



# Nudging Corporate Law: From Profit Maximization for Shareholders and Creditors to Maximizing Corporate Value by Reputation

Hiromi Fujimori

School of Business, Aoyama Gakuin University.

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## ABSTRACT

In this study, corporate law will be discussed based on the interests of shareholders and creditors. We hypothesized that, based on the reason-based choice of maximization of corporate value by reputation, the use of the Nudge does not eliminate the inefficiencies caused by increased transaction costs for interest adjustment. Conventional financial evaluation is treated as a separate index. In addition, we assume high transaction costs for the interest adjustment of shareholders and creditors. However, it is possible to set forth the same goal of creating corporate value by reputation, suggesting the possibility that conflicts of interest eventually subside. In addition, we want to develop the idea of interest adjustment of parties as reciprocal altruism through behavioral economics.

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## Introduction

In the economics of corporate law, we assume the theoretical model of Michael Jensen and Oliver Hart. In Japan, traditional corporate law emphasizes maximization of shareholder interests. Meanwhile, in economics, “corporate value” is the sum of both shareholder and creditor value. This is because the term “creditors” includes various stakeholders. In addition, economic analysis includes creditor value for shareholder interests for either corporate or shareholder valuation.

Kahneman and Tversky were awarded the Nobel Prize in Economics in 2002 in the new field of behavioral economics. Subsequently, Richard Thaler and Cass Sansutin proposed libertarian-paternalism, which integrates the conflicting libertarianism (freedom supremacy) and paternalism (the patriarchal principle). In recent years, this has provided a solution from a new perspective and has thus attracted attention.

In addition, Thaler and Sunstein, using a technique called “the Nudge,” conducted empirical research related to public policy. The Nudge poked gently at people’s elbows to get their attention. This technique adjusts the conflicting interests within companies’ organizational behavior. Increase of such transaction costs interests adjustment is inefficient, nudge would like to discuss the benefits of making a law policy of the company.

## Background and Significance of This Study in Terms of Corporate Law

In June 2005, the Corporate Law was established by the National Assembly. It was enforced the following year, in May 2006. Corporate law is defined as rules for the organization and management of a company. The purpose of corporate law is to promote the interest adjustment of various stakeholders in the company (stakeholders here refer to the shareholders and company creditors (Ito et. al, 2009). Examples of conflicts of interest include management vs.

shareholders, controlling shareholder vs. minority shareholders, and shareholders vs. employees. Interest adjustment, company authority distribution, legal responsibilities and sanctions, contracts, market mechanisms, and elimination of agency problems due to incentive design are some of the issues enforced by the Corporate Law.

Todd Henderson, University of Chicago professor, The Law & in Economics of Corporate Law entitled Corporate Law of tuition, founded the company purpose of the company’s Corporate Finance and Limited liability utility, corporate governance, company dominion market, etc., we have economic analysis of the main topics of the Corporate Law. Economic analysis of corporate law and agency theory are taught in U.S. law schools. This includes interests of shareholders and creditors. Although overcoming free rider problem is logical, by tying, it is being born flow of positive altruism. While draw the flow, I want to develop the interest’s adjustment of parties until the reciprocal altruism by behavioral economics.

Using Thaler and Sunstein’s “Nudge,” we will consider whether corporate law involves conflicts of interest for a company’s organizational behavior. Further, we consider that an increase of transaction costs in interest adjustment is inefficient, and we discuss the benefits of formulating a legal policy for a company.

## Shareholder and Creditor Conflicts of Interest: Profit Maximization

The corporate value of financial institutions is related to capital adequacy because when a bank makes a loan to a company, it cannot receive more interest than in the original contract, even if the company makes a profitable investment from the loan money. Because creditors want to avoid the risk of possible debt collection, they work with the company to determine the repayment methods and interest. Furthermore, to investigate the risks of debtor attitudes, screening signaling times are used to eliminate the moral hazard problem

Tele:

E-mail addresses: [t61426@aoyamagakuin.jp](mailto:t61426@aoyamagakuin.jp)

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Shareholders, unlike creditors, undertake an equity risk. When a company's performance is strong, corporate value increases, a high dividend is obtained, and shares can be sold at a high price. In other words, by contract, the sale amount of the dividend also shares also not been determined. Therefore, stakeholders of the company, at the time of the agreement, so that the difference is generated in the relationship between corporate value.

A formal agreement between the parties plays a crucial role in improving corporate value. In conventional law and economics research, to reduce transaction costs between the parties, the agreement is prepared in a standard format. However, ensuring agreement about this standard format, which serves as an initial allocation of rights, for reasons such as title endowment effect, should be considered in the future.

#### **Interest Adjustments By Nudge: A Reason-Based Choice**

Thaler and Sunstein (2008) said "words and deeds follow the herd." This describes social influences, three of which are ① "information," ② "pressure from fellow members," and ③ "priming." ① "Information" means how to act when conveying information. ② "Peer pressure" derives from a desire to not be condemned by the population. ③ "Priming" is issuing a signal that appears to be irrelevant at first glance (Leventhal, Singer, and Jones 1965).

Interesting research has been conducted on "peer pressure." The social psychologist Solomon Asch (1995) challenged the subjects who responded with few mistakes when others' judgments were excluded. On the other hand, mistakes were made when subjects' answers were open to everyone else. This was verified more than 130 times (Sunstein, 2003). the subjects showed a tendency tunes at a rate of 20 to 40 percent. As a result, since it was not difference seen by the government, using the social impact, it is to be capable of businesses and governments to pursue various purposes. (Thaler and Sunstein (2008)<sup>1</sup> However, the dilemma about the distribution of the putter analysts exist (Sunstein, CR, and Thaler, RH, 2003). From this fact, only the Nudge indicates robust decision-making by interest groups, The "reason-based choice" hypothesis was proposed as an alternative to the utility maximization theory by Shafir (1993) and Shafir-Simonson-Tversky (1993). Humans rather than utility maximization, was thought to be to choose an option from the viewpoint of easily put the reason. The reason is that self-justification is large, even when faced with difficult questions, including an actively selected Nikki, which may result in consistent decision making (Fujimori et al., 2013, Fujimori, 2014). "Reason-based choice" was discussed in terms of active resistance and passivity. Based on the results of these studies, for the interests of shareholders and creditors, and to maximize corporate value, we would like to nudge the purpose of the stakeholders.

#### **Maximization of Corporate Value by Reputation: The Corporate Law Behavioral/Economic Analysis**

<sup>1</sup>Thaler and Sunstein's (2008) initial six principles of "NUDGES" are represented as follows:

iNcentives, Understand mappings: correspondence between the selection and happiness. Defaults: default, default rules, such as the default option. Give feedback: the system, whether the operation is successful, it will tell whether the user failed. Expect error: upon system design, if it is assumed that the user is wrong, try to eliminate the problem. Structure complex choices: to organize a complex selection.

Fombrun, C. J., van Riel, C. B. M. (2004)'s "Corporate Reputation," reputation and financial evaluation are stated to be associated with each other. First, reputation affects the performance of the company, affecting profitability. Second, profitability becomes a future basis of the company's decisions, affecting the stock price. Third, the stock price will form a value of corporate activities, called "reputation capital," which spreads to commodity companies. Thus, the stakeholders' attitude toward the company becomes positive. Better profitability also benefits employees, which strengthens the growth potential of the company.

If corporate law aims to maximize corporate value, companies possibly can pursue a social purpose. This would also benefit government legislation and regulations. The concept is that of reciprocal altruism of human beings; Becker mentions that altruistic behavior enhances utility through reciprocity. In addition, the recent development of experimental economics has become a fully observable event (Kahneman, Knetsch and Thaler (1986), Fehr and Schmidt (1999)).

In reality, humans are not faultless in their economic judgments. Therefore, they need to be protected by legal institutions. One idea is called pre-commitment strategy. This anticipates human error in society, creates a mechanism that cannot be easily discarded, and prepares the management system. There, nudge also be utilized, is also possible to induce in deliberately selected that it. Already, it has been used in the field of corporate law (Bainbridge, 2003).

#### **Conclusion**

Capturing laws as a device for pre-commitment is not always desirable from the following viewpoints. Enactment of the law is also done by the society because there is a limit on the ability to foresee errors. This economic position is assumed, which means that it does not leave scope for "selection under constraint." In future, we want to advance the economic analysis of law from this perspective.

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<sup>1</sup>Fujimori et al. (2013) discussed the relationship between the sunk cost effect and risk-oriented behavioral economics, from a neuro-economics point of view. This expanded the discussion, distinguishing the passive risk-oriented from the active risk-oriented by "Reason-based Choice." Humans, not using utility maximization, make Choices based on reason.. For example, when faced with a difficult problem, man actively selects the reason-based choice. In conventional economics, action maximizes the utility of outcomes. However, experimental results suggest that emotions are present in the decision process.

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