

The Role of Business Registers in the Economy

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Bad news: Registers ignored or seen as rent-seeking hurdles

- Contractual theories of the firm
 - ◆ Judges for solving disputes
 - ◆ Default law for easier contracting
 - ◆ Mandatory law for externalities
- History of the firm
 - ◆ North, Wallis & Weingast '09
 - ◆ Guinnane, Harris, Lamoreaux & Rosenthal,
 - ◆ Hansman, Kraakman & Squire
- Policy
 - ◆ De Soto '89; Djankov *et al.* '02: “toll booth” thesis →
 - ◆ WB's *Doing Business*, MCC: GIGO simplification w/o value

Good news: Registries essential in modern economy—Outline:

- Theory: General → Corporations
 - ◆ Reduce transaction costs in sequential exchange
- Empirical support
 - ◆ History in UK, F, ESP
 - ◆ Test: tradeoff bwn ex ante and ex post costs
- Implications
 - ◆ Stop focusing on ex ante costs
 - ◆ Abandon silly simplification policies
 - ◆ Kill or at least forget WB's "Doing Business"

Based on

- Theory & history: “Institutional Support of the Firm,” *J. of Legal Analysis*, 2010. (Revised: *Ch. 3 of Foundations of Impersonal Exchange: Theory & Policy of Contractual Registries*, Univ. of Chicago Press, 2012.)
- Test: “The Tradeoff Between Ex Ante and Ex Post Transaction Costs: Evidence from Legal Opinions,” *UPF WPs*, 2015 (with C. Manzanares)
- Policy: “Measuring Institutions—DB” (*JCE*, ‘07)
- Related works:
 - ◆ “Regulation of Conveyancing” (*EJLE* ‘07)
 - ◆ “Choice of Titling System” (*JLE*, 05), with N. Garoupa
 - ◆ “Property Enforcement as Organized Consent” (*JLEO* ‘03)
 - ◆ “Title Insurance” (*GPRI* ‘01)

Part I. Theory (a):

What is the economic function of company registers?



Contract b/w
parties *P* & *A*

Ex ante

Judicial
decision

Ex post



Originative
contract b/w
P & A

Subsequent
contract b/w
A & T

Judicial
decision
P or T



Originative
contract b/w
LP & GP

Subsequent
contract b/w
GP & CC

Judicial
decision
LP or CC

Borrowing by a hidden
LLP



Originative
contract b/w
 $P_1 \dots P_n \& M$

Subsequent
contract b/w
 $M \& P_{n+j}$

Judicial
decision
 $P_1 \dots P_n$ or P_{n+j}

Sale of new shares



Originative
contract b/w
 $P_1 \dots P_n$ & M

Subsequent
contract b/w
 M & T

Judicial
decision
 $P_1 \dots P_n$ or T

Company
representation



Originative
contract b/w
P & A

Subsequent
contract b/w
A & T

Judicial
decision
P or T

Problem

Some P&A will misbehave → All third parties will assume the worst →

“Externality”: good P&As are damaged

“Private ordering” does not do b/c (3 parties; 1 absent): Demand for *verifiable* evidence on contracts →



Originative
contract b/w
P & A

Subsequent
contract b/w
A & T

Judicial
decision
P or T

Solution

Protect innocent third parties: they are granted priority over principals' (often shareholders') rights

Preserve principals' consent → enforcement

Ensure commitment → judicial verification

Publicity as **byproduct** vs. **registration**



Originative
contract b/w
P & A

Subsequent
contract b/w
A & T

Judicial
decision
P or T



Originative
contract b/w
P & A

Subsequent
contract b/w
A & T

Judicial
decision
P or T



Market-enabling
'contract' rules used when
adjudicating the
subsequent contract



Originative
contract b/w
P & A

Subsequent
contract b/w
A & T

Judicial
decision
P or T

+

VERIFIABILITY
Automatic publicity
or
Organized publicity or
registration



Market-enabling
'contract' rules used when
adjudicating the
subsequent contract

Theory (b):
Types of company registers

Corporate contract as a relational contract

- Repeated transactions
- Not only originative & subsequent but:
 - ◆ Creation (“personification”):
 - Asset partitioning
 - Definition of company rules → i.e., company will
 - ◆ Structural changes: applies & modifies such rules
 - ◆ Subsequent business transactions: applies rules



Originative contract
b/w
 $P_1 \dots P_n$ & M
Ex ante

Structural changes,
apptns.,
etc.

Subsequent
contracts b/w
 M & T_i

Judicial decisions
Ex post



Originative contract
b/w
 $P_1 \dots P_n$ & M
Ex ante

Structural changes,
apptns.,
etc.

Subsequent
contracts b/w
 M & T_i

Judicial decisions
Ex post

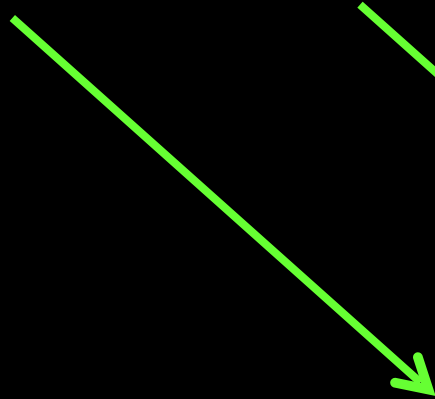


Originative contract
b/w
 $P_1 \dots P_n$ & M
Ex ante

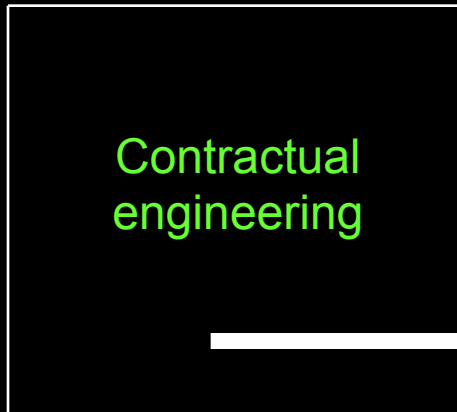
Structural changes,
apptns.,
etc.

Subsequent
contracts b/w
 M & T_i

Judicial decisions
Ex post



+



Market-enabling
rules used when
adjudicating
subsequent
contracts



Originative contract
b/w
 $P_1 \dots P_n$ & M
Ex ante

Structural changes,
apptns.,
etc.

Subsequent
contracts b/w
 M & T_i

Judicial decisions
Ex post

+

+



“Ministerial” recording w/o substantive compliance review (e.g., 1.20c MBCA)



Market-enabling
rules used when
adjudicating
subsequent
contracts



Originative contract
b/w
 $P_1 \dots P_n$ & M
Ex ante

Structural changes,
apptns.,
etc.

Subsequent
contracts b/w
 M & T_i

Judicial decisions
Ex post

+

+



**Compliance review
of mandatory legal
rules**

Record of changes



Market-enabling
rules used when
adjudicating
subsequent
contracts



Originative contract
b/w
 $P_1 \dots P_n$ & M
Ex ante

Structural changes,
apptns.,
etc.

Subsequent
contracts b/w
 M & T_i

Judicial decisions
Ex post

+

+

**Compliance review
of mandatory legal
rules**

**Compliance review
of changes**



Market-enabling
rules used when
adjudicating
subsequent
contracts

Part II

Testing the theory

Stark contrast in the development of
the law of impersonal transactions (understood as adjudication rules
favoring innocent third parties)

- Since Middle Ages
 - ◆ Movables
 - ◆ Agency
- Since 19th century
 - ◆ Real property
 - ◆ Companies
- Based on appearance & documentary formalization
- Based on *organized* land and company registries
 - ◆ Prevalence of exceptions

Episodes in Company registers

- English unincorporated cos. (Harris, 2000):
 - ◆ Purely contractual companies viable but hugely costly
- English 1844 Reg. Act: Monopoly not the main entry barrier
 - Effects 1844 law >>> 1825 Bubble Act derogation
 - North, Wallis & Weingast, 2009
 - ◆ Registries needed for corporate contracting, not mere tollbooths, as in De Soto, 1989; Djankov et al., 2002; and WB “Doing Business”
 - Even to limit liability contractually (HK, 2000)
 - Court conservatism (HKS, 2006) not enough
- French 1673 and Bilbao 1737 company registries
 - ◆ Private interest but with collective action
 - ◆ Main determinant: registry organization

Hypothesis: Tradeoff b/w extent of registration & lawyers' opinions

Extent of legal
opinions



Extent of
registration

Tradeoff b/w extent of registration & opinions (separate OLS eqns. coeff.)

Independent variables:	Dependent variables:		Mean Std Dev
	<i>Use of private sources (0, 1)</i>	<i>Length, comments on opinions (lines)</i>	
<i>All info on corp. auth. regtred. (0, 1)</i>	-0.47*	-13.21**	0.52 0.51
<i>Regtred. info. on corp. auth. (score)</i>	-0.20***	-6.15**	2.96 1.22
Mean Std Dev	0.30 0.47	34.14 17.10	

N = 27. Source: Arruñada & Manzanares (2015)

Part III. Policy implications

- Registries required for efficient corporate contracting
- They are no mere tollbooths, as assumed by WB's Doing Business →
 - ◆ Should stop focusing on *some* ex ante costs
 - ◆ Explore tradeoffs
 - ◆ Aim for efficiency:
 - value (ensure reliability)
 - costs, both ex ante and ex post

Thanks