Opportunism, stewardship, and the dynamics of conflict in a theory of corporate governance

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Abstract

This paper aims at increasing conceptual precision with respect to the role of conflict in a theory of corporate governance. It searches to complement traditional approaches to governance problems, typically conducted according to an exclusively disciplinary perspective, by introducing a cognitive argument. The latter allows for an explanation of conflict in situations where the CEO, far from always pursuing opportunistic aims, is himself convinced of having the conduct of a good steward. The case study of a hostile takeover attempt illustrates the proposed explanation and shows that certain governance mechanisms are capable of initiating a learning process, inducing convergence of apparently conflicting interests.

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1. Introduction

In a somewhat oversimplified way, the contractual approach to the study of organization which is closely linked to the development of corporate governance theory is sometimes confounded with a narrow perspective, representing human behavior as fundamentally opportunistic [1]. In fact, the assumption of opportunism features prominently in transaction cost theory (Williamson, 1975). It implies a fairly extreme representation of human behavior which is supposedly characterized by a tendency to cheat and even transgress ethical standards in search of personal advantage. From a methodological perspective, opportunism is interesting because it allows for parsimonious modeling. Hence, the implementation of governance mechanisms constraining the action of a potentially opportunistic CEO can be explained by a search for efficiency. The identification of the entire contractual approach with such a behavioral assumption is however incorrect and leads to a reduction in the applicability of this field of theory to the study of organizational phenomena in general and of corporate governance in particular. This ill-considered identification is incorrect, because the assumption of opportunism in its explicit form, prominently featuring in Williamson's writings, is much less utilized in other contributions to the field. Positive agency theory [2], for example, simply assumes a conflict of interests between different stakeholders. Making a confusion between the entire set of contractual theories and opportunism potentially undermines their acceptation, especially for two reasons. First, from a normative standpoint, opportunism has a negative connotation and thus makes certain students of organizational

[1] Hence, Donaldson (1990, p. 373) explicitly mentions Jensen and Meckling (1976) and Williamson (1975) when he states: "Organizational economics creates a theoretical scenario in which managers act opportunistically, and any other type of behavior falls outside of the theory [...] such behavior is assumed in the fundamental axioms, rather than treated contingently or empirically, all managers are presumed to act in this fashion". We will demonstrate further on that this is a relatively superficial and unprecise reading of the analyzed theoretical field.

[2] The fundamental axioms of this theory can be found in Jensen and Meckling (1976, 1994). Charreaux (1999) proposes a detailed analysis.

phenomena reluctant to adopt the contractual tool-kit, even though they are conscious of its predictive power in some areas[3]. Second, and most importantly, the assumption of opportunism appears to be of limited acceptability from a methodological perspective.

In fact, according to French social scientist Raymond Boudon (1999), for a theory to qualify for scientific acceptability, the mere convergence of its predictions with real world evidence is insufficient. In addition, it seems important that the fundamental assumptions, which cannot be observed directly, also be plausible in themselves, which means that they potentially allow for an explanation of a variety of different phenomena. Hence, the very general assumption of a potential conflict between stakeholders seems to have greater acceptability than the more restrictive notion of opportunism. In this context, by explicitly introducing a cognitive argument, one may broaden the explanatory scope of some of the central ingredients of the contractual perspective, thus improving their plausibility. Besides, to proceed in this way is an attempt to contribute to the more general effort of emphasizing that the contractual theory of the firm, traditionally focused on the question of incentives and value appropriation, and certain strategic theories which are more oriented towards the comprehension of the value creation process in itself, featuring the acquisition and exploitation of knowledge and competencies, are complementary (Conner and Prahalad, 1996; Demsetz, 1988; Hodgson, 1998; Langlois and Foss, 1999; Williamson, 1999). As we shall demonstrate, the cognitive argument allows for a justification of the assumption of *apparently* conflicting interests in certain situations where the CEO is convinced to act as a faithful steward of his company's shareholders. In fact, this seemingly paradoxical situation

[3] The following remark by Ghoshal and Moran (1996, p. 38) is a good example. "In arguing that Williamson's particular version of TCE [transaction cost economics] is bad for practice we are not arguing that opportunism does not exist. Also, we are not arguing that Williamson does not account for some behavioral regularities in our societies."

may well be explained by the divergence of different actors' mental patterns, without refuting the fundamental assumptions of positive agency theory.

Hence, the present paper's primary objective is to clarify the role played by the assumption of opportunism in the contractual approach to a theory of corporate governance and to add a cognitive explanation of conflict in order to gain explanatory strength. Following this conceptual discussion, we illustrate the plausibility of the cognitive argument by confronting it to a real-world case. In the latter, the interaction between certain governance mechanisms and a learning process leads to an equilibrating shift in the perception of interests. The intensity of conflict is thus reduced.

2. Conflict: opportunism, personal utility and mental maps

The confusion existing in some of the second-hand literature calls for added precision concerning the meaning of the notion of conflict in transaction cost economics (TCE) and positive agency theory (PAT) (2.1.). Especially the latter clearly shows that the assumption of pure opportunism is not a necessary premise for considering the potential of a conflict of interests between stakeholders. Hence, PAT does not exclude altruism from its basic assumptions (Jensen and Meckling, 1994). The explicit introduction of a cognitive argument (2.2.) then allows for an explanation of the appearance of a conflict, even in situations where different actors - the CEO being one of them - are convinced that they act in the best interests of others.

2.1.Opportunism and conflict in the contractual theories

The contractual approach to the study of organization assumes that the relationship between different actors carries the burden of potential conflict to explain the fact that governance mechanisms are put in place. The latter aim at directing the CEO's conduct (Charreaux, 1997) in a fashion that is compatible with the objective of reducing the extent of deviant behavior (Shleifer and Vishny, 1997). Theoretically, this enhances efficiency because governance may decrease the cost resulting from behavior originating in incongruent interests. The latent conflict which characterizes the relationship between stakeholders is thus a central assumption of the contractual approach to the phenomenon of corporate governance.

The particular version of TCE developed by Williamson (1975, 1985) explains the latent conflict by the possibility of opportunistic behavior on behalf of the different parties to a transaction. In this context, opportunism is a stronger assumption than the mere pursuit of personal interest to the detriment of others. In fact, referring to the meaning that Williamson confers on the concept, opportunism also comprises the idea of cheating by transgressing ethical rules of conduct. "Opportunism is self-interest seeking *with guile*" (Williamson, 1988, p. 569, italics added). According to the same author, it implies conscious reasoning[4]. Use of the expression of "calculated efforts to mislead" is revealing (Williamson, 1985, p. 47, quoted *in* Ghoshal and Moran, 1996, p. 18).

[4] This is different from the cognitive explanation of conflict proposed in the following section. It must be added, however, that the latter does not aim at replacing the hypothesis of voluntarily detrimental behavior, for it seems unrealistic to reject the actual existence of guileful cheating in certain real-world situations. We would simply like to complement this hypothesis, hence contributing to the effort of constructing a richer conceptual framework for the analysis of corporate governance. Proceeding along this path carries the potential of improving methodological acceptability (Boudon, 1999). In fact, the scope and number of phenomena governance theory is thus capable of taking into account is potentially broadened. This is because a simple rejection of opportunism would not suppress all types of conflict.

It is, however, important to specify that Williamson's basic assumption only implies the *possibility* of opportunistic behavior. He rejects the idea that every individual is necessarily driven by opportunistic motives[5]. An excerpt from Williamson (1988, p. 569, note 3) is quite revealing: "H.L.A. Hart's remarks help to put opportunism in perspective [...]: ... Neither understanding of long term interest[6], nor the strength or goodness of will ... are shared by all men alike." Hence, Ghoshal and Moran (1996, p. 19) are correct in stating that, for TCE to work, the hypothesis that *all* individuals are opportunistic is not a necessary assumption. It is sufficient that only some sometimes are, and that it is *a priori* impossible to distinguish the opportunists from the others. As a matter of consequence, far from naively presuming that all parties to a transaction have an innate tendency to pursue personal advantage by voluntarily harming other persons' interest, employing dubious means, Williamson only puts strong emphasis on this possibility to construct his explanations.

Agency theory shows that it is not indispensable to emphasize such extreme motivations to obtain a theoretical framework with comparable implications. Hence, the REMM (resourceful evaluative maximizing model) of human behavior (Jensen and Meckling, 1994), which is the implicit foundation of many explanations derived from PAT, is based on four central assumptions, none of which explicitly mentions opportunism. According to REMM, each actor simply tries to dynamically maximize his personal utility or private interest. This perspective does not reject the idea of an individual's utility function possibly integrating, at least partially, other stakeholders' interests, for Jensen and Meckling (1994) explicitly name altruism as one potential source of utility. Consequently, opportunism in its extreme version does not appear to be an undeniable premise of the contractual approach to organizational

[5] This observation directly contradicts an improper interpretation of TCE sometimes to be found in the literature. Hence, Donaldson's (1990, p. 373) statement that "all managers are presumed to act in this [opportunistic] fashion" is simply incorrect.
[6] It may be emphasized that the idea of the cognitive argument developed in section 2.2. is implicit in the above quotation.

studies, in spite of certain claims to the contrary. In fact, we have already shown that, even for Williamson, the most vigorous supporter of the concept, opportunism is not everywhere. He only puts strong emphasis on this very particular phenomenon. Note that Williamson himself does not consider his own standpoint with respect to conflicting interests to be fundamentally different from agency theory's[7]. More recently, he actively exposes the complementary nature of his work with more cognitive approaches (Williamson, 1999), implicitly admitting that he only proposes partial explanations[8], very much attached to a purely disciplinary perspective.

For methodological reasons, the use of agency theory's terminology[9] with respect to "conflicting interests" should hence be preferred to the relatively narrow concept of "opportunism" in order to build an acceptable theory of corporate governance. To justify this assertion, let us briefly expose the way in which Boudon (1999) appreciates the *plausibility* of a scientific theory. This author's criterion as to the scientific nature of theory appears to be stricter than the simple convergence of predictions with factual evidence. In fact, according to Boudon (1999), even though this convergence can be considered as a necessary condition, alone it is insufficient to assure the quality of a theory. Here, Boudon clearly differentiates himself from the methodology defended by Friedman (1953). What makes an essential difference with the latter's approach is the idea that a theory's *acceptability* critically hinges on the plausibility of the description of causal mechanisms themselves (Boudon, 1999, p. 366-

[7] "[Agency theory] refers to 'moral hazard' and 'agency costs' rather than opportunism. But the concerns are the same, whence these are merely terminological differences" (Williamson, 1988, p. 570). Thus, abandoning the emphasis put on the notion of opportunism, which seems to be somewhat of a burden from a methodological perspective, would not appear to put in question the principal findings of TCE.

[8] "Both [perspectives] are needed in our efforts to understand complex economic phenomena as we build towards a science of organization" (Williamson, 1999, p. 1106).

[9] At this point, we may be accused of launching a purely terminological discussion, supposedly without much interest to further the comprehension of governance phenomena. The existence and dissemination of certain confusions (see Donaldson, 1990) carry however the risk of putting into question the adequacy of the theoretical perspective under study or, at least, of blurring the perception of its achievements from an external observer's point of view (be he an academic student or a practitioner). It is thus in order to recall that, according to Jensen (1983, p. 329), a detailed discussion concerning the definition of concepts is beneficial for the development of a scientific field. "The choice of tautologies or definitions has a large impact on the success or failure of research efforts [...]".

367), in addition to the compatibility of real-world observations with only the predictions derived from the supposed mechanisms. This plausibility is fairly high when the mobilized concepts allow for the explanation of a great number of phenomena in various settings. Consequently, careful choice of concepts in elaborating a theoretical framework appears as a crucial task assigned to scientific discussion. Between two concepts, leading *a priori* to identical conclusions with respect to the consequences of a particular situation, it is rational to choose the one on which experience in other contexts apparently confers superior plausibility.

Within an interactionist frame of reference, social science phenomena can often be explained in a satisfactory fashion by the actors' *reasons* (Boudon, 1995). Corporate governance is not an exception[10]. It thus appears to be legitimate to question the acceptability of the important weight attached to the notion of opportunism in some explanations of corporate governance phenomena. In fact, among other things, governance mechanisms give general direction to the CEO's behavior in his arbitrage between the (potentially conflicting) interests of diverse stakeholder categories. In this context, it does not seem to be very plausible to sum up the *reasons* of managerial behavior under the label of purely opportunistic motives. As Ghoshal and Moran (1996, p. 36) justly emphasize, "initiative, creativity, or leadership [...] are difficult to differentiate ex ante from opportunism". It is thus not because the CEO's behavior diverges from the expectations formulated *ex ante* by the other stakeholders (such as the shareholders) that the motivation underlying such conduct is necessarily opportunistic. On the contrary, in a dynamic efficiency framework, where the actors are presumed to be capable of constructing themselves hitherto unknown

[10] In fact, in corporate governance theory, the CEO's behavior is never completely constrained and predetermined. The top executive maintains some degree of freedom, also called "managerial discretion". Because of the latter's existence, there is dynamic interaction between the CEO and the system of governance, and thus, more or less directly, with the other stakeholders. In this context, the governance system is constraining and enabling at the same time. It is this very absence of structural determinism that confers a decisive role on managers' *reasons* in explaining their behavior.

opportunities[11], one cannot reject the idea according to which non-anticipated decisions, taken by the CEO, are honestly conceived of in the interest of the other stakeholders, even if the latter do not necessarily perceive things this way. In such a situation, characterized by incongruent perceptions, resistance is likely to be opposed to managerial policy on behalf of those who consider their interests to have been spoiled. And the result may be an *apparent* conflict of interests breaking out. In this case, can one honestly refer to the concept of opportunism as the prime cause of the problems governance mechanisms have to cope with? Simply speaking of conflict[12] appears to be preferable, because this larger concept complies with Boudon's criterion of wide applicability to a great number of diverse phenomena. We may illustrate the above explanation of conflict resulting from perceptual bias by the example of certain decisions made by the parents of young-age children. The latter, sometimes annoyed, still have to learn that *a priori* such decisions are not made with the objective of *consciously* harming their interests[13].

[11] It should be emphasized that dynamic efficiency is compatible with REMM (Jensen and Meckling, 1994), where individuals have incentives to conceive of innovative solutions to circumvent constraints and hence dynamically optimize their utility function. However, most studies conducted in the PAT paradigm, especially those concerning the field of finance, have not extended this idea, instead considering the set of investment opportunities as preexisting and externally given. According to this perspective, there is objective knowledge about the opportunity set. Jensen (1986) is a well suited example of this type of restrictive modeling. This representation, according to which the central problem consists of simply finding an incentive system, inducing the CEO to choose the best investments in a preexisting and objectively known menu, completely ignores an essential step in the value creation process. That is to say the very conception of the opportunities in an uncertain universe. In this respect, Charreaux (2001 b) proposes a detailed analysis of the principal limits of the contractual theories and of the potential contribution of the cognitive approach concerning a better comprehension of development strategies and, thus, of the value creation process. The contractual tradition strongly emphasizes the allocation and redistribution of wealth. According to this point of view, any increase in wealth depends essentially on a reduction of costs stemming from an "objective" conflict of interests, whereas the cognitive approach considers the dimension of the *creation* (in its original sense) of value, for which the emergence and exploitation of new and innovative ideas are significant concepts. An objective and immediate access to knowledge about the whole opportunity set consequently appears to be problematic, especially when accounting for innovative strategies. The relatively open formulation of REMM however proves that the basic concepts of the two approaches (contractual and cognitive) are not at all incompatible, but rather complementary.

[12] This notion is sufficiently large to encompass different situations. Hence, in terms of mutually inconsistent interests, a conflict may be *real* (potentially exacerbated by opportunism, but not necessarily so) or simply *apparent*.

[13] In an interactionistic frame of reference, this does not mean that parents may not also learn from their children. Especially, the desire to act in the children's interest presupposes an adequate representation of the latter. Such a representation is not necessarily static, but evolves in the interaction between the involved actors.

2.2. The cognitive origin of conflict

Let us briefly summarize the arguments advanced up to this point in our effort of conceptual clarification. The contractual theories of organization, which have originally inspired much of the research aiming at a better comprehension of corporate governance (Shleifer and Vishny, 1997), presume the existence of a latent conflict of interests between different stakeholders. Such conflict possibly takes on different forms. Firstly, it may have real substance. In that case, one extreme version has its origin in *certain* actors' opportunism (TCE according to Williamson). Otherwise, it merely stems from incongruent utility functions (PAT). Secondly, dynamic efficiency considerations in a context of uncertainty and innovation make room for the possibility of certain conflicts only *apparently* involving divergent interests. The present section is destined to work out the latter aspect, making explicit the cognitive factors which may further our comprehension of the phenomenon. Finally, we shall show how such an approach can contribute to the study of the dynamics of corporate governance mechanisms. Especially, some of those mechanisms occasionally force the CEO to question his perception of opportunities and hence nurture an evolution of the judgement criteria applied to a "good steward's" conduct. In other words, beside their disciplinary function for potentially opportunistic managers[14], the pressures emanating from governance eventually trigger a learning process[15], allowing to resolve merely apparent

[14] The disciplinary perspective has traditionally received most attention on behalf of research on corporate governance in the contractual paradigm. Charreaux (2001) distinguishes between the contractual model of governance (which may either be shareholder or stakeholder oriented) and the cognitive model, the latter having made its appearance more recently. According to this author, the contractual model explains the value creation process (innovation, learning) only insufficiently, because it narrowly focuses attention on the reduction of problems of discipline.

[15] This may be the case of a hostile takeover attempt. The latter implies a confrontation of the incumbent CEO's policy with the proposals of an external competitor, laying open the reasons justifying the actual approach and those behind the proposed alternative and leading to their analysis. This reflection nurtures, among other things, the defense argumentation of the takeover target as well as the arguments of the potential raider. Eventually, this may lead to more or less significant adjustments in the initial strategic orientations. In fact, the analysis and public discussion of the different strategic options has a potential impact on the different stakeholders' perception of opportunities. Charreaux (2001 b) gives another example of a governance institution, namely the board of directors, which potentially contributes to learning about the opportunities of value creation. Hence, the directors' role may be conceived of as "an aid to the CEO in constructing his vision – by confronting it to the

conflicts of interests. Once such learning takes place, it also probably influences what governance mechanisms are then effectively implemented in the process characterized by a search for new organizational equilibrium. This is because of the modified intensity of conflict.

Implicitly, some hints as to the significance of the cognitive argument are already contained in Alchian (1950), one of the precursors of the contractual approach to the study of organization[16]. In fact, decision makers are presumed to act in an uncertain universe, where they are incapable of anticipating all possible future contingencies. As a consequence, the actors must base their choices on a certain number of subjective judgements and on their personal opinion. Alchian (1950, p. 216) expresses this in the following terms: "Where there is uncertainty, people's judgements and opinions, even when based on the best available evidence, will differ [...]". Even though the quoted article does not further develop this point, it hints at the significance of the decision makers' personal and subjective representations as a basis of action.

In the terminology of cognitive analysis, these representations are referred to as *mental maps* (Huff, 1990) or *mental patterns* (Denzau and North, 1994). Such patterns allow for an intelligent reading of reality, helping individuals in decoding situations to make appropriate decisions and to act consequently. As in geography, however, the map must not be confounded with the territory itself. It is merely a representation of the latter, facilitating certain decisions. What is, for example, the best route to get in the fastest possible way from

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mental models of the directors - , or in detecting or building up growth opportunities. [...] Beside this directly productive cognitive contribution, the board may also be seen as a device allowing for a harmonization of cognitive structures. [...] one may pretend that certain apparent conflicts of interest simply result from divergent interpretations. The latter are linked to different cognitive models, and discussion on the board can sometimes eliminate or, at least, attenuate those conflicts by making explicit the points of view (p. 40-41, our translation).

[16] Jensen and Meckling (1976, p. 80) explicitly refer to several contributions from this author. Cognitive arguments also figure prominently in Demsetz (1988).

point A to point B? The efficacy of the decision making process hence critically depends on the relevance of the employed map.

Such an approach does not reject the idea according to which the actors, whose motivation it tries to understand, may behave rationally. It only substitutes procedural rationality (Simon, 1982) for substantive rationality[17]. As the individuals can never have exhaustive knowledge of all "objective" parameters to determine optimal solutions, it is simply presumed that their reasoning and choice are based on their subjective perception of what the relevant parameters are. This perception is molded by the mental patterns.

Such cognitive constraints are theoretically characteristic of all types of stakeholders involved in a corporation's business[18]. Before this background, it can be assumed that the perception of the opportunities a firm may grasp in its evolution is conditioned by different types of mental patterns. The latter potentially cover various aspects of a company's life. Hence, the notion of mental pattern appears to be relevant not only to study managerial decision making concerning the general orientation of corporate policy[19], but also to capture some ideological phenomena which are directly linked to the issue of corporate governance[20]. In its role as a representation of reality, the mental pattern establishes for example causal relationships between the contribution of different stakeholder categories (shareholders, employees, managers, ...) and the creation of value. In the context of international comparisons (Yoshimori, 1995), empirical observation indicates that the mental patterns of

[17] Procedural rationality is compatible with the cognitive and dynamic analysis of conflict. It can also be distinguished from bounded rationality. Where the former strongly emphasizes the decision making process as such, the latter rather puts its emphasis on the outcome of this process (Charreaux, 1999, p. 72, note 2).
[18] The hypotheses underlying REMM (Jensen and Meckling, 1994) clearly indicate that individuals are far from being omniscient. Hence they commit errors when incorrectly anticipating the consequences of their action. The interested reader may refer to Charreaux (1999, p. 71-73) for an informed discussion of the type of rationality assumed in the contractual theories, especially of the PAT kind.
[19] For a relatively large overview concerning the literature on managerial cognition, see the extremely well informed discussion by Walsh (1995). Laroche (2001) contains a more recent analysis.
[20] See Wirtz (1999, 2002).

the majority of people differ from country to country with respect to the relative weight attached to the interests of different stakeholders. Hence, before ascertaining if a CEO's conduct corresponds to what may be expected from a "good steward", one should first answer the question of what interests ought to be privileged in a firm's objective function[21]. Wirtz (2002) demonstrates that there is no simple and universally applicable answer to this question. On the contrary, the treatment of the related problems depends on the cognitive structures of the person having to tackle them.

As mental patterns are subjective representations, their diversity is a potential source of conflict. Hence, two managers, A and B, may theoretically have different perceptions of their duties as loyal stewards if they do not share the same mental pattern with respect to the interests to be privileged. But even when they agree on the dominant stakeholders, there may still be conflict. In fact, cognitive structures eventually show up to be quite complex and contain, beside some ideological core assumptions, an appreciation of the technical means to be put to work to reach the announced overall objectives. The preceding arguments thus demonstrate that diverging mental patterns are a source of discord. Conner and Prahalad (1996, p. 483) express this in the following terms: "truthful individuals honestly may disagree about the best present and future course of action for their business activities. Or, the parties may possess different mind sets generally. Discord fundamentally derives from personal knowledge that cannot be communicated fully to others at the time of the disagreement."[22]

[21] Traditionally, in the Anglo-Saxon countries, much weight has been attached to the interests of the single category of shareholders. Other stakeholders play an important role in the typical mental patterns of a country like Germany. It is however in order to emphasize that mentalities change. Wirtz (2002) hence shows that the theme of *shareholder value* gains increasing support in Germany. Furthermore, Lazonick and O'Sullivan (2000) explain that, even in the United States, shareholder value ideology is not a static reality, but has benefited from increasing acceptance during the nineteen-eighties.

[22] See also Hodgson (1998, p. 190, note 9): "Undoubtedly, opportunism exists in the real world, but failures of cooperation and coordination can also arise because of divergent perceptions, lack of information and understanding, or even incongruous individual motives which are entirely altruistic."

Such disagreement may eventually bring about an apparent conflict of interests if the holders of divergent mental patterns effectively translate their perceptions into action.

It should not however go unnoticed that the actors' mental patterns are not static but evolve over time (Denzau and North, 1994). They are molded by the effects of learning, which may modify the perception of their relevance while events are unfolding in the process of interaction with others. As a matter of consequence, this adjustment in cognitive structures may influence the intensity of conflict. Hence, it does not appear to be implausible to imagine certain cases where mental patterns tend to converge, thus reducing one potential source of conflict. Consequently, the associated agency costs should also be diminished. In other words, if apparently conflicting interests between stakeholders have a cognitive origin, learning is a potential source of efficiency.

An important question then arises concerning the role played by governance mechanisms in such a learning process. If the explanation of phenomena related to the issue of corporate governance is based on the assumption of conflict in the largest sense – which means that certain types of unanticipated behavior are not motivated by opportunism but simply have their roots in divergent perceptions – it is theoretically possible to represent at least part of the governance mechanisms as inductors of learning. In fact, a particular form of learning is given by an adjustment in the knowledge structure as a consequence of its confrontation with external *stimuli*. There are a number of governance mechanisms which carry the potential of giving such *stimuli*[23]. As a matter of consequence, governance does not only play a disciplinary role, but also a cognitive one.

[23] Recall the hostile-takeover example mentioned in note 15, as well as Charreaux's (2001 b) interpretation of the role of the board of directors.

But, if we consider for an instant things the other way around, learning equally appears as an important factor in explaining the very governance mechanisms which are effectively implemented by stakeholders in their search for organizational equilibrium. That is because the learning process is presumed to exert influence on the intensity of conflict and on the related costs. In an evolutionary framework, a new equilibrium is however necessarily unstable and transitory, being merely one step in the complex interaction between stakeholders. The dynamic relationship between the reassessment of apparently conflicting interests and different governance mechanisms may be sketched out as follows (figure 1).

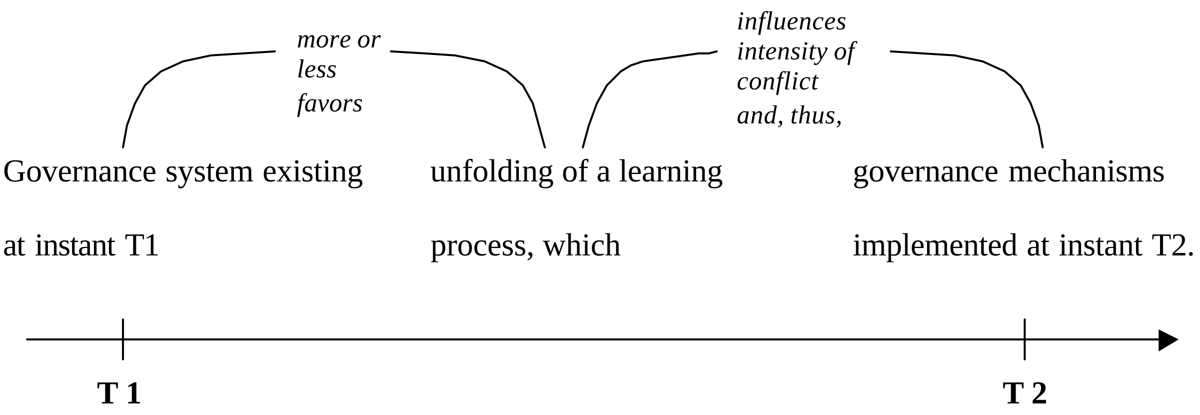

Fig. 1. The dynamics of learning and governance

3. Divergent perceptions of shareholder interest as a source of conflict in a real case

The following analysis of a real-world case[24] helps to illustrate the plausibility of the preceding developments. The takeover of Mannesmann by Vodafone is initiated at the end of 1999 and reaches a conclusion in early 2000. The events are characterized by a hostile confrontation of the two companies' top managers, each pretending to act in the best interest

[24] The empirical elements contained in this section stem from qualitative content analyses applied to different sources of data. These include a series of press articles covering the period under study, the press releases of the two concerned companies, the official exchange offer prospectus, and the testimony from Messier (2000).

of the German firm's shareholders. Before engaging in a detailed analysis through the lens of cognitive sources of conflict, we propose a brief description of the chronology of events.

At the outset, Mannesmann is a German industrial conglomerate looking back on a long tradition. Initially, the company's main business is steel tubes, but the last decade has witnessed successful diversification into the mobile telecommunications sector. In this way, Mannesmann builds up Germany's most important private network. Vodafone has been set up much more recently, but has attained a leading position in the world market for mobile telecommunications in only a few years' time. The first direct contacts between the two companies' top managers are established in January 1999. Between this date and October of the same year, several discussions are organized to explore the potential synergies that can be expected from a close collaboration (*Exchange Offer Prospectus*, p. 47). During these discussions, Vodafone CEO Chris Gent comes to the conclusion that an integration of the two entities holds the promise of a high value creation potential for all shareholders due to the constitution of a worldwide mobile network. At the helm of the German company, Klaus Esser however does not share this representation of the best strategic opportunities. Quite to the opposite, he considers that a strategy focused on majority shareholdings integrating mobile and fixed networks in a dominantly European setting would enhance his possibilities to best control value creation for his shareholders. In the following, these incongruent perceptions of the best strategic opportunities become the cause of an open conflict between the two managers. In fact, given his preference for the integrated European strategy, K. Esser translates this perception of opportunities into action. On October 20th 1999, he announces the friendly takeover of Orange, one of Vodafone's most important competitors in the British market. C. Gent, who was already considering himself as a Mannesmann stakeholder and partner (Messier, 2000, p. 23), is convinced that his interests have been spoiled and that the project he proposes offers the better perspectives to all shareholders. The conflict between the managers breaks open as K. Esser, when contacted by Gent, refuses to abandon the Orange takeover. In the following, the British CEO tries to defend his perceived interests by different means. First, he approaches the Mannesmann supervisory board (between November 16th and 28th 1999), but its members initially support their CEO, convinced of the soundness of his strategy. In the face of the board's refusal, Gent considers the possibility (beginning November 18th 1999) of mobilizing the hostile takeover mechanism in the form of a public exchange offer. Such a direct offer made to shareholders implies a public confrontation of the two strategic models and a potential reassessment of interests by the various stakeholders. Hence, the pressure on Esser intensifies. Being incapable of convincing a potential white knight[25] of the superiority of his strategic concept as well as of the details of its execution, he also looses unconditional support from part of the supervisory board. Hence pushed to engage in negotiations (February 3rd 2000), he finally recommends the Vodafone offer to his shareholders[26], not without having obtained certain concessions regarding the terms of the merger. The latter thus takes on a friendly appearance.

3.1. Which opportunities of value creation for Mannesmann?

The analysis of the Vodafone/Mannesmann case highlights a real divergence of viewpoints concerning the best strategic opportunities to capture as being one important cause of the exchange offer launched by Gent. Interestingly, the managerial capabilities of the German CEO, Klaus Esser, are not put in question[27]. Consequently, the protagonists avoid to present

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[25] The French company Vivendi run by J.-M. Messier.

[26] The recommendation is made in the following way: "Mannesmann has reached an agreement with Vodafone AirTouch that opens the way to a combination of the two companies. Mannesmann *believes* that such an agreement reflects the *preferences of the majority of its shareholders*" (Mannesmann press release 02/03/2000, italics added).

[27] According to a well informed direct observer of these events, Mannesmann "had until then [that is to say until the launch of the public exchange offer] done remarkably well in this sector [mobile telecommunications]" (Messier, 2000, p. 36). Furthermore, Klaus Esser is presented as someone "who had magnificently succeeded in reconverting his group from heavy industry towards telecommunications" (Messier, 2000, p. 38).

the hostile approach as a means of eliminating a highly inefficient manager. On the contrary, Vodafone staff recognize the merits of the Mannesmann management in developing the German company. This is made clear in the official offer prospectus, according to which, after a long experience of common work, Vodafone has much respect for the management and the employees of the different Mannesmann activities (*Exchange Offer Prospectus*, p. 56). Another indicator concerning the positive appreciation of the managerial capabilities of the German firm's principal managers[28] is the great effort which is made in attempting to convince the Mannesmann executives of the interest of a friendly merger prior to the public exchange offer. In other words, it is not the person of the CEO himself as someone presumably likely to neglect his shareholders' interests that is criticized[29], but rather his refusal of a strategic model which Vodafone's top executive perceives as a unique opportunity. Hence, during the whole takeover process, the two companies' experts in financial communication[30] stage the conflict between the top executives as the clash of two strategic models. The first one has a limited ambition of primarily European scope but insists on the integration of fixed and mobile technology[31] and on the importance of majority stockholdings, whereas the second one emphasizes the necessity of rapidly extending the mobile network to reach global coverage[32], even if this should come at the cost of merely disposing of minority interests. Gent perceives this second strategic model as being in the best interest of the shareholders of *each* of the two companies (*Exchange Offer Prospectus*, p. 49,

[28] We may also quote this comment made by C. Gent at the moment the final agreement is signed: " We have the greatest respect for the management and employees of Mannesmann and their achievements in building one of Europe's leading telecommunications businesses" (Vodafone press release, 02/04/2000).
[29] Note that Esser's initial resistance brings about significant improvements in the terms of the offer conceded by Vodafone to Mannesmann shareholders.
[30] Witt (1998) puts great emphasis on the significant role played by control of the communication process in gaining "cognitive leadership". The latter term designates a situation in which a particular business conception is imposed on and shared by a larger population or community.
[31] According to a Mannesmann press release (12/23/1999), the great potential of the integrated approach has been demonstrated by the exceptional performance that Mannesmann has attained in these activities at a very early stage. The same source pretends that "[t]his underlines the significant future value Mannesmann shareholders are being asked to give away today".
[32] The following statement can be found in a Vodafone press release (01/18/2000): "Their [shareholders'] decision should focus on the enhanced growth opportunities provided by the global presence of the Combined Group."

50). He already considers himself as a Mannesmann stakeholder and partner and feels a spoliation of his own and of his shareholders' interests at the very instant Esser translates his different perception of opportunities into the Orange takeover. Hence, in the context of these events, Gent declares to Vivendi's top executive: "one does not treat a *partner* in this way" (Messier, 2000, p. 23, italics added). At that moment, the conflict breaks open.

The apparent conflict between Gent and Esser thus appears to be based on incongruent perceptions of the opportunities for value creation. This confers a certain plausibility on the cognitive argument. Theoretically, the perception of opportunities is molded by different types of mental maps. Among other things, these chart out the model of value redistribution[33] to which the different actors subscribe more or less explicitly. This model of value defines the claim of different stakeholders on the organizational rent and may be designated as the *ideological core* of a mental pattern concerning governance issues. In certain cases[34], a divergence at this level happens to be a major source of conflict. The battle between Vodafone and Mannesmann is apparently not fought in this spirit. On the contrary, each of the two protagonists makes every effort to explicitly link the interest of his personal strategy to the same shareholder-oriented conception of value. Hence, the philosophy of value originally subscribed to by C. Gent is of the shareholder kind. His argumentation justifying the merger project by "the best interests of the shareholders" (Vodafone press release, 11/19/1999) is revealing. So is the applause from his shareholders on the occasion of the general assembly approving by a large majority (98%) his project (*Handelsblatt*, 01/25/2000). K. Esser proposes a rather close formulation of his preferred model of value: "The Executive Board

[33] There are, in fact, different competing approaches to the concept of value depending on the stakeholders who are considered to be the residual claimants of the firm (Zingales, 2000). For a detailed discussion of the difference between shareholder value and stakeholder value, the interested reader may refer to Charreaux and Desbrières (1998).

[34] Arguments inspired by ideological core assumptions nurture, for example, the conflict opposing Krupp and Thyssen in 1997 (Wirtz, 1999).

has emphasized that its *focus on shareholder value* also applies to takeover proposals against cash and/or shares. Any proposal will be examined with respect to *the value potential of the Mannesmann share. Shareholder value management* is focused on long term maximization while giving due consideration to the interests of customers, employees and the social environment" (Mannesmann press release, 11/19/1999, italics added). It is remarkable that the shareholder-value argument has not been appropriated by the German CEO only recently, supposedly to better fight off the takeover by mere rhetoric. In fact, shareholder-oriented thinking in Esser's mind can be traced back to well before the public exchange offer. Hence, according to the *Handelsblatt* (11/22/1999), "Mannesmann is one of the companies which have most vigorously pushed forward change in Germany toward the *shareholder-value* [English in original text] philosophy" (our translation from German). A higher education, partially received in the United States[35], may contribute to explain such emphasis on shareholder value. Besides, since it is recognized as being a mechanism which allows shareholders to freely articulate their interests, at no time does Esser question the legitimacy of the hostile public exchange offer. On the contrary, he makes every effort to play by the rules. What he attacks is only the content of the offer, not the mechanism in itself. The German CEO hence demonstrates his refusal to boycott a governance mechanism by which shareholders may directly articulate their interests.

Either one of the two CEOs thus makes great efforts to represent himself as the faithful steward of shareholders. In spite of this emphasis on shareholder interests, it is however worthwhile to note that Gent tries to extend his ideological position to take account of other stakeholders, especially employees and politicians. In fact, he declares wanting to avoid layoffs, promises a share in the growth prospects, and guarantees the continuity of employee

[35] According to information retrieved from Mannesmann's web site, K. Esser is a graduate of the *Sloan School of Management* at the MIT.

rights already acquired (Vodafone press release, 11/16/1999). Gent thus avoids to communicate an *exclusively* shareholder-oriented mental pattern. It may realistically be presumed that he hence tries to circumvent another apparent conflict of interests, not merely opposing him to Mannesmann's CEO but also to employees and regional politicians. In doing so, the British top executive eliminates the potential foundations of a conflict nurtured by the ideological core assumptions which traditionally differentiate German from Anglo-Saxon corporate governance. This way to proceed allows him to more easily dominate the communication process (Witt, 1998), because he expresses himself in a language which is familiar to the different German stakeholders.

Thus, according to the offer terms and to the defense argumentation, the conflict between the two CEOs does not seem to stem from a divergence of mental maps at the level of ideological core assumptions. The distance between points of view and the resulting conflict are rather located at a different mental level, namely the representation of the specific means that should be put to work in the pursuit of shareholder-value optimization. Hence the "strategic"[36] mental patterns of Gent and Esser lead to significant differences in the identification of opportunities. Even though they share very close ideological core assumptions with respect to the general model of value redistribution, the two camps' protagonists disagree on the representation of specific cause-ends relationships. In this context, the cause is strategic orientation and the expected end enhanced shareholder value.

[36] A top executive's knowledge structure is potentially complex. But, according to Laroche (2001, p. 111), "simplification is a legitimate and fruitful research strategy, if it is well adapted to its object." Hence, for analytical reasons, we propose a somewhat simplified representation of a CEO's overall cognitive structure. Such an overall structure can be supposed to be made up of different mental maps, each concerning one of the different aspects, or levels, of a company's evolution. Hence, one may distinguish the ideological level, containing the model of value redistribution, from the level of the "strategic map", leading to the identification of opportunities in industrial strategy. It is this latter level which is mobilized in the defense of Gent's and Esser's conflictual positions.

The preceding discussion does not imply, however, that the CEOs are completely selfless, not at all pursuing any interests of their own. In fact, the German top executive appears to value his independence in its own right. At a certain moment, he even seems to be “torn apart by his personal wish to stay independent on the one hand and the effort to respect the interest of his shareholders on the other” (Messier, 2000, p. 44). At this point, we should recall that our aim is to defend an extensive formulation of the notion of conflict and to demonstrate the plausibility of the cognitive argument as being complementary to other explanations. With all the precaution required by such an interpretation, the motivation at the origin of the conflict examined in the present case does not appear to be opportunistic in the strong sense given to this notion by Williamson, implying cheating with guile in the pursuit of personal interest. On the contrary, in the Vodafone/Mannesmann case, “each protagonist has *sincerely played* by the rules of the market game” (Messier, 2000, p. 49, italics added). Hilmar Kopper, chairman of Deutsche Bank’s supervisory board, thinks that the behavior of the Mannesmann management in the context of the takeover process should serve as an example with respect to the protection of minority shareholders’ rights (*Handelsblatt,* 02/29/2000). The rules of the game associated with the shareholder-oriented philosophy thus seem to have been respected, at least in their formal aspects. In this case, the assumption of strong opportunism consequently does not appear to be very plausible. The wider concept of conflict remains however valid.

3.2. Vodafone/Mannesmann: reassessment of positions and resolution of conflict

The intensity of the above described conflict is however changing, being related to the dynamics of the takeover process. Particularly, during this process, Klaus Esser’s managerial discretion undergoes transformation, and its width seems to have an impact on the distance between the different actors’ mental maps. *A priori*, to study the evolution of managerial discretion, especially when reducing it, seems to be a well suited strategy to understand the pressures putting more or less strain on mental maps. As a result of such strain, mindsets are either maintained or modified. In this context, the fact of accepting external rules[37] which confer on certain stakeholders the possibility to legitimately constrain managerial discretion is conducive to an attitude potentially open to a reevaluation of one's own position. A manager with such an attitude implicitly admits that he is not someone infallible whose decisions never need to be revised. In certain circumstances, the implementation of particular governance mechanisms may hence make abandon positions that were hitherto taken for granted. In other words, imposing external limits on actors which the latter accept as legitimate may stimulate a process of learning leading to a changed representation of the "map" of opportunities. A hostile public offer, for example, violently disrupts the continuity of managerial discretion and, as a matter of consequence, the CEO's means of implementing the vision he defends. Acting as an organizational crisis (Fiol and Lyles, 1985, p. 808), the offer may thus initiate a learning process.

During the events preceding the launch of the public exchange offer, the acquisition of Orange rather than an alliance with Vodafone potentially confers on Klaus Esser the capacity to retain unshared control over strategic orientations and the process of rent creation and redistribution. In fact, his demand for information on rumors concerning Vodafone's potential takeover intentions at the beginning of 1999 signals that he fears being dominated by the very pugnacious Chris Gent. Hence, the Orange takeover may be interpreted as a means to consolidate control exercised by the German CEO on the process of rent creation and

[37] We have already indicated that K. Esser apparently complies with this attitude. According to several observers he has sincerely played by the rules of the control market, his defense essentially taking on the form of allegedly persuasive arguments with respect to the offer's content. "There have been no dishonest maneuvers" (Messier, 2000, p. 49).

redistribution. Such control is made possible by large managerial discretion[38]. The latter thus appears to be relatively wide at the time of the Orange acquisition and subsequently undergoes increasing pressure. This pressure emanates from the hostile public offer launched by Vodafone. Thus, the public exchange offer may be considered as an effective external constraint. We have seen that the German CEO does not reject the proceeding. He is merely hostile toward the content of the offer, putting forward his disagreement with Gent's strategic orientations. This means that Esser accepts the idea that the shareholders may freely pronounce themselves[39] on the strategy being perceived as the most value inducing. It does not seem to be unrealistic to interpret this as an indicator of Mannesmann's top executive's sincerity. If he is really convinced of the superiority of his industrial strategy in terms of shareholder value, hence supporting the credibility of our cognitive argument, he may hope having the possibility to persuade the shareholders by the mere strength of his arguments. Thus, he is not afraid of confronting his model with the expression of shareholder interests in the market. Conversely, a negative vote on investors' behalf with respect to his strategic model would force him to reconsider his representation of the best opportunities.

In fact, a pending public exchange offer potentially obliges *all* stakeholders to reassess their position with respect to the value-creation opportunities. The effort in terms of thinking and argumentation forced upon the different actors in such a context potentially sets their mental maps "in motion". Hence, at the beginning, Esser has unanimous support from the supervisory board, the latter being in favor of the defense strategy (Mannesmann press release, 11/19/1999). The "map" held by board members and representing the strategic

[38] It should be stated here that a manager's effort to widen discretion is not necessarily inspired by opportunistic motives which are a potential cause of inefficiency. Theoretically, a top executive may sincerely be convinced of being best suited to act in the interest of value creation. In this case, large managerial discretion is perceived as a facilitator in the implementation of the value-creation strategy conceived of by the CEO.

[39] The behavior of the Thyssen CEO in March 1997 may be quoted as a counter-example (Wirtz, 1999).

choices supposedly allowing for value optimization is thus initially very close to Esser's[40], only to shift away in the following. In fact, certain members of the control instance apparently make pressure to obtain a common solution with Vodafone at the moment the deadline of the offer approaches (*Handelsblatt*, 02/03/2000). Probably, their perception of the opportunities has thus evolved to get closer to Gent's standpoint.

Besides, the only serious white knight potentially interested in supporting Mannesmann is the French firm Vivendi. The negotiations concerning this alliance are however called off in the face of disagreement on the attribution of board seats. Klaus Esser asks for the majority in favor of Mannesmann (Messier, 2000, p. 43), which would assure him a position of strength. Vivendi's CEO refuses, not being persuaded that such a solution is in his own interests. The concrete interaction with his Mannesmann counterpart thus leads J.-M. Messier to erase a merger with the German company from his own map of strategic opportunities, although he initially perceived it as rather positive[41]. These events seem to shatter the German manager's conviction, giving way to some doubt with respect to the best strategy to adopt[42]. According to Messier (2000, p. 44), at that moment Esser feels being torn apart between his personal ambition "to stay independent and his commitment to the respect of shareholder interest". In his account of the events, Messier (2000) does not appear to question the sincerity of this commitment[43]. Esser merely enters into a phase of hesitation[44] towards the end of the offer period and in the face of his failure to convince of the superiority of his strategic approach. This illustrates the plausibility of the dynamic nature of mental maps. In fact, thus being put

[40] A Mannesmann press release (November 28, 1999) quotes Mister Funk, chairman of the supervisory board: "This offer [...] fails to meet the value test."
[41] "[...] during several weeks we thought that the operation *Millenium* [a Vivendi-Mannesmann merger] was on the tracks. It would have given birth to a magnificent company [...]" (Messier, 2000, p. 38).
[42] "This man fell a prey to doubt" (Messier, 2000, p. 43).
[43] Besides, the *Handelsblatt* (02/01/2000) quotes Messier according to whom Esser's resistance must not be interpreted as purely selfish behavior. On the contrary, the German manager supposedly attempts to win the highest possible gain "*for his shareholders*".
[44] "I did not understand Klaus Esser any more. There was something of Shakespeare in this character, being ever more hesitant, anxious, isolated from his staff. [...] he had lost his ability to act as a chief" (Messier, 2000, p. 44).

and putting himself into question, the Mannesmann top executive is lead to a major reassessment of his position.

Under increasing pressure, especially since the defection of Vivendi and without any other serious projects of alliance, Esser engages in negotiations. Gent proposes an improvement in the offer terms. This makes continued resistance difficult to sustain because it considerably weakens the German CEO's last defense argument, which is the pursuit of his shareholders' (financial) interests. At the end of this round of negotiations, the respective positions finally come closer, making possible what is called a "friendly" merger. Hence, the apparent conflict of interests is eradicated, and the Mannesmann management recommends the merger with Vodafone, supposing it to comply with the wish of the majority of shareholders. "Mannesmann *believes* that such an agreement reflects the preferences of the majority of its shareholders" (Mannesmann press release, 02/03/2000, italics added). It should be noted, however, that the convergence of the different positions is not the result of adjustments made in only the German company's strategic maps. In fact, Vodafone also reassesses the respective interests and evaluates henceforth the offer made to Mannesmann shareholders at a price which goes beyond that of the initial approach (58.96 Vodafone shares offered for each Mannesmann share; *source:* Mannesmann press release, 02/04/2000). The more or less explicit negotiations between the firm's different stakeholders which have been induced by the public exchange offer may thus reasonably be appreciated as a significant vector of learning. Such learning appears to reduce the latent conflict between stakeholders. Figure 2 summarizes the dynamics of apparent conflict in the Vodafone/Mannesmann case study.

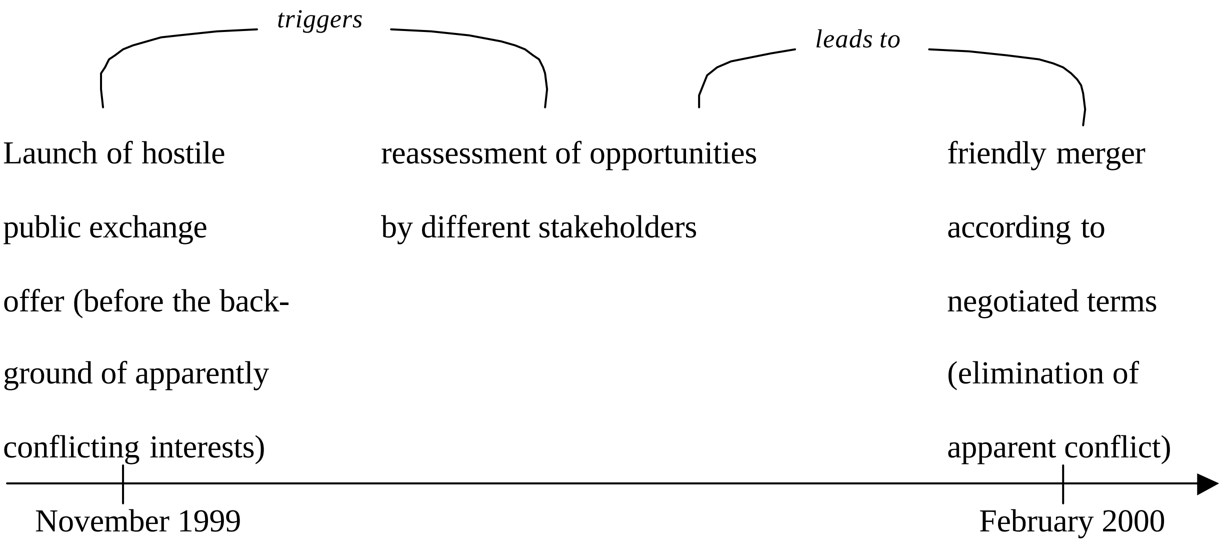

Fig. 2.

4. Concluding remarks

This paper makes an attempt to redefine the contours and to enhance the significance of the concept of conflict in a theory of corporate governance. It demonstrates that the assumption of opportunism, which is very present in Williamson's perspective on transaction cost economics, is not a synonymous term for conflicting interests. Positive agency theory, for example, has less restrictive conceptual foundations. For plausibility reasons, it appears to be useful to abandon the narrow concept of opportunism in favor of a wider definition of latent conflict. Far from underestimating the real existence of opportunistic behavior, such a conception is open to a cognitive approach to conflict, the latter not being explicitly developed by the contractual theories although there seems to be no incompatibility. According to this cognitive perspective, it is *a priori* impossible to reject the idea that certain conflicts, far from resulting from purely opportunistic motives, are merely induced by a divergence of the different stakeholders' mental maps. As these maps are not static, learning, which is among other things stimulated by certain corporate governance mechanisms, potentially leads to their convergence. Theoretically, the result is a shift of or a reduction in the apparent conflict. An approach introducing the cognitive argument without rejecting other possible causes for conflict may build a bridge between two complementary fields of theoretical research. We think that this way to proceed is conducive to the construction of a richer and more realistic theory of corporate governance.

The analysis of the hostile public exchange offer launched by Vodafone against Mannesmann and of its friendly outcome contains empirical elements which reinforce the cognitive argument's plausibility. In this case study, two CEOs initially confront each other on grounds of divergent perceptions concerning the best opportunities to capture to maximize shareholder wealth. Later on, the respective positions converge under the influence of the takeover process which triggers learning that leads to a reassessment of opportunities. Hence, it appears that aiming at the construction of an acceptable theory of governance obliges us to overcome the simple dichotomy between opportunism and stewardship. Alone, neither one of these two behavioral assumptions is capable of producing a plausible explanation of the real case where a top manager actively tries to maximize shareholder value without encountering unanimous perception as to the efficacy of his strategy. At least in the case studied in the present paper, the opposition between stewardship and opportunism does not appear to be very relevant. Admitting that one of the potential sources of the observed conflict may be of a cognitive nature hence emerges as one possible fashion to make our theoretical grid more acceptable.

To conclude it is in order to open the discussion for future research. In fact, the case study highlights the sometimes complex and dynamic links existing between cognitive aspects and aspects of personal interest in the context of conflict. Even though they are shown to be intimately related in a real case, there is no theoretical necessity for them to have identical implications, especially with respect to efficiency. In certain cases, they may even lead to contradictory results. It would thus certainly be worthwhile for future research to sharpen the understanding of the various links between what may be labeled as “cognitive conflict” and “conflict of interests”[45]. This would add analytical focus, allowing for future work to be done on the relationship between different types of conflict and their interaction on the one hand, and efficiency in an evolutionary perspective on the other.

[45] We are indebted to Gérard Charreaux for having suggested these terms.

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