

Reframing the Firm as a Governance System: A Critical Synthesis of Transaction Costs, Capital Structure, and Agency Theory

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Abstract

This paper reinterprets the firm as a governance system by critically synthesizing three foundational theoretical contributions: Ronald Coase's theory of transaction costs, Modigliani and Miller's capital structure paradigm, and Jensen and Meckling's agency theory. While these frameworks have traditionally been explored in isolation, this study integrates them into a coherent perspective, highlighting how firms internalize market imperfections through governance mechanisms that coordinate transactions, align incentives, and manage risk. The paper also uncovers theoretical tensions among these approaches—particularly regarding assumptions of rationality, contractual completeness, and stakeholder scope—and argues for a more pluralistic view of the firm. A structured review of empirical research supports the idea that governance structures such as leverage, board composition, and ownership concentration are shaped by institutional environments and have measurable effects on firm behavior and performance. The paper concludes by emphasizing the need to extend classical theories to address contemporary challenges, including stakeholder governance, ESG imperatives, and digital organizational models.

Keywords

Corporate Governance, Theory of the Firm, Agency Costs, Capital Structure, Institutional Economics

1. Introduction

Corporate governance has become a central theme in understanding the functioning of modern organizations, particularly those characterized by complex structures of ownership and control. Its relevance stems from the need to align the interests of various stakeholders—such as shareholders, managers, creditors, and

employees—in order to ensure economic efficiency and sustainable value creation.

Although often treated as a set of regulatory or normative practices, corporate governance is grounded in a robust theoretical foundation developed over the 20th century by economists who sought to understand the firm not merely as a production function, but as an institutional arrangement aimed at resolving specific economic frictions. Three foundational contributions are significant.

First, **Ronald Coase's (1937)** seminal article *The Nature of the Firm* which argued firms exist to minimize transaction costs that would otherwise be excessive if all exchanges were performed through markets. In this view, the firm is an institutional solution to the price system high cost as a transaction governance option in transactions that carry some special characteristics (such as recurrence or asset-specificity), and internal governance mechanisms become essential to managing intra-organizational transactions.

Second, **Modigliani and Miller (1958, 1963)** laid the groundwork for modern capital structure theory. Initially asserting the irrelevance of financial structure under ideal market conditions, they later acknowledged that with taxes considered, leverage can indeed impact firm value. Following developments of their work, **Kraus and Litzenberger (1973)** highlighted the importance of bankruptcy costs, connecting financial decisions to governance by highlighting how financing structure shapes incentives and control. Finally, **Jensen and Meckling's (1976)** theory of agency costs introduced a framework for understanding conflicts that arise from the separation of ownership and control in large corporations. Corporate governance, in this context, is a system of incentives and mechanisms designed to mitigate these conflicts by reducing information asymmetries and aligning managerial actions with shareholder interests.

This article seeks to explore these three foundational contributions as the theoretical basis of corporate governance, linking their insights to contemporary research that expands upon and applies these ideas in real-world corporate and financial environments. While these theories are well established individually, this paper aims to integrate them into a unified model of the firm as a governance system—a synthesis rarely made explicit in governance literature.

2. Defining Corporate Governance: Institutional Meaning and Evolution

Corporate governance usually refers to the system of rules, practices, and processes by which firms are directed and controlled. At its core, it involves the mechanisms through which shareholders, boards of directors, and managers interact to decide, allocate resources, and safeguard the interests of various stakeholders¹.

¹While the literature often refers to “shareholders”, “board of directors” and “management” which are normally to be found in corporations, the idea of corporate governance is independent of the legal structure of the firm. Hence, the use of the above mentioned concepts are not to be taken in their technical-corporate law-based meaning but rather as referring to the owners of the firms (those that bear the main risk of the investment and hold a contingent claim on the firm's assets) and to the management (those that have the responsibility to run the business, without bearing the same risks as the owners).

Although definitions vary slightly across disciplines, the central aim of corporate governance is to align managerial behavior with the long-term goals of the firm, ensuring accountability, transparency, and the efficient use of capital.

The concept gained prominence in academic and policy debates during the 1970s and 1980s, a period marked by growing concern over the performance of large, publicly traded corporations. The increasing separation between ownership and control in these firms, first noted by [Berle and Means \(1932\)](#), became more acute as capital markets expanded and institutional investors emerged as dominant shareholders. The publication of [Jensen and Meckling's \(1976\)](#) agency theory formalized these concerns, providing a microeconomic framework to explain how conflicts of interest arise and how they can be managed.

Corporate governance attracted even greater attention in the 1990s and early 2000s, spurred by a series of high-profile corporate failures and financial scandals—including Enron, WorldCom, and Parmalat—that highlighted deficiencies in oversight, transparency, and incentive alignment. These events prompted regulatory reforms such as the Sarbanes-Oxley Act (2002) in the United States of America and spurred global efforts to formalize governance codes and best practices across jurisdictions.

Today, corporate governance is a multidisciplinary field encompassing economics, law, finance, and management. It is widely recognized not only as a determinant of firm performance and investor protection but also as a critical pillar of broader financial system stability and institutional development. Moreover, contemporary debates have expanded the scope of governance to include environmental, social, and governance (ESG) criteria, emphasizing the role of firms in addressing collective societal challenges.

In what follows, this paper adopts an economic lens to examine how governance emerges endogenously from the structure of the firm itself. The next sections delve into the key theoretical contributions that define the governance function as a response to transaction costs, capital market imperfections, and agency problems.

3. Ronald Coase and the Nature of the Firm: Governance as a Market Substitute

The starting point for understanding corporate governance from an economic perspective is Ronald Coase's classic article, *The Nature of the Firm* ([Coase, 1937](#)). In this work, Coase questions a key assumption of neoclassical economics: if the price system is efficient at coordinating agents, why do firms, with their hierarchical organization and production processes, exist and not all transactions occur in the market?

The distinction between the coordination by prices and coordination within firm becomes clear in the following passage:

Outside the firm, price movements direct production, which is coordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market

structure with exchange transactions is substituted the entrepreneur-coordinator, who directs production. These are alternative methods of coordinating production. Yet, having regard to the fact that if production is regulated by price movements, production could be carried on with no organisation at all, well might we ask, why is there any organisation? (Coase, 1937)

Coase (1937) argues that using the market entails costs—search, negotiation, monitoring, and enforcement—that may render direct coordination between agents inefficient. Firms emerge as hierarchical structures that internalize operations to reduce these transaction costs. Rather than continuously engaging in market transactions, economic agents use administrative orders within a system of authority to coordinate production more efficiently. Again, in Coase’s words:

The [firm] contract is one whereby the factor, for a certain remuneration (which may be fixed or fluctuating), agrees to obey the directions of an entrepreneur within certain limits. The essence of the contract is that it should only state the limits to the powers of the entrepreneur. Within these limits, he can therefore direct the other factors of production. (Coase, 1937)

This view shifts the analysis of the firm from a “production function” as seen by economists at that point, to a “governance institution”. Hierarchical organization is not merely operational, it is a system for coordinating activities in the face of transaction costs. In this sense, corporate governance refers to the internal mechanisms that regulate this hierarchy: decision-making structures, monitoring mechanisms, residual control rights, and incentive systems. All with the goal of minimizing transaction costs as compared with the market system and also compared to competing firms.

Coase’s framework thus provides a foundational lens for modern corporate governance: firms are institutional responses to market imperfections, and governance mechanisms are necessary to manage internal coordination effectively. Later scholars, including Oliver Williamson (1979), extended this approach, emphasizing the firm as a nexus of governance structures adapted to minimize transaction costs:

Faced with the prospective breakdown of classical contracting in these circumstances, three alternatives are available. One would be to forgo such transactions altogether. A second would be to remove these transactions from the market and organize them internally instead. Adaptive, sequential decision making would then be implemented under common ownership and with the help of hierarchical incentive and control systems. Third, a different contracting relation which preserves trading but provides for additional governance structure might be devised. This last brings us to what Macneil refers to as neoclassical contracting. (Williamson, 1979)

This theoretical base is essential for understanding how capital structure, incentives, and control systems interconnect in subsequent sections.

4. Modigliani and Miller: Capital Structure and Governance Implications

The work of Franco Modigliani and Merton Miller stands as a cornerstone of corporate finance theory. In their seminal 1958 article, *The Cost of Capital, Corporation Finance and the Theory of Investment* (Modigliani & Miller, 1958), they assert that under perfect market conditions—no taxes, no bankruptcy costs, and no information asymmetry—a firm’s capital structure is irrelevant to its value. In this idealized world, a firm’s value depends solely on its ability to generate future cash flows, not on how those cash flows are financed. This conclusion, that challenged traditional thinking up to that point (e.g. Durand, 1952) is reached through the idea of arbitrage, since, if the value of a levered company were greater than the value of an unlevered company, investors might feel inclined to take debt on their own account, thus influencing the rates to converge².

However, in their 1963 revision, Modigliani and Miller (1963) incorporated corporate taxes and showed that debt financing can indeed increase firm value through the tax shield on interest payments. This evolution of their theory opened the door to a wave of studies that introduced real-world frictions into capital structure analysis, including bankruptcy costs (Kraus and Litzenberger, 1973), asymmetric information (Myers and Majluf, 1984), and agency problems (Jensen and Meckling, 1976; Jensen, 1986), as shown by Ferdous (2019).

It is within these imperfections that the connection between capital structure and corporate governance becomes clear. For instance, since the original paper of 1958, Modigliani and Miller had shown that the return on equity for a levered company should be greater than for an unlevered one³. This is because debt introduces financial risks and costs, which demand control and monitoring by debt holders and also by equity investors. Higher leverage demands complex contractual obligations that can discipline managerial behavior, avoiding opportunistic behaviours not aligned with the debt holder’s interests (e.g. taking on high-risk low-return investment projects, considering only the upside benefits), as pointed out by Jensen and Meckling (1976)⁴.

The choice between equity and debt financing affects control rights, incentive alignment, and monitoring dynamics. Thus, capital structure is not merely a financial decision—it is a governance decision, shaping the distribution of power and responsibility within the firm (Anh and Thao, 2019). Modigliani and Miller’s

²“...as long as $V_2 > V_1$ we must have $Y_1 > Y_2$, so that it pays owners of company 2’s shares to sell their holdings, thereby depressing S_2 and hence V_2 ; and to acquire shares of company 1, thereby raising S_1 and thus V_1 . We conclude therefore that levered companies cannot command a premium over unlevered companies because investors have the opportunity of putting the equivalent leverage into their portfolio directly by borrowing on personal account” (Modigliani & Miller, 1958).

³“That is, the expected yield of a share of stock is equal to the appropriate capitalization rate p_k for a pure equity stream in the class, plus a premium related to financial risk equal to the debt-to-equity ratio times the spread between p_k and r .” (Modigliani & Miller, 1958).

⁴At the same time, as Jensen (1986) later argued, debt may reduce the “Free cash flow problem” by limiting managers’ discretionary resources “a governance mechanism embedded in the firm’s financial structure. This favours the alignment of interests of equity holders and management, reducing agency costs.

contributions, therefore, as well as the contributions of the authors that expanded Modigliani and Miller's ideas to real-world assumptions, go beyond cost of capital considerations: they highlight how financial structure interacts with governance arrangements in the presence of market imperfections, thus, enhancing the idea of the firm as a governance system rather than a simple production function.

5. Jensen and Meckling: Agency Costs and the Core of Corporate Governance

A transformative shift in the firm's theory and corporate governance occurred with Michael Jensen and William Meckling's *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* (Jensen & Meckling, 1976). This seminal work reframed the firm as a nexus of contractual relationships, focusing on the conflicts between principals (shareholders) and agents (managers) that arise from the separation of ownership and control.

Jensen and Meckling show that delegating control to managers generates agency costs—monitoring expenses, bonding costs, and residual losses—that reduce firm value. These costs stem from divergent interests: managers may pursue personal benefits, underperform in their duties, or invest in suboptimal projects unless constrained⁵ Corporate governance, in this context, emerges as a set of mechanisms—legal, structural, and financial—designed to align the interests of managers and owners. These include: 1) ownership structure and voting rights, to tie financial incentives to performance; 2) boards and audits, to improve monitoring and accountability; 3) capital structure choices, where debt serves as a disciplining device to reduce managerial discretion (Jensen and Meckling, 1976).

Regarding the capital structure and its relation with agency costs and corporate governance, Jensen and Meckling (1976) challenge the Modigliani and Miller conclusion of capital structure neutrality in establishing the firm value. According to Jensen and Meckling (1976) equity holders can extract value from debt holders creating agency costs that must be identified and properly controlled. As Leland (1998) puts it:

Two insights have profoundly shaped the development of capital structure theory. The arbitrage argument of Modigliani and Miller (M-M) (1958, 1963) shows that, with fixed investment decisions, nonfirm claimants must be present for capital structure to affect firm value. The optimal amount of debt balances the tax deductions provided by interest payments against the external costs of potential default. Jensen and Meckling (J-M) (1976) challenge the M-M assumption that investment decisions are independent of capital structure. Equity holders of a levered firm, for example, can potentially extract

⁵“In most agency relationships the principal and the agent will incur positive monitoring and bonding costs (non-pecuniary as well as pecuniary), and in addition there will be some divergence between the agent's decisions* and those decisions which would maximize the welfare of the principal. The dollar equivalent of the reduction in welfare experienced by the principal due to this divergence is also a cost of the agency relationship, and we refer to this latter cost as the 'residual loss' We define agency costs as the sum of: (1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent, (3) the residual loss.” (Jensen and Meckling, 1976)

value from debt holders by increasing investment risk after debt is in place: the ‘asset substitution’ problem. Such predatory behavior creates agency costs that the choice of capital structure must recognize and control.

Beyond this, [Jensen \(1986\)](#) introduces the “free cash flow problem”, emphasizing that managers with surplus cash may misuse resources. Debt commitments, in this view, effectively “tie the hands” of managers by mandating cash outflows, thus limiting waste and reinforcing accountability. This idea further connects the capital structure analysis started by Modigliani and Miller to the agency costs approach to corporate governance. In short, agency theory provides the analytical foundation of corporate governance, explaining why it exists and how it can be structured to minimize conflicts in decentralized, modern corporations.

6. Theoretical Synthesis, Tensions and Limitations: The Firm as a Governance System

Integrating the insights of Coase, Modigliani and Miller, and Jensen and Meckling, among others, allows us to conceptualize the firm as a governance system—an institutional arrangement aimed at minimizing both market and internal inefficiencies. Though each theorist addresses a different dimension—transactions, capital, and incentives—they collectively build a coherent framework in which governance is the mechanism that holds the firm together under real-world conditions.

[Coase \(1937\)](#) provides the institutional rationale: firms arise to internalize transactions that would be too costly in the open market. In this context, the cost reduction obtained is dependent, among other factors, on the expected recurrence of the transaction, being easier to justify specialized governance structures in face of recurrent transactions than in face of occasional transactions ([Williamson, 1979](#))⁶. However, internalizing transactions also introduces new risks—particularly the potential misalignment of interests between owners and decision-makers.

Developments of the work of Modigliani and Miller by different authors show that, once imperfections are introduced, capital structure choices affect not only financial outcomes but also the distribution of control and accountability—core concerns of governance ([Kraus and Litzenberger, 1973](#); [Myers and Majluf, 1984](#); [Jensen and Meckling, 1976](#)). Debt, in particular, becomes a tool for shaping managerial behavior consequently influencing governance inside the organization ([Jensen, 1986](#)).

[Jensen and Meckling \(1976\)](#) complete the economic foundation of corporate governance, along with Coase, Modigliani and Miller, by modeling the firm as a web of contracts with inherent agency problems. Governance, in this view, is the strategic design of mechanisms—ownership, incentives, oversight—that mitigate

⁶“Transaction-specific Governance: Relational Contracting. The two types of transactions for which specialized governance structures are commonly devised are recurring transactions of the mixed and highly idiosyncratic kinds. The nonstandardized nature of these transactions makes primary reliance on market governance hazardous, while their recurrent nature permits the cost of the specialized governance structure to be recovered.” ([Williamson, 1979](#))

these conflicts and enable value creation, through the reduction of agency costs.

Corporate governance, therefore, is not merely a response to regulation or a set of best practices. It is an endogenous institutional response to the economic realities of transaction costs, information asymmetry, and agency conflicts. It connects the logic of institutional efficiency (Coase), the financial architecture of control (Modigliani and Miller) and the behavioral economics of incentive alignment (Jensen and Meckling). This theoretical foundation provides a powerful lens for analyzing both firm-level governance structures and broader patterns in corporate finance and strategy.

Although the models proposed by Coase (1937), Modigliani and Miller (1958, 1963), and Jensen and Meckling (1976) may appear complementary, a critical analysis reveals that these approaches rely on significantly different assumptions and theoretical emphases, however. Coase views the firm as an institutional solution to transaction costs. His analysis centers on bounded rationality, incomplete contracts, and marginal efficiency between hierarchy and market. Williamson (1979) later developed this framework by emphasizing that organizational forms emerge to reduce contractual inefficiencies in uncertain environments with asset specificity. In contrast, the Modigliani and Miller approach assumes perfect markets, complete contracts, and frictionless arbitrage. While later extensions incorporate taxes, bankruptcy costs, and asymmetric information, the foundational model remains grounded in full rationality and contractual neutrality.

These differences are also reflected in their treatment of capital structure. For Coase and Williamson, financial structure is one of various dimensions of governance and value creation. For Modigliani and Miller, it is a central aspect as it can influence the value of the company considering the impact of the debt tax shield. Jensen and Meckling bridge these perspectives by introducing agency costs into financial decision-making, explaining why some capital structure decisions are the rational choice aiming to minimize total costs in the firm and maximize value. However, this “bridge” also brings theoretical tension: while Coase accepts cognitive limitations and contractual incompleteness, agency theory assumes utility—maximizing agents who respond predictably to incentive structures.

Moreover, the conception of the firm as a nexus of contracts, popularized by Jensen and Meckling, has been criticized for neglecting organizational, cultural, and relational dimensions that transcend formal contracting. Ghoshal and Moran (1996), for instance, argue that this overly economic lens risks naturalizing opportunistic behavior and undermining cooperative forms of coordination⁷:

⁷“TCE has been criticized for many things—for embodying a hidden ideology that distorts more than it illuminates (Perrow, 1986), for ad-hoc theorizing divorced from reality (Simon, 1991), for lacking generality because of ethnocentric bias (Dore, 1983), for ignoring the contextual grounding of human actions and, therefore, presenting an undersocialized view of human motivation and an oversocialized view of institutional control (Granovetter, 1985), and for other such purported acts of omission and commission. Although we sympathize with most of these arguments, our critique of the theory rests on a very different ground. Like Pfeffer (1994), we are concerned with its normative implications.” (Ghoshal and Moran, 1996)

Organizations are not mere substitutes for structuring efficient transactions when market fail; they possess unique advantages for governing certain kinds of economic activities through a logic that is very different from that of a market. TCE is 'bad practice' because it fails to recognize this difference.

Finally, the shareholder-centered model inherent in agency theory has been increasingly questioned considering contemporary demands for broader corporate accountability. Recent models, such as stakeholder theory (Freeman et al., 2010) and institutional comparative approaches (Aguilera and Jackson, 2003), view corporate governance as mediating plural, interdependent interests—not merely as a mechanism for aligning managers with capital owners.

In summary, in transaction-cost economics, the principal governance variables are asset specificity, uncertainty, and frequency, which predict shifts among market, hybrid, and hierarchy; the operative controls are authority allocation and relational safeguards. In the capital-structure tradition, the pivotal levers are leverage, the tax shield, and expected distress costs; governance effects operate via creditor monitoring and cash-flow commitment. In agency theory, key variables are ownership concentration, board oversight, incentive pay, and information asymmetry; the mechanisms are monitoring, bonding, and residual risk-sharing. Overlaps arise where leverage disciplines managerial discretion, residual control rights allocate adaptation authority, and board design mediates make-or-buy and financing choices.

Thus, a critical and integrative view of the firm as a governance system must acknowledge not only complementarities but also theoretical frictions among these schools.

7. Contemporary Applications and Empirical Evidence

The theoretical foundations laid by Coase, Modigliani and Miller, and Jensen and Meckling have inspired an extensive body of empirical research aimed at testing and refining our understanding of how governance mechanisms operate in real-world settings. These studies have not only confirmed key aspects of the original frameworks but also introduced new complexities by exploring diverse institutional environments, legal systems, and ownership structures. For example, using a cross-country panel, Ghabri (2022) find that, for comparable governance quality, firms in common-law systems exhibit stronger valuation effects and higher performance than firms in civil-law systems—consistent with higher investor protection amplifying governance payoffs.

A structured review of the empirical literature also reveals consistent support for the proposition that governance mechanisms significantly influence firm outcomes. Capital structure has been shown to serve as both a financial and governance lever. Anh and Thao (2019), examining Vietnamese listed firms, found a non-linear relationship between leverage and return on equity, consistent with agency theory: moderate debt levels discipline managers, while excessive debt increases the risk of value-destroying behavior.

El-Chaarani (2014), analyzing European firms, obtained empirical evidence that capital structure decisions affect firm performance, especially under strong investor protection regimes. This supports the view that institutional context conditions the governance function of debt. Similar results are observed in emerging markets. Kajananthan (2012), in a study of Sri Lankan manufacturers, and Bulathsinghalage and Pathirawasam (2017) both found that board structure and internal governance mechanisms are correlated with capital decisions, although this correlation is not present for all mechanisms. The same correlation was found by Cunha and Martins (2015), for Brazilian companies. Gondrige and Clemente (2012) found a relationship between board structure (number of members) and company value for the Brazilian market.

Beyond capital structure, recent empirical work has emphasized the governance role of board composition, ownership concentration, audit structures, and transparency policies. These variables have been linked to reductions in agency costs and improvements in performance across varied jurisdictions. For instance, Dyck and Zingales (2004) highlight the cross-national variation in private benefits of control, reinforcing the role of institutional quality in shaping governance outcomes, among other factors. Troeger (2007) examined how legal forms, such as partnerships and corporations, shape agency conflicts between equity holders and creditors. His findings suggest that institutional governance choices—like joint liability or asset partitioning—are essential tools for managing risk and aligning incentives.

In a broader institutional view, Gilson (2016) frames corporate governance as an evolving system shaped by interactions among legal frameworks, political institutions, and capital markets. In this perspective, governance is not a static set of practices but a dynamic architecture co-evolving with broader socio-economic conditions⁸ More recent scholarship has incorporated contemporary challenges such as stakeholder governance, ESG metrics, and digital transformation. Studies increasingly analyze how traditional mechanisms (e.g., debt discipline or board oversight) adapt to new governance expectations, including sustainability reporting, stakeholder engagement, and algorithmic decision-making (Eccles et al., 2014; Zuboff, 2019).

This body of evidence supports the idea that the firm, as a governance system, must be understood not only through its internal coordination mechanisms but also considering its institutional embeddedness and the diversity of stakeholders

⁸As stated in page 9 (Gilson, 2016), “A corporation should be defined functionally by reference to the structure that allows those pieces of paper to operate a business and makes it possible for third parties to confidently do business with a legal fiction. Some of these structures are legal rules that, in specified circumstances, allow the corporation to be treated, like Pinocchio, as if a real boy. However, the mass of the corporate structure, both in importance and in bulk, is not legal at all. It consists of processes of information flow, decision making, decision-implementation, and decision-monitoring: how the corporation (i) obtains the information it uses in making, implementing, and monitoring the results of, its business decisions (including information relevant to regulatory compliance); (ii) re-distributes information from information originators to managers with sufficient expertise and experience to evaluate it; and (iii) makes decisions, communicates decisions to the employees who implement them, and then gathers information about the consequences, for the next round.”

and firm objectives. Future research will benefit from more nuanced, cross-disciplinary approaches that integrate law, economics, and organizational sociology in studying how firms adapt their governance architectures in response to shifting global norms.

8. Conclusion

This paper has examined the intellectual foundations of corporate governance by integrating the seminal contributions of [Ronald Coase \(1937\)](#), [Modigliani and Miller \(1958, 1963\)](#), and [Jensen and Meckling \(1976\)](#), along with different authors that expanded their original ideas. Each of these authors approached the firm from a different angle—transaction costs, capital structure, and agency conflicts—but together, they provide a theoretical framework that tries to explain why firms exist, how they are financed, and how they must be governed.

[Coase \(1937\)](#) taught us that firms arise to reduce the costs of using the market. However, this internalization introduces new governance challenges, as coordination within hierarchies requires effective mechanisms of control. [Modigliani and Miller \(1958, 1963\)](#) demonstrated that under realistic conditions—such as taxes and market imperfections—capital structure affects firm value and thus can serve as a governance lever. Finally, [Jensen and Meckling \(1976\)](#) articulated the agency cost problem that lies at the heart of corporate governance: the divergence between managerial interests and those of shareholders.

The synthesis of these ideas reveals a powerful insight: corporate governance is not an auxiliary discipline or a regulatory imposition—it is a necessary economic response to the structural and behavioral frictions inherent in modern firms. Governance systems emerge to align incentives, reduce opportunism, and allocate decision rights efficiently in the presence of uncertainty, asymmetry, and decentralization.

Empirical research continues to validate and extend these theoretical insights. Studies have shown how governance structures, capital policy, and institutional environments interact to influence firm performance and managerial behavior. These findings confirm that effective governance is context-dependent, evolving in response to firm-specific conditions and broader institutional dynamics ([Gilson, 2016](#)).

While the foundational theories explored in this paper were developed in 20th-century corporate structures, their core insights remain highly relevant in addressing the challenges of 21st-century governance. The rise of stakeholder capitalism, the increasing emphasis on environmental, social, and governance (ESG) criteria, and the transformation of organizational models in response to digitalization have all reshaped the boundaries of the firm and expanded the scope of governance. These developments underscore the enduring need to manage information asymmetries, incentive misalignments, and coordination costs “now not only between owners and managers but also among a broader set of stakeholders. As such, the theoretical pillars laid by Coase, Modigliani and Miller, and Jensen

and Meckling continue to offer valuable analytical tools, even as the institutional and normative landscape of governance evolves.

These classical theories are not without important limitations, though. They are grounded in assumptions of rationality, contract enforceability, and market-based incentives, often abstracting from social, psychological, and behavioral factors that influence real-world corporate dynamics (Ghoshal and Moran, 1996). Omitting elements such as trust, organizational culture, bounded rationality, and informal norms limits their ability to fully capture how governance operates within complex human systems. Behavioral agency theory, institutional theory, and sociology of organizations have since offered necessary extensions to account for these dimensions.

The shareholder-centric model embedded in agency theory may be increasingly insufficient in an era where corporations are called to address broader societal responsibilities. Recent scholarship pushes beyond shareholder primacy toward stakeholder governance and multi-capital value. Stoelhorst and Vishwanathan (2024) theorize that any group's primacy (shareholders included) is an inefficient solution for governing knowledge-intensive firms, arguing for governance by stakeholders as a collective-action design. McDonnell (2024) reframes stakeholder governance as governance by stakeholders, emphasizing institutional mechanisms that give non-equity stakeholders decision rights. Complementing the theory, emerging empirical and review works (e.g., Buchetti et al., 2025) document how corporate governance influences ESG outcomes.

The classical frameworks largely assume that maximizing shareholder value is the principal aim of governance, whereas contemporary models emphasize the need to balance multiple stakeholder interests—including employees, communities, regulators, and the environment. In this light, the challenge for scholars and practitioners is not to discard the insights of Coase, Modigliani and Miller, or Jensen and Meckling, but to critically assess their limits and to build upon them with a more inclusive and adaptive vision of governance suited to the complexities of the 21st century.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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