

# Politicized Corporations and Legitimacy Gaps: Challenges for Corporate Governance

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# Definitions of Corporate Governance

narrow view: ‘Corporate Governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.’  
(Shleifer and Vishny, 1997)

broad view: ‘Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, of corporations, and of society.’  
(Cadbury, 2003)

narrow view is dominant in CG practice as well as in a major part of theory

# Corporate Governance: Assumptions & Justifications

- Assumptions:**
- effective regulatory framework in place for the enforcement of contracts
  - well-defined division of labor
  - shareholders as owners of the corporation
  - principle-agent-constellation:
    - shareholders as residual claimants, all stakeholders (except shareholders) are subject to contracts and hence protected by the state by means of law
  - maximization of corporate revenue maximizes societal welfare
  - single-valued objective function (firm value) necessary for purposeful behavior

# Consequences of Globalization for CG

## **(1) limited legal enforcement mechanisms**

- limited application of the law
- insufficient enforcement of contracts

## **(2) negative externalities**

- societal costs due to increasingly unbuffered impact of corporate action (e.g. in the area of human rights)
- limited legal prevention of externalities
- no internalization of externalities by means of property-rights (see 1)

## **(3) public goods:** firms increasingly:

- provide infrastructure
- administer rights
- participate in global governance

# The Individualization of Risk

- aim of regulation: minimizing and mitigating risk resulting from corporate action, minimizing and socializing potential cost
  - insufficient regulation → risks increasingly affect individuals unbuffered
- basic assumption of dominant corporate governance (insufficient protection of shareowners) does not hold any more
- negative impact of corporate action on individuals threatens the legitimacy of firms as well as of the system of market economy as a whole

# Legitimacy

**legitimacy:** „*Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions*“ (Suchman, 1995)

**(1) pragmatic legitimacy**

**(2) cognitive legitimacy**

**(3) moral legitimacy**

## **Globalization/PC:**

constitution of (1) & (2) increasingly difficult

→ deliberation as a means to constitute moral legitimacy  
(Palazzo & Scherer, 2006; Scherer & Palazzo 2011)

# Stakeholder Democracy as Means to Restore Legitimacy

## The normative reason

Government/law is not legitimate without consent of the governed

Firms increasingly exercise state-like power/assume legislative tasks  
(with CG as the rule-making level)

→ No legitimacy of ‘legislation’ without democratization of CG

## Technical reasons

- 1) identification and localization of responsibility by the shareholders as well as by the general public
- 2) implementation of politically relevant decisions takes part on the highest decision-level
- 3) diffusion of responsibility on lower hierarchical levels  
→ need of a guarantee of democratically legitimated decision making