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The political economy of corporate governance

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Introduction

Corporate governance reform for promoting efficiency and wealth creation by large corporations has been much in vogue for a few decades now (Lazonick and O'Sullivan, 2000; Filatotchev and Boyd, 2009). The academic field of corporate governance has been equally vibrant with a burgeoning of theory and research (Filatotchev and Boyd, 2009; Ireland, 2009), and influential publications on corporate governance matters, such as Jensen and Meckling (1976) and La Porta et al. (1998), rank among the most cited in the social sciences. Notwithstanding literature on financialization that suggests finance has in some ways sidestepped the corporation as capital's primary vehicle of extracting value (see e.g. *ephemera*, 9(4) on 'the university of finance'), or literature on the common(s) which implies productive activity might today more often than not be organized outside of corporations (see e.g. *ephemera,* 13(3) on 'the communism of capital'), corporate governance asserts the corporate form as a key social technology of our time. This *special issue* engages with this field and the outcomes it entails, suggesting it is a political-ideological project based on a set of questionable conceptual and empirical assumptions, which in turn entail a set of norms and prescriptions – a normativity – with devastating political-economic effects.

Despite the variety of disciplinary backgrounds in theory, and country-specific institutional arrangements in practice, a limited set of related theories focused in a reductive number of research questions – i.e. property rights theory, agency theory, and other contractual approaches – have been strikingly dominant in corporate governance (Blair and Stout, 1999; Zingales, 2000; Aglietta and Reberioux, 2005). Daily et al. (2003) argue that this is likely due to such theories' simplicity and alignment with the well-established tradition of methodological

individualism. Corporate governance is reduced to a conflict of interest among a handful of economically rational actors – most frequently shareholders and managers – that must be mitigated (e.g. Jensen and Meckling, 1976), and the only relevant variable to maximize is shareholder value (e.g. Hansmann and Kraakman, 2001). Rhetorically convincing these theories may be, there are many reasons to question their assumptions, such as its underlying conception of the corporation, contracts and markets, which has transformed previous conceptions prevalent e.g. in law (Aglietta and Reberioux, 2005).

Since the 1970s, this dominant variety of corporate governance based mostly on agency theory has succeeded in shaping the accepted standard for 'good governance' in practice and conquered research (e.g. Aguilera and Cuervo-Cazzura, 2004) – notwithstanding critiques articulated for example in critical management and organization or business ethics literature (e.g. Fleming and Spicer, 2007). It has thereby come to influence political, legal, and economic decision-making worldwide through a normativity – a set of norms and prescriptions derived from questionable conceptual assumptions and empirical observations – programmed into law and policy by means such as: strong common law-inspired formal investor protection and limited influence of blockholding shareholders (e.g. La Porta et al., 1998; Lele and Siems, 2007); fair-value accounting and extensive disclosure (e.g. Pesqueux and Damak-Ayadi, 2005); high-powered equity-based executive compensation (e.g. Ezzamel et al., 2008); and elements of corporate board and control structures such as independent or non-executive directors (Gordon, 2007). More recently, this model has inspired governance codes that institutionalize a very limited model of financial accountability of boards to shareholders, e.g. in the UK Corporate Governance Code (Veldman and Willmott, 2016). Both corporate elites and regulators around the world now regularly take this model into account when acting and representing their actions for fear of repercussions by transient international capital (Westphal and Zajac, 1998; Yoshikawa and Phan, 2001; Rose and Meyer, 2003; Bednar, 2012).

The understanding of the purpose of corporations, and its codification, directly influence which interests can or cannot be taken into account in individual corporations. As such, this normativity is directly connected to the distribution of corporate value and, in turn, to broad macro-economic outcomes (Ireland, 2005; 2009). Corporate governance typically supports shareholder primacy, e.g., by adhering to the realisation of shareholder value as the overall goal of corporations (Aglietta and Reberioux, 2005), and ultimately defends this choice with the promise of greater overall social utility. Particularly after the financial crisis of 2008, it has become quite obvious that the promises of micro-economic efficiency enhancement and the creation of overall social utility based on these

prescriptions have not been fulfilled (Lazonick and O'Sullivan, 2000; Ireland, 2005; Stout, 2012; Piketty, 2014). Major corporate scandals all over the world during the last decades and the ongoing financial crisis after 2008 have made discussions about corporate governance more open to critique than they had been for long. Nonetheless, there is a lack of work that draws direct links between the normativity of corporate governance theory and its outcomes in terms of political economy.

This *special issue* brings together a number of contributions that undertake this work. We focus on three strands of research. A first strand of research has focused on the *distributive effects of the orientation towards shareholder primacy*, suggesting how this has led to more inequality and poorer working conditions for those outside of top management circles (Demir, 2007; Dore, 2008; Brenner and Wernicke, 2015). The second strand of research suggests a more complex story concerning *the diffusion and dominance of new ideas in corporate governance*, involving issues such as globalization, academic idea production and rhetoric, power, elites, resistance, and local adaptation (e.g. Froud et al., 2000; Fiss and Zajac, 2004; Heilbron et al., 2014). This kind of research questions the usual functionalist story purporting to explain the diffusion of good governance and shareholder value ideas – i.e. that these ideas simply are better and more competitive than the alternatives and therefore come to reign supreme. A third strand of research dissects *the conceptualization of the corporate form* propagated by agency theory, and the departure point of shareholder value as the ultimate goal of corporations. This line of research shows how this conception is plagued with both inconsistencies and false assumptions (e.g. Ireland, 1999; Robé, 2011; Stout, 2012; Veldman, 2013).

In the remainder of this editorial, we will outline the discussion pertaining to these three strands and relate the contributions of the special issue to them. We conclude by identifying a number of interesting research agendas that we believe are opened up by this discussion.

Distributive effects of the orientation towards shareholder value

The political economy of corporate governance comes to the fore most prominently in debates around income distribution. The 1970s and onwards has seen a flatlining of real income growth for low and middle income workers (Van Arnum and Naples, 2013), while incomes for the top 10% skyrocketed. Spearheading this development is corporate remuneration, as the bulk of the so-called 'super-wages' (top 0.1 %) is found among corporate top-executives, a group almost immune to public debate on income inequality (Piketty, 2014; Brenner

and Wernicke, 2015). Moreover, the flatlining of employees' income comes in a time when average employee productivity, as well as average earnings per employee, have been rising. Meanwhile, we find that public corporations have been dropping their retained earnings by a large degree, with money spent on dividends and on share buybacks rising extremely fast, with Jacoby (2008) and Lazonick (2014) reporting that total redistribution to shareholders may have reached 90% of corporate profits in US and UK corporations in the last few years. Although these figures have not been broadly confirmed, and the level of profit distribution may vary significantly among countries due to various institutional factors, it is nevertheless safe to say that payouts to shareholders have risen dramatically.

These trends in the distribution of global wealth, in which large corporations are major agents, are consistent with the emergence of the new corporate governance normativity from the 1970s onwards (Ireland, 2005; 2009). Hence, shareholder primacy and supporting theories arguably have a strong connection to broader distributional effects, both at the organizational level and at the macro-economic level. Together with the way the ideas behind this type of corporate governance thinking have spread and the problematic conceptualization of the corporate form central to this thinking, this provides a reason to suggest that the ascendancy of this new regime and normativity for corporate governance was not accidental, but was closely related to the production of a particular type of political economy. In this perspective, the development of contemporary corporate governance theory can be looked at as a political-ideological project (Ireland, 2005, 2010; Davies, 2010; Veldman and Willmott, 2015).

Noticeably, the macro-shift toward an upward wealth distribution (Piketty, 2014) that is effectuated by corporate governance theory coincides quite closely with a shift in the political landscape from leftist and regulationist to neoliberal. Associated with a renewed belief in neoliberal policies all across the OECD countries from the 1970s is the rise of what is now known as globalization; the demise of the state in terms of the ability to regulate; and regulatory and tax arbitrage by corporations. In this way, financialized versions of corporate governance came to play a central role in wealth distribution (Fligstein, 2001; Lazonick and O'Sullivan, 2000). The prioritization of shareholder value thus connects both historically and programmatically to the emergence of neoliberalism (Lazonick and O'Sullivan, 2000; Ireland, 2009; Mirowski and Plehwe, 2009; Peck, 2010; Heilbron et al., 2014).

As Will Davies points out in *The limits of neoliberalism* and elaborates upon in his interview with Stephen Dunne (this issue; see also the book review by Dunne, this issue), neoliberalism has not been opposed to the corporation at least since

Coase made his case for corporations playing a part alongside markets for the efficient allocation of resources. For the last few decades, and continuing after the financial crisis, the normativity of 'good governance' of corporations has gone hand in hand with a neoliberalism that justifies its dominance with reference to claims to efficiency achieved through competition. This competition, often limited by monopolistic tendencies (Birch, this issue), puts vast financial resources under the control of corporate giants, ossifying differences between those inside and those outside of this system.

The diffusion and dominance of new ideas in corporate governance

The contemporary theory of corporate governance has become dominated by a very specific idea of the corporation and of corporate governance. This conception, in which 'shareholder value' is typically identified as the legitimate goal of the corporation, defines problems and prescribes practical corporate governance solutions in terms of a normative blueprint of what constitutes 'good governance' (Fligstein, 1993; Lazonick and O'Sullivan, 2000). The purpose of corporate governance becomes to rectify deviations from this ideal (Jensen and Meckling, 1976). These ideas have also been extremely influential in many adjacent disciplines such as accounting, strategic management and law (Power, 2010).

This 'optimal' view of the corporation and its governance has with equal vigour and instrumentality been used in the development and rapid enforcement of governance standards by individual nations as well as international standards setters like the EU, OECD and IASB, and will continue to influence future regulation, for example through the European Commission's green book on corporate governance regulation (2011). Most jurisdictions around the world have seen at least some tendency for regulatory change in the direction towards the globally present normativity pertaining to corporate governance, be it by adopting a British-style corporate governance code (Larsson-Olaison, 2014; Veldman and Willmott, 2015), the IFRS accounting standard (Pesqueux and Damak-Ayadi, 2005), or various other minority protection devices made fashionable by comparative studies of corporate law (e.g. La Porta et al., 1998).

The dominant approach for explaining the diffusion of new ideas and reforms in corporate governance is functionalist, suggesting that competitive pressures force states and managers to adopt the most efficient corporate governance measures (e.g. Jensen, 1989; Hansmann and Kraakman, 2001). This view is perhaps best illustrated by the well-known statement of Hansmann and Kraakman (2001: 468):

> The triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured [...] the standard model earned its position as the dominant model of the large corporation the hard way, by out-competing during the post-World War II period the three alternative models of corporate governance: the managerialist model, the labor-oriented model, and the state oriented model.

This functionalist understanding has been challanged from at least two angles. First, a number of studies that have explored the ascent of the shareholder value principle, or 'shareholder value ideology' (Lazonick and O'Sullivan, 2000). These studies suggest that the rise of shareholder value can be explained by the interaction of factors such as exogenous shocks, strategic action and academic idea production in the corporate governance field (see also Fligstein, 2001; Davis, 2009). Thus, the emergence of this new set of theoretical assumptions was not a functionalist response to competitive pressures, but rather reflected shifting power relations in the corporate governance field. When previous relative 'outsiders' such as corporate 'raiders' and institutional investors rose to prominence, they endorsed the development of a theory of corporate governance that gave primacy to their interests (Heilbron et al., 2014). Agency theory, developed in the 1970s (e.g. Jensen and Meckling, 1976), lived up to these aspirations and could thus give academic credence and legitimacy to the claims made by propagators of shareholder value (Fligstein, 2001; Veldman, 2013).

Second, the literature on the diffusion of 'good governance' equally supports the argument that the development of contemporary corporate governance was an outcome of a political process. The initiation of changes in corporate governance theory and practice to some extent lead to changes in global and local power relations and social relations. However, the original ideas are also remoulded and sometimes decoupled from practice when meeting local resistance. Such a pattern is replicated in various national corporate governance systems, for example in Germany, Denmark and Japan (e.g. Mills and Weinstein, 2000; Yoshikawa and Phan, 2001; Rose and Meyer, 2003; Goergen et al., 2008). It is also observable in a variety of organizational and regulatory settings (e.g. Ezzamel et al., 2008; Morris et al., 2008; Jansson, 2013; Mehrpouya, 2015; Veldman and Willmott, 2015).

In order to understand and critique the functionalist thesis, one arguably has to understand the ways in which its dominating ideas have come to permeate regulation and behaviour at various levels (global, national, organizational). Two contributions to this special issue explore just this: Yuliya Ponomareva and Jenny Ahlberg engage with the discussion about the diffusion of corporate governance normativity on the organizational level, while Thomas Clarke addresses the question of convergence or divergence of corporate governance by looking at

convergent forces emanating from financial forces and contrasting these with the ongoing vitality of institutional differentiation.

Clarke argues that the current push towards shareholder primacy leads to an obsession with shareholder value, manifested in financial performance measures and stock options, increasingly short term business horizons, and a move away from the use of retained earnings to finance raised on the equity market. Clarke argues, however, that the 'optimal' outcome of corporate governance arrangements differs considerably among different perspectives on history and politics, law and regulation, culture, and institutional complementarities. A focus on the strengths of a functional diversity of corporate governance systems would mean that corporate governance as a field would need to embrace the *variety of governance systems* and *multiple equilibria*, rather than strive for the development of one optimal model. This model would maintain the comparative advantages of (competing) systems of corporate governance, and would counter the current 'debilitating ideology' of shareholder value and preserve more positive outcomes for the economy and society.

The idea of shareholder value is also central to the work provided by Ponomareva and Ahlberg (this issue). They analyze how the increasingly dominant normativity of 'good governance' acts on family-controlled corporations and what effects this may have. These family firms are generally recognized as characterized by a higher degree of social embeddedness and a specific type of logic, in which such factors as family control and esteem are prioritized at the expense of financial return. With tight family control through family members at both board and top management positions, a traditional 'agency problem' is simply not as relevant. Given the objectives pursued and the structure of board membership, it is obvious that the tools of 'good governance' that are theoretically grounded in assumptions about atomized, rational actors contracting in the context of widely held corporations and designed to achieve shareholder value, are not well-suited for this category of corporations. They find that in family-controlled corporations, adopting rationalized governance practices such as independent board members becomes a way to counteract an image of family firms as conservative and unprofessional and thus to appear pleasing in the eyes of stakeholders. The advantages of conforming, they argue, lies primarily in the benefits that can be reaped by being held in good esteem by outsiders (e.g. capital markets), while the downside may be decreased strategic adaptability.

Both contributions support the idea that prescriptions for 'good' corporate governance lead to strong institutional pressures. They also suggest that these pressures are not unquestioningly adopted, but run up against competing ideas

of what corporate governance should accomplish, both at the organizational and at the national level.

The conceptualization of the corporate form

At the heart of many critiques of contemporary corporate governance theory is an extended notion of the modern public limited liability corporate form. As described by Ciepley (2013), Ireland (1999), and many others, the corporate form has undergone a number of fundamental transformations since its emergence. The earlier versions of the corporate form as we know it today existed essentially as institutions with an intrinsically public purpose, with their corporate privileges such as perpetuity and limited liability premised on the ability to further the interests of the public or state in addition to those of the shareholders. The modern corporate form, characterized by perpetuity, and further attributions of ownership, agency, rights and protections is based on an extremely specific understanding of its legal status that only emerged by the end of the 19th century (Johnson, 2010).

The effects of the commonly recognized lack of proper understanding of the public limited liability corporate form have been amplified by further shifts in how it has come to be understood in various domains – specifically in corporate governance. Although the basic legal idea of what is now understood as the public corporation has remained fairly constant since the end of the 19th century, the content of much of the adjacent regulation affecting corporations (e.g. regulation of accounting and auditing as well as corporate law) has changed significantly. A major factor behind these institutional changes is the contemporary normativity pertaining to corporate governance (Lazonick and O'Sullivan, 2000; Fligstein, 2001; Heilbron et al., 2014; Clarke, this issue), with its very specific conception of the corporate form as a 'nexus of contracts' among economically rational individuals, and of the legal entity as nothing but a 'convenient legal fiction' (e.g. Jensen and Meckling, 1976). This move away from an understanding of the public limited liability corporate form as a highly specific construct with special privileges (Biondi et al., 2007) has been charged with the criticisms of having little traction with its historical development (see Veldman, 2013) and of treating the socially complex phenomenon of corporate law in a conceptually reductive way (Ireland, 2005; Robé, 2011; Blair and Stout, 1999).

Matthew Lampert (this issue) takes such critiques of the status of the corporate form to hand. He suggests that the corporate form is not much more than a technical construct, a 'piece of technology' mandated by law that can be shaped

ex ante by setting the conditions under which such a construct can come into existence. Because the corporate form is not a (moral) 'person' in any meaningful sense, the attribution of intentionality, agency and responsibility to the corporation as a formal organization is fundamentally distinct from the agency and responsibility exhibited by or attributed to the individuals that constitute that organization. If we accept that it is a simple category mistake to attribute personhood, moral personhood, or (anthropomorphic) ideas to corporations, we find that CSR looks for ethics in the wrong place.

Rather than 'appealing to baseless ethical notions of corporate moral agency' the goals of CSR should explicitly be understood as a political, rather than a normative or ethical goal in which corporate governance 'ought to be determined through democratic process and political struggle, rather than through moral appeals to either business agents or lawmakers' (Lampert, this issue). Directing corporations toward moral agency can only be part of a political project that changes their structure, notably by providing rules that are embodied in law, such as 'industry-wide, externally-enforced codes of conduct' that explicitly set limits to the organization's operations on the basis of 'legally-instituted and -enforced social goals'. From this perspective, Lampert reminds us that the corporation was once the explicit result of a charter that defined the scope of its duties and 'agency' and that the decline of charter revocation has led to a vacuum in terms of demarcating the social and political duties of corporations.

That corporate governance is a question of *politics* rather than *ethics* also becomes apparent in the roundtable discussion on the nature and purpose of the corporation that took place at the Centre for Philosophy and Political Economy in December 2013 between Stephen Dunne, Sam Mansell, Martin Parker and Jeroen Veldman (this issue). While the discussion briefly addresses the question of corporate ethics, it is mostly concerned with the legal status of corporations and swiftly moves to a discussion of political regulation and governance. The format of the discussion itself also highlights the agonistics that mark any political conversation about corporations. Yet opening up a political contestation of the corporate form, as Lampert and the roundtable seek to do, must first of all grapple with the ways the corporate form is always already shaped by political projects.

For Kean Birch (this issue), it is the neoliberal project that has most profoundly shaped the corporate form. Contrary to many suppositions, Birch argues, neoliberalism is not opposed to the monopolistic tendencies coming from the corporate form. He carefully dissects neoliberalism as an analytical category, a political economic project as well as an epistemic community. Birch's starting point is that neoliberalism in a popular understanding often is perceived as a

market-based order, which is contradictory considering that neoliberals quietly have accepted the expansion of large monopolistic corporations during the last 50 years. Birch characterizes neoliberalism as a distinct epistemic and social order, different from other forms of liberalism. In this order, the development of 'contractual theory' legitimizes corporate monopoly, as a corporation is understood as contracting individuals rather than an entity in itself. This, in turn, creates an incentives structure for management to pursue shareholder value at all costs, influencing markets and societies negatively.

If contesting the corporate form, then, leads us upon a terrain where the neoliberal project is already present and has already, for many decades, conducted a political program for shaping the corporate form, then what kind of political practices can the 'business politics' proposed by Lampert build upon? One strategy, also suggested by Martin Parker in the roundtable discussion (this issue), is to look elsewhere, for example to social movements, for a political contestation. Certainly, it will also require exploring subjectivities within a wider social field; subjectivities not so closely tied to neoliberalism as entrepreneurial subjectivity and the corporate form are (cf. Beverungen and Case, 2011). At the same time, as Birch insists, it also requires contestation at the level of epistemic order, which implies an extensive research program on the political economy of corporate governance.

Future research agenda

The contributions in this special issue divert from the functionalist thesis that contemporary notions of 'good governance' provide an optimal or necessary point for convergence and develop a number of critical points. The ideology of shareholder value continues to play an important role in shaping most corporate governance systems, establishing a normativity that regulators, standard setters, and corporate elites must take into account in their communication, rule making and organizing. Although there is plenty of divergence and localized resistance to be found in existing corporate governance theory and practice, the normativity embedded in academic theorizing and in regulatory practice continues to provide the means to dominant groups in the domain of corporate governance to align the distribution of wealth with their interests. As such, the theory and practice of corporate governance is a key marker for understanding contemporary political economy. In line with these findings, we suggest three perspectives for further research.

The distributive effects of the orientation towards shareholder primacy

A first aspect future research could take into account is the broad distributive effects of conceptions of the corporation and of corporate governance. The notion of what corporate governance is and who it is for (Veldman and Willmott, 2013) prioritizes particular legal and economic claims over others. In this sense, financialized versions of corporate governance provide micro-level principles for theory and regulation that have strong effects in terms of macro-level wealth distribution (Lazonick and O'Sullivan, 2000; Fligstein, 2001; Piketty, 2014). There is, as of yet, little consideration of how this distribution of wealth might be produced and legitimated by particular ideas of the corporation and its governance or by the contract as a key building block of a capitalist legal architecture (Mitropoulos, 2012). Because corporate governance is of fundamental importance to all constituencies involved in the process and for broad sections of society who are outside this process, we propose to focus specifically on the rules and regulations that currently reinforce a financialized conception of the corporation, a shareholder value-oriented conception of corporate governance, and, ultimately, the reinforcement of a political economy that prioritizes the interests of a very small subsection of the constituencies that have a direct or indirect claim on the modern corporation.

The diffusion and dominance of new ideas of corporate governance

We found that existing varieties of corporate governance, both in terms of national variety (Clarke, this issue) or in terms of organizational-level variety in ownership and governing logic (Ponomareva and Ahlberg, this issue), provide valid and interesting alternatives to the existing normativity. We believe these, and similar, studies provide interesting ways to show how the dominant normativity in the field of corporate governance provides a purportedly functionalistic, but in practice normative, approach to corporate governance that works to 'crowd out' valid alternatives. One further promising approach to study such crowding out would be to look at the diffusion of corporate governance codes and practices. There is evidence to suggest that the terminology of 'good governance', such as policies regarding independent directors or executive compensation packages may be diffused across jurisdictions, but that the content of these ideas is often drastically changed. Although the language of such changes is adopted in external communication for legitimacy purposes, this does not necessarily entail major, substantive changes in how corporations organize or are made to organize by national governments (Westphal and Zajac, 1998; Bednar, 2012; Larsson-Olaison, 2014). Such collective 'window dressing' is a promising area of research to study how the currently dominant normativity is picked up, resisted, or transformed at the national level.

The conceptualization of the corporate form

A third line of further inquiry is the conceptualization of the corporate form. Lampert (this issue) shows how the perspective of agency theory of the corporation as a collection of contracts, agents, or individuals seriously undermines the legitimacy of its legal status and problematizes the claims that can be made about the corporation from a moral and legal perspective. Understanding the corporate form as a recently developed and constantly evolving legal construct, it becomes possible to take a close look at specific design features such as corporate personhood, corporate ownership, and limited liability.

More specifically, it has been argued that the specific way in which legal theory conceives of the separate legal entity means that this entity has been understood as independent of shareholders or other stakeholders (Ireland, 1999; Veldman and Parker, 2012). From this position, claims can be derived that transcend the claims of separate constituencies such as shareholders (Biondi et al., 2007). By extension, shareholders cannot be considered 'owners' of corporations (e.g. Ireland, 1999; Aglietta and Reberioux, 2005; Robé, 2011) and corporate governance is not just the governance of groups of (contracting) individuals. Rather, corporate governance is about understanding and regulating the modern corporation as a very specific kind of institution, which pre-structures the conditions for contracting relations between individuals and the corporation as a legal entity (Parkinson et al., 2000; Biondi et al., 2007; Robé, 2011).

Looking into the historical – and political – legitimation of the corporate form (Ireland, 2010; Marens, 2012) as a specific legal and economic construct would also help to move beyond limited framings of corporate 'subjecthood' and 'ethics' (Dunne, 2008; Lampert, this issue) and direct the gaze at the intersection of theory creation and political economy. Exploring the context, contents, causes and effects, and the forces that uphold corporate governance as a stream of social, economic and legal theory, as well as its associated practices, can support and develop a critical conversation on the relation between corporate governance as a theoretical and practical field and the political economy this field creates and upholds. It is, then, not just the normativity of corporate governance theory that needs to be studied, but also the institutional setting in which the corporate form is conceived and operates (Aglietta and Reberioux, 2005; Ireland, 2005).

Framing the corporation in this broader socio-economic setting will, we hope, provide the basis for new interdisciplinary research in critical management and organization studies. The contributions in this volume provide an excellent introduction to develop this research.

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