CORPORATE SOCIAL RESPONSIBILITY AND CORPORATE GOVERNANCE

The Contribution of Economic Theory and Related Disciplines

Edited by
Lorenzo Sacconi, Margaret Blair,
R. Edward Freeman and Alessandro Vercelli

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Introduction

Lorenzo Sacconi

1 About the general subject of this book

As early as 2005, well before the eruption of the global financial crisis, the attention of the international economic press was attracted by the corporate social responsibility (CSR) phenomenon. *The Economist,* in particular, acknowledged the spectacular growth of company CSR initiatives throughout the world, and through the relations between companies, business associations, stakeholders' representative groups, NGOs, universities, international organizations, and yet others. What struck *The Economist* as especially disturbing was that:

> Today all companies, but especially the big ones, are enjoined from every side to worry less about profits and to be socially responsible instead. Surprisingly, perhaps, these demands have elicited a willing, not to say avid, response in enlightened boardrooms everywhere: companies at every opportunity now pay elaborate obeisance to the principle of CSR. They have CSR officers, CSR consultants, CSR Departments, and CSR initiatives coming out of their ears. (*The Economist*, 22 January 2005, p. 11)

The idea – along with a famous dictum by Milton Friedman of the 1970s – was that boards of directors, insufficiently committed to making profits for their shareholders, were instead engaging in 'pernicious benevolence' by being philanthropic with money taken not from their own pockets but from those of the corporate shareholders. What in fact this view entailed was that CSR (i) is not a business-related but a philanthropic activity that 'altruistic' managers undertake by misusing corporate money, (ii) as such, it is in contrast with profit maximization and, lastly, (iii) it is a manifestation of managerial slack and (moral) self-dealing.

Barely three years later, however, *The Economist* viewed CSR very differently. It now stated that 'done badly, [it] is just a fig leaf and can be positive harmful. Done well, though, it is not some separate activity that companies do on the side, a corner of corporate life reserved for virtue. It is just good business' (*The Economist*, 19 January 2008, p. 3, *Special report*). And a little further on: 'The more this happens, ironically, the more the days of CSR may start to seem numbered. In time it will simply be the way business is done in the 21st century' (p. 22). To explore further what was understood by the term 'good business', we quote again from the same issue of *The Economist:* 'Some people complain that this sort of "good corporate citizenship" is merely another form of self-interest. Correct and good. They should be happy that this category has grown. The difficulty with CSR comes when companies get it out of proportion. For instance, there is a lot of guff about responsibility being at the core of a firm's strategy…' (leader, p. 13).

Thus, CSR was deemed no longer to be merely philanthropic, but rather an appendix of the core business strategy of any large company operating in the turmoil of the global economy. In fact, companies are involved in a series of challenges with their stakeholders that might essentially affect their business and economic functioning itself. Hence CSR may be understood as the appropriate method for addressing those challenges. Once it was recognized as no longer alien to the proper business and economic functioning of the corporation, however, the second tenet also had to be changed. Henceforth CSR could be reduced to a mere tool (according to an *instrumental* view) for the achievement of the traditional shareholder value maximization objective – the function of the corporation – namely as no more than a detail of the overall strategy of making as much profit as possible. It was something that no longer needed to be denoted by a distinct word or understood as a motivation distinct from the 'selfish' shareholder-value strategy. Of course, managerial slack was no longer involved, as long as this reduction of CSR to a tool for shareholder value maximization was granted.

This changed appraisal, which does not involve any real change of mind, quite clearly illustrates the typical dogmatic attitude of libertarian supporters of the 'free market economy' towards how capitalism 'should' work when they are faced by recalcitrant facts – such as the evidence that sometimes, albeit not systematically, corporations are not exclusively focused on shareholder value maximization, but pursue other objectives and take account of different and also, to some extent, conflicting interests. This evidence was initially dismissed as resulting from misguided decisions by self-serving ideologues entrenched within corporate boards or pressure groups and lobbies. Thereafter, once the anomaly had proved to be widespread in the real world of companies and business organisations, an attempt is made to reconcile recalcitrant facts with the doctrine's core dogmas.

In fact, neither view was satisfactory. The international movement of CSR, including initiatives at company level, and multi-stakeholder initiatives at national and international levels such as the ONU global compact and many others, allows a more ambitious interpretation. If facetious use may be made of the terminology of the philosophy of history, these facts can be understood as the epiphenomena of a deeper confrontation between two partly conflicting tendencies on the battleground of corporate governance models. On the one hand the tendency predominant in the past thirty years and which has consisted in the devolution of the most important economic decisions to private market agents – that is, corporations such as privately owned firms or public companies. On the other hand, the tendency to require these same private agents to account for more than just the efficiency of their results seen in terms of narrow profit maximization: they should also accept social responsibility for their conduct, understood as producing fair and mutual advantages for all the involved stakeholders, and the internalization of social costs engendered by the pursuit of mere profit maximization.

An unconventional reading of the Coase Theorem gives economic substance to this interpretation of the CSR movement: since neither the real world government nor real markets and firms can be considered as governance mechanisms with zero transaction costs, it is possible to experiment with alternative private governance forms aimed at internalizing part of the social and transaction costs of the traditional private governance forms through the emergence of social norms for corporate responsibility. On this view, CSR is defined as an 'extended model of corporate governance' in which those who run the firm (entrepreneurs, directors, top managers) have fiduciary duties (namely obligations and responsibilities) that range from owners and shareholders (in the case of ownership and control separation) to all of the other corporate stakeholders (individuals and social groups with essential interests involved in the company's management). And since these duties act as an internal constraint on the sphere of managerial/entrepreneurial autonomy not concretely regulated by the law, they assume the form of responsibility principles expressed by shared social norms, self-regulatory codes and standards, soft laws and so on (Sacconi 2006b, 2006a).

Thus understood, CSR is not an entirely new notion in the domain of corporate governance. Back in the 1930s the idea that public companies were fiduciaries of constituencies much broader than shareholders was put forward and widely discussed as one of the possible interpretations of the very reason for the large corporations' existence.

> In his earlier writing Berle maintained that corporate powers were held in trust not only of the corporation per se but also for individual members of it (Berle 1931). Dodd (1932) challenged this view by arguing that the directors of a corporation must (if they had not already) become trustees not merely for shareholders but also for other constituents of corporations, such as employees, customers, and particularly the entire community. Later Berle conceded to Dodd, and admitted that modern directors act *de facto* and *de jure* as administrators of a community system, although he remained rather cautious about admitting this as the 'right disposition' (Berle 1959). (Aoki 2010, p. 15, n. 1)

A very similar idea was advanced in the 1980s in the much more precise formulation allowed by new developments in stakeholder theory mainly as a theory of strategic management but also as a view of corporate governance (Freeman 1984; Freeman and Evan 1990; Evan and Freeman 1993; Donaldson and Preston 1995; Freeman et al. 2010). According to stakeholder theory, descriptively a corporation is a constellation of interacting stakeholders (positively acting together or in any case abstaining from interfering with and obstructing the other stakeholder cooperations) coordinated through the firm's managerial and entrepreneurial strategy and the governance structure, so that they are induced to cooperate in order to create as much value as possible to their mutual advantage:

> The basic idea of creating value for stakeholders is quite simple. Business can be understood as a set of relationships among groups that have a stake in the activities that make up the business. Business is about how customers, suppliers, employees, financiers (stockholders, bondholders, banks etc. …) communities and managers interact and create value. To understand a business is to know how these relationships work. And the executives' or entrepreneur's job is to manage and shape these relationships. (Freeman et al. 2010, p. 24)

The normative reading of stakeholder theory (see Donaldson and Preston 1995), however, adds an important element to that description: the recognition that all stakeholders are sources of ends for the corporation. That is to say, they all have legitimate interests that *must* be reflected in the corporate objective function. In other words – to rephrase Kant's second formulation of the categorical imperative – all of the stakeholders are not just *means* for the pursuit of the interests of one single patron of the firm (the owners of corporate physical assets), they also give rise to *purposes* to be pursued by the proper management of the company (which also entails that they are, to a certain extent, complementary). CSR can thus be straightforwardly understood as the formal recognition at corporate governance level of the obligations owed to all the stakeholders because they are legitimate *sources of ends* for corporations.

Nevertheless, most mainstream economists have ignored this perspective and continue to maintain that the multi-stakeholder corporation, even if imagined for a desirable purpose, does not have a uniquely defined objective function, so that a multi-stakeholder objective function would open the way to managerial slack and self-dealing. By contrast, shareholder maximization, albeit in the long run, would allow the internalization of those stakeholders' interests that are instrumental to shareholder value maximization (cf. Jensen 2001), leaving the remaining unaccounted interests to the protection provided by the law of contracts (see Tirole 2001): a rather paradoxical conclusion, considering that the theory of the firm sees contracts as typically incomplete and thus as not protective at all.

But, since the relevance of CSR as a global phenomenon cannot be ignored, economists to date have tended to deal with it by reducing CSR to 'corporate philanthropy' more or less in line with, and instrumental to, profitability. Drawing on recent developments in economic psychology, Benabou and Tirole (2010) observe that pro-social behaviors enable understanding of the increasing interest shown towards CSR in relation to: (1) firms' adoption of a more long-term perspective; (2) the delegated exercise of pro-social behavior on behalf of stakeholders; and (3) insider-initiated corporate philanthropy, even if their conclusions are skeptical about the efficiency of these corporate policies with respect to the economic function of the firm. By contrast, Heal (2008) considers a number of corporate cases that apparently show that pro-social and pro-environment corporate policies pay in terms of profitability.

There is no intrinsic need, however, to understand the economic theory of the modern corporation as entailing this reduction of corporate social responsibility to 'instrumental philanthropy'. Consider the following standard components of the contemporary new-institutional theory of the firm: (i) the idea that corporate authority is necessary for the coordinated use of information in joint production under incomplete knowledge and asymmetric information requiring flexibility of the collective decision process (Simon 1951; Arrow 1974); (ii) the 'efficient monitor' view of the entrepreneur as discouraging moral hazard in team production (Alchian and Demsetz 1972 – even if these authors dissimulate the existence of authority in the firm); (iii) the idea of hierarchy as a way to protect specific investments in incomplete contract contexts where the agents' motivations are opportunistic (Williamson 1975, see also Williamson *infra*). Consider, moreover, the view of the firm's governance as the result of a multi-party contract, as in GHM theory, where (iv) the optimal firm control structure results from an intertemporal bargaining decision model involving at least two parties, such that *ex ante* they choose an allocation of residual rights of control (authority) in order to prevent the inefficient *ex post* renegotiation of each party's essential decision that otherwise would affect the incentive to undertake specific investments at a *mid-way* decision step in the parties' diachronic strategic interaction (Grossman and Hart 1986; Hart and Moore 1990; Hart 1995). Or (v) the theory of enterprise ownership which predicts that alternative ownership forms will emerge as different cases from the very same basic decision exercise of transaction costs minimization, and ranging over different, case by case, configurations of all the stakeholders' contract costs and authority costs (Hansamann 1986, 1996).

All of these theories implicitly conceive the choice of a proper corporate governance form as the solution of a mixed-motives game among different players (Harsanyi 1977) – namely corporate stakeholders – with partially conflicting interests and incentives, who nevertheless also gain a mutual advantage from coordination and mutual cooperation. Put otherwise, a proper solution for the corporate governance problem is the solution of an (albeit implicit) bargaining problem; a situation whereby all the stakeholders can substantially and mutually profit if they are able to cooperate and carry out the joint plan of team production. But it is nevertheless also a situation such that their interests clash over the distribution of the surplus generated by their mutual cooperation. Choosing a governance structure and strategy means selecting a bundle of decision rights and obligations allowing for the selection of a joint plan of action (or abstention from acting) with an expected outcome which is efficient, in the sense that the value created (or surplus) is as large as possible, but also reasonably fair because it represents a distribution mutually acceptable to all the stakeholders involved, even though they all claim as much as possible of the surplus. In this situation – typical of any company – value creation and efficiency cannot be separated from fairness and distributive justice. Separation would entail the failure of the enterprise as a value creation endeavor (this is also a version of the 'separation thesis' rejected by stakeholder theorists; see Freeman et al. 2010). Moreover, because any governance structure allocates authority as long as it assigns decision rights and discretionary powers, under any second-best governance solution (among those conceivable in the real world economy) a risk of abuse of authority against the non-controlling parties is always lying in wait. Hence this problem must be faced by an appropriate balance not just in the *ex post* distribution of payoffs but also in the *ex ante* allocation of rights, powers and responsibilities that allow effective achievement of the proper distributive balance. Hence the choice of the best feasible corporate governance form appears to be a natural candidate as a solution in terms of the 'social contract' among all of the corporate stakeholders. It is an agreement reached in a pre-firm Hobbesian 'state of nature' in order to attain an acceptable consensus on the authority structure, the allocation of ownership and control, and the infrastructure of rights and obligations that allows all stakeholders to access fair shares of the surplus produced through their cooperation – what typically makes sense for the 'constitutional contract of the firm' (Sacconi 2000, see also for a previous view Vanberg 1993). According to this perspective, granted that ownership and control are allocated to a specific class of stakeholders – for example stockholders in the typical capitalist firm – CSR can be understood as the set of obligations owed to the non-controlling stakeholders that any complex structure of corporate governance would entail in order to satisfy the model of a fair 'social contract'.

To date, this has been obscured to a large part of the economic profession by the belief that efficient financial markets would be enabled to circumvent this collective choice problem by their impersonal ability to optimally select those parties that will undertake corporate control, while simultaneously setting the price at which they can buy this right and settling up with all the interests involved. In other words, the efficient financial market of ownership and control thus evades the imperfections of the real world markets and the concrete incompleteness and inefficiencies of contracts. This explains, for example, why the GHM model in fact comprises descriptions of alternative corporate governance and control structures, with associated different ways in which costly multi-party bargaining may occur *ex post*. But *ex ante*, the choice among these different alternatives is not explicitly modeled as a 'constitutive' collective decision concerning the best control structure of a voluntary association among the interested parties. This decision is left implicitly to the financial market of ownership and control. This is assumed firstly to be able to price all of the control structures by computing all the renegotiation effects due to contract incompleteness under each of them, and, secondly, to sell them to the potentially most efficient owners able to average all these costs out through proper pre-payments to the parties, who relinquish their control claims and are thus at risk of suffering authority abuse. A similar motivation seems to lie behind the statement that the 'shareholder-value' model would have said the last and final word about the evolution of corporate governance and control forms (Hansamann and Kraakman 2001).

Unexpectedly – save for those giving an unconventional interpretation to the CSR movement – the global financial crisis that began in the summer of 2007 gainsaid much of the confidence in the key assumptions of the prevailing model of corporate governance – the shareholder value doctrine: *first*, the belief that the real world financial markets are able to collect all the relevant knowledge required to fix the 'true' monetary value of any economic enterprise and firm; and *second*, the belief that in order to successfully align the principal's and the agent's interests, managerial incentives must be linked to stock prices, thereby turning the corporate manager from the old-fashioned figure of somebody else's 'fiduciary' – legally and morally required to be 'other regarding' – into that of a selfish share-value maximizer, whose interests are immediately identified with that of the company's owners. Thus, it can at least be hypothesized that a model of multi-stakeholder corporate governance, based on the idea of corporate social responsibility, could have performed better. That is it could have prevented hazardous behaviors that, claiming to maximize profits, have in effect damaged all of the firms' stakeholders, with catastrophic external effects on the world economy, without even benefitting shareholders in general.

Hence, the alternative view of corporate governance, which understands governance structures as institutions for achieving a fair balance among different stakeholders with different and complementary specific investments at stake and engaged with reciprocal cooperation and coordination problems, once again comes to the fore. Consider in this regard the cooperative bargaining game approach to the firm (Aoki 1984, see also Aoki 2010); the idea that governance structures are mediating hierarchies (Blair and Stout 1999, 2010 *infra*) in firms modeled as 'team production' (Rajan and Zingales, 2000); and the 'social contract theory of the firm' (Sacconi 1991, 2000). To be sure, these are not just rationalizations of the normative claims implicit in the CSR movement; they are also much wider and general ways to explain and interpret different forms of corporate governance empirically observed in the US – namely instances of the *business judgment* principle – and at the international level (Blair and Stout 1999; Elhauge 2005a,b; Aoki 2001). CSR can be comfortably accommodated within these perspectives.

From this point of view, different forms of corporate governance derive from various specifications of the agreement among the stakeholders – both those who own different but complementary investments and assets to be used in joint production (Aoki 2010) and those who are interested in minimizing bad external effects. Moreover, there is no reason to insist on the main objection against the multi-stakeholder corporation view traceable back to the tenet that multi-stakeholder corporate governance would leave the corporate objective function undetermined because of the multidimensionality of the objectives and, consequently, would increase the scope for managerial discretion and opportunism (Jensen, 2001). Actually, since its very beginnings (cf. Aoki, 1984), this view of the economics of the firm has shown that the objective function of a multi-stakeholder enterprise is not at all undetermined but, at least from the theoretical point of view, perfectly defined. It consists in maximizing the Nash product of the stakeholders' payoffs (net of the no-cooperation status quo) that they receive from the bargaining game played when making specific investments and participating in team production by employing interdependent assets (see also Sacconi 2006b, 2006a).

Once corporate governance is understood as an economic institution self-sustainable in a given interaction domain – i.e. once it is conceived as an equilibrium regularity of behaviors supported by mutually consistent expectations based on a mental model representation of the same ongoing equilibrium regularity (Aoki 2001) – the issues of the endogenous choice of the balancing criteria suitable for equilibrating different stakeholders' claims becomes obviously important. The question that then arises is how to identify the norm that will emerge from the process of collective choice among stakeholders as the bundle of rights and duties (or responsibilities) that they would accept. The social contract line of thought provides analytical answers to such a question. From the firm's constitutional contract perspective, stakeholders would agree on the Nash bargaining solution of the game wherein the allocation of rights over assets used to undertake joint production is at stake (which is the same as a distribution proportional to 'relative needs', see Brock 1979; Sacconi 1991, 2006a). Such solution reflects the relative urgency of the players' needs for these rights. Thereafter, in the distribution game played when productive efforts have already been carried out, they would agree to distribute the cooperative surplus according to the Shapley value for coalition games, and this distribution would reflect the relative importance of the stakeholders' contribution given to any possible formation of the productive team (Brock 1979; Sacconi 1991, 2000, 2006a). Finally, in analogy with Binmore's theory of the social contract (Binmore 2005), the constitutional choice on the governance structure of the firm (allocation of rights and of responsibilities which give access to the surplus) should satisfy the condition of an 'agreement under the veil of ignorance', as well as the condition of sustainability in a non-cooperative state of nature, namely the condition of being a Nash equilibrium. If these conditions hold, then the constitutional choice of the corporate governance structure must be compatible with the Rawlsian Maximin and the egalitarian Nash bargaining solution calculated within the symmetrical set of the equilibria that are equally possible under the symmetrical translation of the outcome space with respect to the players' (stakeholders) positions. In other words, in the presence of alternative possible allocations of ownership and control rights/responsibilities and compensation obligations, the Pareto-dominant egalitarian solution will be chosen instead of the allocation associated with the (utilitarian) maximum efficiency (see Sacconi Chapter 8, *infra*).

All of the foregoing models are convergent specifications of the multi-stakeholder objective function of the socially responsible corporation, and they are the basis for ascribing to it extended fiduciary duties owed to stakeholders. Thus, contemporary game theory helps us to specify both of these concepts in a way that should be quite natural to the modern economist.

Beyond the use of complex analytical models, however, the problem of how stakeholders' equilibration principles are agreed could (maybe should) be addressed by using experimental methodology. Such an analysis is particularly important because the convergence on principles of fair balancing – whose pursuit may be ascribed to the firm as a goal – would then be observed as emerging from (experimentally simulated) real life interactions amongst rationally bounded agents. In fact, the main objection against the multi-stakeholder governance model, whereby it would be impossible to maximize an objective function inclusive of many different objectives at the same time, owes its substance neither to a logical argument (which is obviously false), nor to an efficiency argument – for it is clear that protecting many specific investments in a balanced way rather than permitting just one of them at a time to overrule all the others, would work much better in terms of surplus creation. Its strength lies instead in the suggestion that a mono-stakeholder objective function would be a much simpler task requiring much less cognitive effort, being at the same time very simply accountable by boundedly rational managers unable to process a great deal of information and to control many different variables at the same time. Testing experimentally the convergence of many stakeholders and managers on fair balancing principles would signal that it is not beyond the cognitive capacity of managements to uncover the guiding principles for their own conduct also in the stakeholder corporation. The literature is sparse on the issue of experimental choice of equilibrating principles of fairness (see Yaari and Bar Hillel 1984). But recently some experimental studies have been conducted on agreement under the veil of ignorance over fair division principles involving strong and weak stakeholders of productive organizations (see Sacconi and Faillo 2010).

So far, we have introduced the idea of multi-stakeholder equilibration principles as the basis for endowing the company with social responsibilities – namely extended fiduciary duties owed to the non-controling stakeholders. But an additional problem is that of compliance with CSR norms or standards, and in particular the question of what exogenous or endogenous incentives may support the fulfillment of commitments and conformity with agreed CSR principles by those who control the company – owners or managers. Particularly relevant in this regard are the studies on the role and the explanation of social norms and soft law (Posner 2000; Sacconi 2000; Stout 2006; Blair et al. *infra*, 2006; Sacconi 2006). The theory of reputation has been seen traditionally as the natural candidate to answer this problem. But the limitations of reputation mechanisms (Kreps et al. 1983; Fudenberg and Levine, 1989) are also well known (Kreps, 1990) and have been considered in analyses devoted to determining the cognitive role played by explicit general ethical principles in circumventing the cognitive fragilities that characterize these mechanisms in the case of contractual incompleteness and unforeseen contingencies (Sacconi 2000, 2006, 2007; Sacconi and Moretti 2008). Moreover, there is the concrete risk that the long-run player (i.e. the firm) in a reputation game can adopt sophisticated strategies consisting in a mix of opportunistic and compliant behavior, and the adoption of these strategies will induce acquiescence by the short-run players (i.e. the stakeholders). In these cases, reputations would not only support compliance with CSR norms, but also a high level of deviation from them (see Andreozzi, Chapter 9 *infra*).

Nevertheless, the emergent model of corporate governance is supported not just by the new-institutional economics perspective and its game-theoretical formulations. It is also consistent with recent developments in behavioral economics which justify organizational forms based on motivational systems more complex than mere self-interest. To cite only a few of these results, in recent years, thanks to the use of experimental and behavioral economics methodologies, significant progress has been made in the analysis of the complexity of incentive mechanisms. Some authors have studied the relative effectiveness of explicit and implicit incentives in the presence of non-purely self-interested agents (Fehr, Gächter, Kirchsteiger, 1997; Fehr, Klein and Schmidt, 2007). Others have focused on analysis of the problems of the 'hidden cost of reward', 'motivational crowding out' and more in general on the perverse effects of monetary incentives, formal rules and exogenous sanctions when agents are intrinsically motivated (Frey, 1997; Gneezy and Rustichini, 2000; Fehr and Falk, 2002; Fehr and List, 2005). Despite the initial narrow focus of these studies on labor contracts, they can make a wider contribution to the economic analysis of organizations and their governance structures (by considering, for example, the managerial incentive problem within a new view of the principal–agent relationship) because they not only recognize the complexity of incentives, but also provide empirical proof of the relevance of reciprocity, social preferences and other complex motivations within organizations (see also Gintis and Kurama 2008).

According to the behavioral economics perspective, the self-sustainability of CSR norms can be explained by factors such as the existence of agents (stakeholders and firms) characterized by preferences that are much more complex than those traditionally assumed by game theorists, and the complexity of the networks of relations in which agents interact. With respect to the first point, the fiduciary relationship between firms (those who exercise authority in their governance) and stakeholders has been studied on the assumption that agents have conformist and reciprocity-based preferences with respect to compliance with *ex ante* impartially agreed principles of fairness (Sacconi 2007b, 2008, 2010). Thus the 'sense of justice' becomes an effective motivation in fostering compliance with CSR norms. The study of games, like the repeated trust game recast as a psychological game (Rabin 1993) under the assumption that agents (firms and stakeholders) are characterized by conformist preferences shows that equilibria of sophisticated abuse are destabilized – i.e. conformist preferences 'refine' the equilibrium set so that those conducts which would allow the firm to abuse stakeholders by inducing them to give in to sophistcated abuse are discarded from the equilibrium set of strategies. Subjects playing the stakeholder's role in the game punish the firm by not entering the relation with it even if this decision is costly in terms of sacrificing positive monetary payoffs. Such a sanctioning behavior can be explained with the stakeholders' intention of avoiding a wide deviation from conformity with CSR principles that would occur if they acquiesced to the firm's abusive conduct (again, see Sacconi 2010). With regard to the second aspect, Sacconi and Degli Antoni (2009, 2010) draw upon studies on the sustainability of long-run cooperation in networks of agents to elaborate on the relation among complex preferences, the adoption of CSR practices, and the development of social capital understood as a network of stable cooperative relations between the firm and its stakeholders.

2 An overview of the book's contents

This book includes some of the most important and original pieces of research conducted in recent years by outstanding scholars in the field of corporate governance and social reasonability in order to develop and discuss the line of inquiry outlined above. In truth, the book does not illustrate a unique point of view on the subject; rather, it reflects different views on the matters that I have outlined in the first part of this introduction.

2.1 Part I concerns the nature of the firm and its governance structure: human asset specificity, team production and the stakeholder approach. It explores different perspectives on the nature of the firm, such as transaction costs, team production and stakeholder theories. On this basis, consideration is made of the possibility of abuse of discretion by those who govern the productive organization, and hence the reason for extending responsibility to various categories of stakeholders.

In Chapter 1 the Nobel laureate Oliver Williamson states that, although the lens of contract/governance developed in the transaction costs perspective makes significant provision for organization theory, applications pose new challenges. A recurrent theme is that mutual gains will be realized by crafting governance structures that mitigate hazards, in particular by providing credible contracting safeguards for the equity investors by means of the creation of a board of directors that is awarded to the equity investors to serve as monitor. However, a comparison of this theory of the board as monitor with the board in practice – states Williamson – reveals serious disparities, one possible remedy for which is to use the contract with labor (which, like shareholders, also faces a collective action problem) as a template. But a board of directors so actively engaged in running the firm and interfering with the management – as would happen if it functioned as the 'Union of investors' – would undermine the imperatives of effective delegation to managers. In order to provide the shareholders with a monitoring capability without undue detriment to the integrity of delegation, Williamson suggests a modulated view of the board, such that it: (1) presumes that the normal relation between the leadership of the firm and the board is cooperative, yet (2) provides for periodic intervention by the board if and as the essential variables fall outside of control limits, (3) does not begrudge the information, expertise, and initiative asymmetries that the management enjoys over board members, yet (4) because these asymmetries pose foreseeable hazards, takes in advance measures to mitigate downside drift.

What is of greatest relevance to the main subject of this book is the overall picture of (second-best) effective corporate governance emerging from Williamson's chapter. On the one hand, the firm as a hierarchy is not only the tool designed to protect shareholders' investments because a degree of managerial autonomy is recognized as unavoidable. On the other hand, the role of the board as protective of equity holders is parallel to the employees' protection against opportunistic behavior exercised by those running the company in the case of a renegotiation of the labor contract that would expropriate the employees' specific investments in human assets. Such a guarantee should be provided by an institutional arrangement able to solve workers' collective action problems, such as an effective union. While this view bucks the trend at a time when unions have been losing much of their force in many capitalist economies, it also raises the question as to whether better protection could not be guaranteed by a board of directors committed to protecting not only equity holders' investments but also human asset-specific investments. Good corporate governance thus consists of a situation where different stakeholders, endowed with specific assets, are all guaranteed against different types of opportunistic behavior, while the managers are nevertheless granted limited but not renounceable discretion in running the firm.

In Chapter 2, Masahiko Aoki – the author to whom the multi-stakeholder perspective on corporate governance is most indebted within economic theory – returns to the never-ending debate on whether the corporation is the property of the stockholders, or whether the board should owe fiduciary duties to the stakeholders in general. He suggests that the current resumption of force by the stakeholder perspective is the result of two important factors that can be traced back to two concepts – *human asset essentiality* and *corporate social capital* – and he discusses their important implications for the stakeholder–society view of corporate governance. The former concept is extended to distinguish between discrete forms of organizational architecture and the corporate governance structures associated with each of them. Aoki views the firm-specificity of workers' human assets, as well as their complementarities with physical or managerial assets, as ubiquitous in modern corporations, especially in the emergent technological environment. They may not necessarily be incompatible with the stockholder-controlled corporate governance structure. The latter concept – corporate social capital – is then applied to interpret the roles of so-called corporate social responsibility (CSR) programs. Why, Aoki asks, do corporations engage in various non-economic activities to meet societal demands that are beyond their legal obligations? The chapter discusses this issue from the perspective that corporations (and their stockholders and other stakeholders) are players not only in economic games but also in the social-exchange game embedding the former. It analyzes how corporate social capital accumulated through CSR can compensate for the sacrifice of pecuniary economic assets, and how the former can nonetheless indirectly complement the accumulation of the latter.

In Chapter 3, R. Edward Freeman, Andrew Wicks and Bidhan Parmar undertake the ambitious project of showing that stakeholder theory (reinvented in its current form by Ed Freeman in the 1980s) is not only a useful way to understand capitalism, but also a theory capable of incorporating most arguments advanced by the alternative economic views of the firm, such as the arguments of Friedman, Jensen, and Williamson, often seen as opponents of stakeholder theory. Thus stakeholder theory can be conceived as the most general and encompassing view of capitalism, able to return to its very essence – that is, entrepreneurship. The proper understanding of the stakeholder approach conceives it as a theory on how business actually does and can work, answering the crucial question of 'How is value creation and trade sustainable over time?' Freeman, Wicks and Parmar view this question as also being the essential one to be asked in the realm of practical ethics. The answer, provided by the idea of 'stakeholder capitalism', is based – according to the authors – on three principles derived from the mechanics of stakeholder theory: value can be created, traded, and sustained because (i) stakeholders can jointly satisfy their needs and desires by entering into voluntary agreements which are for the most part kept; (ii) stakeholders party to agreements are willing to accept responsibility for the consequences of their actions, so that when third parties are harmed, they must be compensated, or a new agreement must be negotiated with all the parties affected; (iii) human beings are complex psychological creatures capable of acting in accordance with many different values and from many different points of view.

The view that it is the complexity of human motivations and cognition that makes voluntary cooperation in value creation among stakeholders possible, at the same time inducing them to act responsibly toward harmed third parties, is indubitably very attractive. It would also reconcile narrow shareholder maximization with the wider view of value creation for the mutual advantage of all stakeholders, which inevitably raises the issue of possibly conflicting claims over the surplus distribution. The idea is that when faced with possible tradeoffs between opposing stakeholders' interests, a stakeholder-oriented management would reframe the situation with a new entrepreneurial idea that makes it possible to see the situation again in terms of a purely cooperative endeavor (see also Freeman et al. 2010).

A comment is in order here. Emphasizing 're-framing' as a cognitive solution for apparently unanswerable social dilemmas is a major step forward with respect the traditional view of individualist economic rationality (see, for example, Bacharach's 'team thinking'; Bacharach 2006). But it should not be confused with a way of brushing the dust of conflict under the carpet. Even if the corporation is seen as a mutually advantageous and basically cooperative enterprise potentially producing benefits for all its stakeholders, nevertheless typically latent will be distributive conflicts on the distribution of what is essentially a surplus generated by joint cooperation. This is true in so far as stakeholders have contrasting claims over the surplus shares. In order to cooperate they must also solve the distributive problem by agreeing on a principle of justice that prevents the outbreak of conflict. Cooperation and conflict are simultaneously present and they cannot be dissolved by reshaping the situation as one in which the parties will not be faced by the division problem – at least this would not be allowed within the non-holistic multi-stakeholder approach that views stakeholders as legitimate separate agents. The idea of a social contract may intervene at this point by providing a mental model or a re-framing of the situation whereby the parties, even if seen as separated agents, may avoid conflict by agreeing on a governance structure that allows them to select a joint plan of action corresponding to an efficient and fair distribution. The 'veil of ignorance' reframes the situation by changing the stakeholders' view: from that of each individual group engaged in a zero-sum distributive conflict to that of symmetrically situated individuals each confronted by essentially the same decision problem. The problem of how to reach an agreement on a productive/distributive solution that would permit their joint cooperation and prevent conflict among them by giving an acceptable answer to the claim of whichever stakeholder is involved. The veil of ignorance provides such a mental framing in that it induces each stakeholder to account for whatever stakeholder point of view and to identify terms of agreement that are invariant from the perspective of each of them.

In Chapter 4, Allen Kaufman and Ernie Englander go further in the attempt to integrate concepts from law and economics concerning corporate governance, and from stakeholder theory and behavioral economics. Team production and resource-based economics furnish the theoretical foundations: the team production model resides firmly within the behavioral law and economics literature; resource-based economics belongs to the strategic management literature and arguably extends team production into useful management tools. It is here that the *homo socius* of behavioral economics comes into the picture. The new 'rational actor' supplies team production with the psychological 'raw material' with which to describe the firm as a cooperation game in which corporate directors coordinate the surplus allocations and distributions that stakeholders consider fair. Mutual gain sets the baseline 'fairness' standard within the market. Fairness, however, is conceived here in a particularly 'soft' version. The choice of allocations does not obey any intrinsic or objective, impartial standard, in so far as what matters is only the parties' subjective estimate that cooperation (Pareto efficiency) beats non-cooperation. Thus mutual-gain 'fairness' (economic efficiency) has a minimal ethical content – does no harm – but its assessment depends wholly on each group's voluntary agreement to a deal. Consequently, Kaufmann and Englander dissent from the usual stakeholder theory interpretation whereby boards can select among the primary distributive policies of mutual gain and impartiality. Product and financial market competition constrain US boards from deviating far from a Pareto/Kaldor–Hicks standard, so that they concur with economists that directors cannot choose between an impartial standard and mutual gain (reciprocity/procedural justice) – see, for example, the chapter by Viktor Vanberg (chapter 6 below). Public policy, instead, is the proper domain for remedying 'unfair' market outcomes.

In this domain, correctives may rely on direct redistribution or they may take the form of regulatory initiatives to strengthen the least advantaged party's bargaining position. But managers, even when they participate in the polity, may also continue to hold the minimalist view of procedural justice, which, in effect, corroborates market outcomes. Historically, US corporate managers have demonstrated a preference for both of these two views.

Of indubitable interest is the opening of a new perspective on how corporate managers are not only active in the corporate governance domain but also players in the more general polity realm (a point also made in Aoki's contribution). However, a question can be raised about the adequacy of a view on the management of stakeholders' cooperation that seeks to evade the problem of distributive conflict, i.e. such that no attempt is made to go beyond the mere assertion of an efficient mutually advantageous result. To be sure, the most acute supporter of the agreement-for-mutual-advantage view of ethics also clearly saw that such a contractarian theory should at the same time select one among the many possible Pareto-efficient allocations, and a unique distributive principle for the univocal solution of a bargaining game (see Gauthier 1986). The question is not relevant solely to the theoretical question of the stability of a multi-stakeholder agreement, from which a social norm of corporate governance may emerge (see the translation of the social contract methodology into the corporate governance domain entailing an application of the Rawlsian maximin, cf. Sacconi *infra*). I is also relevant to the proper description of how boards of directors perform their mediating role amongst different stakeholders' claims and interests.

This last point has been made by the two main legal theorists of the corporate board as an impartial mediating hierarchy, and who have written Chapter 5 in this book. Margaret Blair and Lynn Stout start their chapter with the observation that for most of the last three decades, corporate governance scholarship has been dominated by the powerful paradigm termed the principal–agent model, and which holds that the corporation must be understood as a nexus of private contracts, of which the most important is the contract between the shareholders of the firm (the 'principals') and the directors and executive officers (the shareholders' 'agents'). According to this contract – the model says – the directors and executives will run the firm so that the shareholders' wealth is maximized. Even though an entire generation of experts has embraced the principal–agent model, it is impossible not to observe how many aspects of corporate law are inconsistent with the paradigm's tenets, giving rise to what can be termed – to use Thomas Kuhn's phraseology – the paradigm's anomalies. Blair and Stout list the following: (1) corporate law does not grant shareholders the legal rights of principals; nor do they burden directors with the legal obligations of agents; (2) corporate law does not treat shareholders of solvent firms as sole residual claimants; (3) far from being a vacuous fiction, legal personality is a key feature of the corporate form; and (4) corporate law does not impose any obligation on directors to maximize shareholder wealth.

As in the hard sciences, however, a paradigm cannot be rejected solely because of the accumulation of anomalies. What is needed for a significant conceptual shift to occur is the emergence of a new paradigm, and this may come about quite randomly. According to Blair and Stout, in the domain of corporate law and governance such a new paradigm seems to be arising because a number of theorists have recently begun to study the different problem of how to protect and encourage 'specific' investments – specialized resources that acquire their highest value only when used in a particular process or project. In fact, when corporate production requires more than one individual or group to make specific investments, problems of intra-firm opportunism arise if shareholders try to exploit each other's specific investments or the specific investments of creditors, employees, customers, and other groups. Board governance, while worsening agency costs, may then counteract these intra-firm types of opportunism. Focusing on the problem of specific investment – Blair and Stout continue – the new perspective suggests that the proper purpose of the public corporation is not to maximize shareholder wealth but to promote long-term, value-creating economic production under conditions of complexity and uncertainty, doing so in a manner that yields surplus benefits not only to shareholders but also to other groups that make specific investments in corporations.

2.2 Part II of the book considers alternative normative foundations of CSR based on new developments in the 'social contract' and other rational choice theories – expanding on issues such as distributive justice, constitutional choice, collective rational agency and commitment, and different kinds of reputation. Some of the questions left unanswered in the first part of the book are now tackled: for example, how to balance different stakeholders' claims and how far the choice of fair equilibrating principles may go within the domain of corporate governance. What results is the discussion of CSR as a normative model of the productive organization and its governance, the purpose being to ascertain whether corporate obligations can be extended to serve different stakeholders' interests; and then discussion of the role that the 'social contract over the constitutions of the firm' can play in providing a model foundation. Also discussed are the rational choice models required to cope with the problem of endogenous sustainability of such normative models, with particular regard to the question of whether self-interest is sufficiently strong in the long run to support some kind of CSR. This typical tenet of economists is scrutinized under the heading of 'reputation effects'. The result is a recognition of both equilibrium *existence* and *selection* problems that can only be solved by taking an explicit (not simply self-interested) ethical-impartial perspective. This also entails a change in the idea of rational agency and commitment.

In Chapter 6, Victor Vanberg challenges the idea of giving CSR a contractarian foundation by re-examining the project in light of his personal and competent account of constitutional political economy. His aim is to re-establish the role and goal of corporations operating in a market economy as near as possible to that envisaged by great libertarian (but not contractarian) economists like Friedman and Hayek. In his reply to Sacconi (2006b) he assumes not only that markets are effectively places where a Smithian 'invisible hand' is at work, but also that this model is reflected by the rules of the game for market economies with which we comply under our constitutional contracts. In order to avoid confusion in applying a contractarian-constitutionalist perspective to the issue of CSR, Vanberg recommends a clear distinction to be drawn between two levels of 'social contract': on the one hand, the social contract among all members of a polity that establishes the rules of the 'economic game'; on the other, the various social contracts into which persons, in the course of playing the 'economic game', enter, or which they establish, when participating in any joint enterprise. The social contract at the societal level defines the rules according to which the economic game is to be played in a jurisdiction, and it has systematic priority over social contracts of the second kind because it defines the constraints within which the latter may be concluded. The social responsibility for a well-functioning market game – Vanberg maintains – is 'divided': the social responsibility of the member of a polity *in playing the market game* is to pursue their ambitions in a fair, rule-abiding manner. Their social responsibility *for the market game* is the responsibility that they share as members of the respective political community and that they exercise through their government.

The main conclusion that Vanberg draws for the issue of CSR is that the very point of playing the market game under the current constitutional contract is to relieve the participants from the responsibility of considering, as they play the game, all the consequences that their actions may possibly have for the 'common good', and to allow them, instead, to concentrate their attention on playing the game successfully within the constraints defined by its legal and moral rules: in other words, the maximization of profits within the legal constraints. But what about cases in which – as Vanberg concedes – there are good reasons to consider CSR-demands as 'appropriate' moral demands, i.e. as demands that point to actual conflicts between profit interests and common interests? When the 'market game' produces patterns of outcomes that the participants consider undesirable, they have reason to seek a remedy in a suitable adjustment of the rules of the game at constitutional level. The remedy – Vanberg contends – cannot be found in calling upon the players to sacrifice their own ambitions to play the game successfully in order to compensate for deficiencies in its rules. The only viable option is to exercise political responsibility at the polity level where the rules are established. In fact – Vanberg says – serious problems of