that make the right of unilateral alienability less valuable than would otherwise be the case.

maintain a relatively concentrated ownership structure for a number of years. If the firm is initially chartered in a strict state, it will tend to stay there until its share concentration decreases to the point that market governance becomes desirable. Since Delaware is the only state with a notably liberal corporation law and a well-developed body of case law, firms tend to migrate to Delaware when they choose to change their state of incorporation.

Regarding the second empirically testable hypothesis, as long as governance arrangements are carefully matched to organizational attributes, there should be no systematic relation between alternative corporation laws and measured financial performance. Moreover, the same proportion of successful and unsuccessful business corporations should appear in each jurisdictional category because success is not entirely a function of property rights assignments.

B. Empirical Results

In order to evaluate these hypotheses, we ranked the U.S. incorporating jurisdictions according to the strictness or liberality of their corporate law. Next, we selected a sample of corporations incorporated in each type of jurisdiction. Relevant organizational attribute and performance measures were then obtained for the sample.[11] We conducted statistical tests to determine the effects of key organizational attributes on the firm's choice to remain in a strict jurisdiction (that is, be a "stayer") or migrate to a more liberal jurisdiction (be a "leaver"). The analysis focuses on stayers and leavers headquartered in strict rather than liberal states in order to assure robust statistical results: very few firms are headquartered in the archetypically liberal, but small, state of Delaware.

1. *Evaluating the Relative Strictness of State Laws.* We chose to measure the relative outflow of members of a large population of corporations from the various states. The organizational population consisted of 2,200 corporations tracked by Standard and Poor's investor services, listed on the New York and American stock exchanges in 1983. Table 1 shows the percentage of corporations headquartered in those states having any corporations followed by Standard and Poor's investor services, as well as the percentage that have incorporated in that state. All else equal, corporations probably migrate to Delaware because of its more liberal corporate law. Therefore, states that lose a *relatively* high share of their domestic corporations to Delaware must have *relatively* strict laws, both with respect to Delaware (obviously) and with respect to states that

[11] All data in the study were collected from Standard & Poor's 1983 Stock Reports. All data are available on request.

charter a higher proportion of their domestic corporations. Using Table 1 as a guide, we chose corporations headquartered in California, Illinois, New York, and Texas for empirical study. These states are strict by our standards, and they also have a sufficient number of corporate headquarters to permit meaningful empirical analyses.

From the 2,300-firm sample mentioned above, all manufacturing corporations that were both headquartered and incorporated in California, Illinois, New York, and Texas in 1983 were identified. Then an equal number from each strict state and each exchange that had migrated were drawn randomly from the same pool of corporations. This produced a sample of 302 firms, evenly divided among stayers and leavers, but matched in terms of geographical location and stock exchange affiliation.

2. *Criterion Variables and Descriptive Analysis.* For present purposes we needed a measurable organizational attribute that discriminates between stayer and leaver firms. According to our theory, differences in the concentration of residual claimants should affect the probability that a given firm has migrated to Delaware. Measures of financial performance should not differ across categories and thus should not be related to the criterion variables.

From information published by Standard and Poor's, and using their definitions, we specified eight criterion variables for use in statistical analysis: (1) share concentration (calculated as the average percentage of voting stock per shareholder of record); (2) proportion of voting stock held closely and by other corporations; (3) proportion of voting stock held by members of families closely identified with the firm or its founders; (4) proportion by voting stock held by institutional investors; (5) proportion of stock held by the firm's officers and directors; (6) return on equity as a measure of relative financial performance; (7) a numerical transformation of Standard and Poor's quality rating (high scores indicate superior financial performance), also included as a measure of relative financial performance; and (8) market value of the firm's equity as a measure of relative size. The latter is included as a covariate rather than a predictor of jurisdictional choice. These variables provide simple but satisfactory measures of the ownership structure, size, and relative performance of sample firms. The mean values of these variables, for stayers and leavers, are displayed in Table 2.

The information contained in Table 2 permitted simple difference-of-means tests to be run between categories. The results of these tests generally support the hypotheses. As expected from our theory of shareholder activism, corporations staying in strict jurisdictions have residual claimants who, on average, hold larger blocks of common stock than similar firms in liberal jurisdictions. Firms that stay in strict jurisdictions also

TABLE 1
GEOGRAPHICAL AND GEOPOLITICAL DISTRIBUTION OF MAJOR U.S. BUSINESS CORPORATIONS, 1982

State	Percentage Headquartered*	Percentage Incorporated†
Alaska	.0	0
Alabama	.7	28
Arkansas	.4	100
Arizona	.8	25
California	12.7	59
Connecticut	3.4	29
Colorado	1.7	35
District of Columbia	.7	71
Delaware	.4	100
Florida	4.0	53
Georgia	1.6	68
Hawaii	.1	100
Iowa	.4	50
Idaho	.1	0
Illinois	4.6	17
Indiana	1.2	92
Kansas	.1	60
Kentucky	2.2	0
Louisiana	1.9	50
Massachusetts	1.7	63
Maryland	.1	58
Maine	.1	100
Michigan	2.2	54.5
Minnesota	1.9	74
Missouri	1.7	47
Mississippi	.1	100
Montana	.1	100
Nebraska	.3	67
North Carolina	1.4	71
North Dakota	.0	0
New Hampshire	.5	20
New Jersey	4.5	58
New Mexico	.1	100
Nevada	.3	67
New York	12.7	44
Ohio	5.4	67
Oklahoma	1.2	17
Oregon	.8	100
Pennsylvania	6.1	60
Rhode Island	.6	50
South Carolina	1.0	90
South Dakota	.1	100
Tennessee	1.7	71
Texas	10.5	39
Utah	.5	60
Virginia	1.7	59
Vermont	.1	100
Washington	2.6	50
Wisconsin	2.2	68
West Virginia	.1	0
Wyoming	.2	100

*Percentage of NYSE and Amex firms, listed in Standard & Poor's Stock Reports (N = 1400; 800), headquartered in the state.

†Number of firms incorporated divided by number headquartered.

TABLE 2
RESULTS OF STATISTICAL ANALYSIS

CRITERION VARIABLE	Mean (Stayers)	Mean (Leavers)	COEFFICIENTS	
			OLS	Logit
Institutional holdings (%)	15.45	14.85	.13**	.56**
Family holdings (%)	8.50	4.88**	.09**	.39**
Officer and director holdings (%)	8.22	7.47	.07	.28
Close and corporate holdings (%)	15.69	11.28*	.10**	.44**
Share concentration (percentage of voting stock per holder)	.0062	.0004**	.10**	.49**
Market value of common ($1000s)	321,619	362,011	−.02	−.20
Return on Equity (%)	16.47	15.74	.01[a]	n.a.
S&P Quality Index	8.80	8.49	.31[a]	n.a.

[a]Coefficient of stay-leave dummy (SLD) where stay = 1: Financial Performance = $a + b_1$ Size + b_2 SLD.
*$P < .05$.
**$P < .01$.

have significantly higher proportions of their voting stock held by members of identifiable family groups, held closely, and held by other corporations. Stayers and leavers do not, however, display significant differences in the percentage of common shares held by institutional investors. The proportion of stock held by corporate insiders also does not differ between stayers and leavers. Since the insiders do not negotiate the corporation's governance structure with themselves, this is not surprising.

In addition, the second hypothesis is supported by the finding that stayers are not outperformed by firms that migrate away from strict jurisdictions. This appears to be at odds with published research finding that firms reincorporating in Delaware experienced an unexpected increase in share prices.[12] The analysis presented in this paper, however, is consistent with those findings. If there is an advantage from incorporating in Delaware, then all firms not incorporated in Delaware would be threatened with extinction. The fact that such firms survive and prosper is evidence that Delaware is not the best chartering jurisdiction for all firms. We hypothesize that firms shift their state of incorporation to Delaware because changes in other aspects of their governance structure make such a move attractive. The firms that did shift to Delaware presumably had relatively greater share dispersion prior to the shift than other firms, also incorporated in strict states, that chose not to shift. The exact timing of a shift in incorporation, however, is difficult to predict on the basis of owner concentration alone; the choice of legal rules depends on other corporate objectives and other dimensions of a firm's governance structure. In addition, our analysis predicts no differences in changes in the performance of firms moving to liberal states relative to firms moving to strict states (if such an event ever occurs). A shift in jurisdiction simply indicates that managers and active shareholders found the previous legal environment to be less than optimal.

3. *Multivariate Analysis.* Difference-of-means tests are useful for descriptive analysis but are not always appropriate for hypothesis testing. Further analysis of the data using multivariate techniques provides a more sophisticated evaluation of our hypotheses. Such techniques explore the simultaneous influence of many potentially related factors and permit the isolation of the marginal effect of particular factors after controlling for the level of all others. Since the choice of incorporating jurisdiction is influenced by a number of organizational attributes in addition to ownership structure, multivariate techniques are useful. Multiple regression analysis and logistic regressional analysis, each using a dichotomous de-

[12] Peter Dodd & Richard Leftwich, The Market for Corporate Charters: "Unhealthy Competition" versus Federal Regulation, 53 J. Bus. 259 (1980).

pendent variable, are in order because the basic research issue concerns factors affecting the probability that any observed firm is a stayer or leaver.

The dichotomous dependent variable in the ordinary least squares (OLS) analysis was assigned a value of one for firms staying in a strict jurisdiction and a value of zero for firms leaving for a liberal jurisdiction. Variables capturing the size and ownership structure of the firm were standardized to Z-score values and used as independent variables. The resulting partial correlation coefficients for each independent variable indicate its marginal influence on the probability that a firm has remained in a strict jurisdiction. Significant positive coefficients indicate that higher values of the associated variable increase the probability of staying. The sign, magnitude, and significance level for the size and ownership variables are reported in Table 2 under the OLS subhead.

From these results it appears that the relation between individual measures of ownership structure and the character of legal rules remains strong and in the predicted direction, despite partialing out the effects of other contributing factors. Firms with high proportions of stock held by identifiable ownership groups and also with larger average holdings per shareholder are more likely to choose a strict jurisdiction rather than migrate, all else equal. In addition, multivariate analysis, unlike the simple difference-of-means tests, reveals that higher institutional involvement is associated with the choice of a strict jurisdiction. This mixed result is not surprising in the light of recently reported increases in the governance activism of institutional investors.[13] If some money managers prefer to change corporate policies rather than change their portfolios, then the positive and significant coefficient on the institutional investment concentration variable is consistent with our theory of jurisdictional choice.

While these results are encouraging, the dichotomous nature of the migration variable makes the direct application of ordinary least squares somewhat problematic.[14] Logistic regression analysis provides an alternative procedure for estimating the effects of continuous variables on dichotomous response probabilities.[15] Using a weighting process and generalized least squares, logit analysis corrects for the heteroscedastic re-

[13] See generally James Perham, Big Investors against Managers, 122 Dun's Bus. Mon. 73 (September 1983); and James Roher, The New Activism at Institutions, 17 Inst. Investor 177 (October 1983).

[14] Henry Theil, Estimation of Relationships Involving Qualitative Variables, 76 J. Soc. 103 (1976).

[15] See, for example, James L. Medoff, Layoffs and Alternatives under Trade Unions in U.S. Manufacturing, 69 Am. Econ. Rev. 380 (1979).

siduals associated with predicting the value of a dichotomous variable. However, the interpretation of the results, reported in Table 2 under the logit subhead, is similar to the interpretation of OLS regression coefficients.

The results not only confirm the previously discovered relations existing between owners' characteristics and migration probabilities, but also concur with the findings of other researchers that OLS and logit analysis are almost equally efficient techniques for large-sample estimation.[16] The existence of relatively high concentrations of family, close, and corporate holdings tends to increase the probability that a firm will remain in a strict jurisdiction. The same conclusion holds for the size of the average holding.

Finally, in order to evaluate performance differences in a multivariate context, we conducted a regression analysis using a dummy variable. Measures of return on equity and investment quality ratings were used as dependent variables. Size, in terms of market value, was regressed on these performance measures along with a dummy variable taking a value of one for stayers and zero for leavers. Table 2 reports partial correlation coefficient values for the stay-leave dummy variable. The value of this coefficient is not significantly different from zero for either measure of performance. Holding size of firm constant, performance is the same for firms in both strict and liberal jurisdictions.

4. *Summary of Results.* The combined empirical analyses fail to refute the hypotheses that corporate managers choose legal rules on the basis of the preferences of the firms' residual claimants and that these adaptive choices serve to economize on the transaction costs associated with the agency relationship in the large corporation. Therefore, the ownership structure of large U.S. business corporations influences the decision to stay in a strict incorporating jurisdiction or to migrate to a more liberal jurisdiction. Firms with distinctive concentrations of residual claimants are less likely to migrate than firms with more dispersed ownership structures, all else equal. Moreover, there are no clear performance differences between stayers and leavers in the sample used in this study. This finding, while contrary to legal intuition, is economically unsurprising.

III. Concluding Comments: Policy Implications

This paper developed and tested a theory of the role of corporate law in the contractual theory of the firm. The paper's major contribution is the

[16] John Thomas Delaney, Union Success in Hospital Representation Elections, 20 Indus. Rel. 149 (1981).

recognition of a logical role for shareholder activism in large corporations and, hence, the contractual theory of the firm. Corporate law facilitates the performance of this role. The study reveals patterns of jurisdictional choice consistent with managerial self regulation in the control of agency problems in corporations. The evidence presented supports the view that both managers and shareholders recognize the associated costs of strict and liberal corporate laws, and choose legal rules that balance the benefits and costs of nonmarket forms of shareholder protection. In this regard, jurisdictional competition in the market for corporate privileges is desirable because it produces a variety of standard-form contracts from which firms can select the appropriate role for legal rules in their governance structure. Our theoretical contribution is reinforced by the absence of significant performance differences across firms under different legal rules.

The research presented in this paper suggests significant policy implications regarding the Pareto efficiency of proposals for a federal incorporation law or federally mandated (and thus uniform) higher minimum standards of managerial behavior.[17] If the goal of corporate law reform is the maximization of shareholders' wealth, then the wisdom of these proposals is questionable. The success of individual corporations depends on the freedom of managers to choose a legal environment consistent with their firm's ownership structure. As a result, policy proposals that demand uniformity in corporate law (that is, advocate the end of jurisdictional competition) are Pareto inefficient. Shareholders who feel they would be better off under a strict corporate law currently have the choice of investing in firms incorporated in strict jurisdictions. A uniform strict law will not benefit these shareholders. On the other hand, shareholders who prefer liberal laws will be denied a choice and thus be injured. Consequently, a move to a uniform law would not be Pareto superior.

[17] See, for example, Cary, *supra* note 8; Melvin A. Eisenberg, The Structure of the Corporation: A Legal Analysis (1976). For discussion of the many corporate reform proposals and the defenses of the current system, see Fischel, *supra* note 4; and James S. Mofsky & Robert D. Rubin, Introduction: A Symposium on the ALI Corporate Governance Project, 37 Miami L. Rev. 169 (1983).