Closing the Legitimacy Gap in Corporate Governance: Governing the Multinational Corporation by Means of Democratic Decision Making

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Abstract

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CLOSING THE LEGITIMACY GAP IN CORPORATE GOVERNANCE: 
GOVERNING THE MULTINATIONAL CORPORATION 
BY MEANS OF DEMOCRATIC DECISION MAKING 

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ABSTRACT
Beyond national peculiarities, corporate governance practice is mainly centered on the protection of investors’ rights. However, this view neglects the fundamental changes of the operating conditions of business due to globalization and the weakening of regulatory frameworks. Weak or absent enforcement of contracts, increasingly unfettered negative externalities of corporate action, and involvement of private actors in the provision of public goods change the role of business in a fundamental way, rendering it a political actor in part. Resulting in the extension of corporate power these developments challenge the very assumptions of dominant corporate governance theory. Recurring misuse of this power poses a threat to organizational legitimacy as well as to the legitimacy of the system of market economy. Drawing on suggestions to restore organizational legitimacy by means of discursive processes, I argue that corporate governance needs to become open to such processes to contribute to the safeguarding of organizational legitimacy and therewith the legitimacy of the system of market economy in a globalized world. Based on these considerations, basic requirements as well as limits for an according modification of current corporate governance practice will be introduced.

INTRODUCTION
Globalization fundamentally changes the operating conditions of firms in general and of multinational corporations in particular. Worldwide trade and foreign direct investment increase, the influence of transnational corporations is growing, the movement of capital is accelerating, and financial markets are gaining momentum. As a result of these changes the capacity of national states to fulfill tasks that were ascribed to the state in the historical constellation of territorially constituted economies declined and still is declining. Despite the lingering formal monopoly of
coercion, the effectiveness of national politics can be doubted in cases where problems transcend national borders and become global (Scherer and Palazzo, 2008).

With this decrease of national steering capacity, the freedom of action of multinational corporations expanded decisively (Strange, 2000). Whereas political action still is mostly restricted to the territory of the respective country, the latitude of multinational corporations is in many cases boundless (Perraton et al., 2000). The increasing importance and power of such enterprises on the one hand and the weakening of the power of states to provide for legal security and guarantee enforcement of contracts on the other hand result in regulation gaps (Beck, 2000; Giddens, 1991). In this ‘post-national constellation’ political control is increasingly being replaced by economic steering mechanisms – money substitutes power (Habermas, 2001). The more societal coordination is transferred to the price mechanism, the less society is capable of democratic self-control (Habermas, 2001). Examples for this shift of power between nation-states and corporations are the decrease of taxes on corporate revenues (Hertz, 2001), the incapacity to pursue corporate misconduct, be it by national or by international law (Weissbrodt and Kruger, 2003) and the power of rating agencies decisively influencing the fortune of whole countries and their inhabitants (Sinclair, 2005).

Furthermore, in the course of these developments corporations increasingly engage in activities that were traditionally seen as the domain of national states. Ranging from social activities (Teubner, 2000a), the provision of infrastructure and education, the administration of civic rights (Matten and Crane, 2005a) to involvement in rulemaking on the global scale (Scherer et al., 2006), and to the generation of new law (Teubner, 2000b), corporations take on a political role besides their generic economic role. In such ways, corporations contribute to the efficient solution of societal problems and thus take part in the peaceful integration of society on the one hand. On the other hand, societal peace is threatened by these very actors. Examples are political lobbying benefitting corporations at the expense of individual citizens (Barley, 2007), the direct violation of human rights by corporations (Kobrin, 2009) (e.g. the use of forced labor by Unocal in Myanmar) (Kinley and Tadaki, 2004) as well as the complicity of corporations with undemocratic and violent regimes (e.g. in the era of apartheid in southern Africa) (Muchlinski, 2001), often directly flowing
from the devotion to the objectives of growth and profit maximization (Kinley and Nolan, 2008).

These developments show that the division of labor and power between the economic and the political actors emerged over the last centuries gets increasingly challenged. With the soaring power and latitude of firms, their actions affect an increasingly wider range of individuals such as workers in complex global supply chains or persons affected by pollution, whereas the firms are not accountable to these individuals, and this results in declining acceptance and rising critique of corporate action. In cases where the impacts of a firm’s action are perceived as unjust, the legitimacy, i.e. the confirmation with social norms, values and expectations, of this specific firm (Palazzo and Scherer, 2006) as well as of the system of market economy as a whole (Pies et al., 2009), which is in part reproduced by corporate action, is threatened. Since legitimacy is a vital condition for a firm (Meyer and Rowan, 1977; Pfeffer and Salancik, 1978) such cases potentially jeopardize the survival of the firm (Kostova and Zaheer, 1999). Thus, the demands for firms rise to secure their survival not only in economic terms, but also with respect to societal acceptance and legitimacy.

In the pre-globalization era of efficient national steering mechanisms, legitimacy was no direct problem for business. Firstly, legitimacy of economic actors as well as of the economic system was provided by regulatory agencies, generating a link to governmental legitimacy by protecting shareholders and consumers (Hillman et al., 2000) as well as other stakeholders. Secondly, the invisible hand – postulated in classical economics as well as assumed in neoclassical economics – has worked sufficiently to maximize societal welfare through the maximization of individual (and thus also corporate) utility, legitimizing firms due to their contribution to the common good (Jensen, 2002; O’Sullivan, 2000). From this perspective economic efficiency and legitimacy converged. By safeguarding efficiency legitimacy got safeguarded as well (Hasse, 2005; Steinmann and Löhr, 1992), and therefore business could mainly concentrate on the maintenance of economic efficiency. Nowadays, one necessary condition for this convergence – a functioning regulatory framework – is not satisfied any more in many instances. This is either due to the cross-border operations of multinational enterprises resulting in the incapacity of nation states to control these operations (Scherer and Smid, 2000) or due to the operation in states with insufficient
or absent legal protection mechanisms, exemplified by the engagement of Unocal Corp. in Burma and connected violations of human rights (Richardson, 1997). Securing economic efficiency does not assure legitimacy in every case and regulatory agencies increasingly fail to protect stakeholders that are negatively affected by corporate action, furthering the legitimacy deficit. Therefore firms increasingly need to engage in the self-supply of legitimacy (Pies et al., 2009), actively seeing about its maintenance or reestablishment.

Corporate governance conceived of as a mechanism that aims at guaranteeing the efficiency of corporations is challenged by this new situation in particular. Mainly referring to agency theory, in the dominant conception corporate governance is described as a set of mechanisms and rules designated to secure the efficient deployment of investments in firms (Shleifer & Vishny, 1999), accommodating the specific role of shareholders bearing risk not completely covered by means of contracts (Collier and Roberts, 2001; Judge 2009). In turn, it is assumed that all other stakeholders ‘(…) such as employees, suppliers, bondholders, communities, and customers are protected by contractual law and regulation’ (Sundaram & Inkpen, 2004, p. 355). Practice of corporate governance as well as the majority of theoretical approaches (Judge, 2009) refer to this conception of corporate governance. The erosion of the traditional division of labor between private actors and the state has a twofold impact on corporate governance: Firstly, the assumptions of traditional corporate governance become increasingly challenged. Contracts are not enforceable in every case, externalities matter more in absence of state regulation and new responsibilities are being assigned to corporations in the global marketplace by an increasingly active civil society. Secondly, corporate action reaches further and affects more diverse stakeholders than in the context of congruence between national state and economy. In addition, states’ capacity to protect stakeholders affected by corporate action is limited in many cases, potentially undermining corporate legitimacy and thus viability, as described above. Besides the narrow, shareholder-centered perspective, there is a broader conception of corporate governance which is not only concerned with safeguarding the supply of new capital, but

(…) 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).

Following this approach, corporate governance is of central importance for rendering firms accountable to a wider range of stakeholders and making them capable of meeting the requirements of rapidly changing societal conditions and of a changed distribution of power between economic and political actors.

The first aim of this paper is to show that the dominant conception of corporate governance does not adequately consider the changed economic and political conditions firms are increasingly confronted with. The second aim is to propose basic modifications to enable corporate governance to fulfill the function suggested in the broader conception. Following this introduction, the explicit as well as implicit assumptions of the dominant conception of corporate governance will be delineated and their appropriateness to the currently shifting division of power and labor between the economic and the political system will be explored. It will be shown, that these changes severely affect the rationale of dominant corporate governance and, furthermore, pose a threat to the legitimacy of single firms as well as for the system of market economy as a whole. In the third section, I will detail alternative approaches to corporate governance – team production theory, stewardship theory and stakeholder democracy – regarding their potential to address the problems resulting from increasing corporate power, decreasing steering capacity of nation states and the lack of functional equivalents on the international level. Based on these findings, in the fourth part requirements for the modification of corporate governance will be delineated. In the fifth section, as a possible conceptual foundation for rendering corporate governance capable of meeting these requirements, suggestions to apply the approach of deliberative democracy to corporations (Palazzo and Scherer, 2006; Scherer and Palazzo, 2007) will be discussed. The concept of democratic corporate governance will introduced as one way to constitute the legitimacy of both corporations and the system of market economy as a whole under the new conditions of the post-national constellation. Finally, following a short conclusion will conclude this paper.
The Foundations of Current Corporate Governance Theory and Practice

Current corporate governance theory and practice is based on an entangled set of assumptions and arguments. In this section these foundational assumptions dominating corporate governance theory and practice will be characterized. The validity of these assumptions will be analyzed in the light of the fundamental changes of globalization. In particular, I will examine changes in the enforceability of contracts, the decreasing feasibility of limiting negative externalities and the increasing importance of private actors in the provision of public goods. Based on this analysis, a shift of risk from the society and the firms towards individuals will be identified as a threat for the legitimacy of corporations as well as of the system of market economy as a whole.

The concept of corporate governance in the form as it is prevalent nowadays can be traced back to a change of the relation between ownership and control of businesses, first described by Berle and Means (1932). By subdividing the concept of firm-ownership into several functions, Berle and Means highlighted problems arising from this changing relation. Their analysis was based on the observation of an increasing spread of shareholding. According to their study, an increase in the number of shareholders of corporations diminished the capacity of individual shareholders to participate in the steering of corporations. Professional managers gained influence and the owners lost the capacity to monitor the behavior of the managers. Assuming utility-maximizing behavior of the managers, shareowners ran the risk of managers shirking or utilizing the money supplied to the company to maximize their own utility instead of maximizing corporate value. This situation could eventually lead to undersupply of capital. Therefore a mechanism preventing the managers from missing profits of the owners of capital by bad decisions or waste them became necessary to secure a constant supply of new capital (Shleifer and Vishny, 1997). Thus, from this perspective corporate governance can be described as a mechanism protecting the shareholders as owners of a firm.

In the course of the development of the theory of the firm, the conception of corporations changed: initially seen as an entity, corporations were redefined as a nexus of contracts (Coase, 1937). Therewith the definition of shareholders as owners
of a fraction of corporate assets was replaced by the definition of shareholders as having particular contractual claims towards a corporation. Accordingly, the distinctiveness of shareholders got justified by the fact that shareholders hold unspecified claims towards the management of a firm. While stakeholders of a corporation, such as employees, debtors, and suppliers have well defined claims towards a firm, the shareholders need to rely on the management to maximize their return by maximizing the firm value. This argument, describing shareowners as residual claimants, is the basis for further justifications of corporate governance due to efficiency reasons. In contractarian logic, the maximization of the residual claims of the shareowners maximizes the overall productivity and value of the firm (Alchian and Demsetz, 1972). This in turn is seen as the optimal contribution to social welfare. The justification for this lies in the assumption that the output of firms is higher than the input. And since each unit surplus (=profit) adds to social welfare, this is maximized by the maximization of profits (Jensen, 2002).

The relation of owners and managers in the constellation of publicly traded corporations got formalized by principle-agent theory (Jensen and Meckling, 1976), highlighting the situation of asymmetric information between shareowners (=principals) and managers (=agents) and determining the optimal relation of cost necessary to prevent managers from shirking and thus to determine them to maximize firm value and simultaneously the value of shares. By means of this precise formulation, shareholder primacy got strengthened in a technical sense: since expression and optimization of relations more complex than the dyadic shareholder-manager-relationship are mathematically challenging and ambiguous, alternative constellations got out of the focus of corporate governance theorists.

Closely interrelated with the efficiency allegedly resulting from the maximization of share value is a further argument pertaining to the management of corporations. Accordingly, corporate governance focussing on shareholder primacy is justified in the following way: To render a corporation manageable, it is necessary to reduce environmental complexity to a degree manageable within a single-valued objective function – shareholder value. And furthermore, thereby managerial performance can be assessed by shareholders and the market for securities by means of a single value (Jensen, 2002). The assumption central to this justification of corporate governance is the view that market-based allocation is most efficient in serving the public good if
extra-economic interferences are minimized (Hayek, 2001; Friedman, 1962; Sundaram and Inkpen 2004). Accordingly, the mechanism of corporate governance remedies the problems resulting from the separation of ownership and control in the most efficient manner by means of market-logics. The market for securities assesses corporate performance by means of the share price. Since market-based allocation is seen as the most efficient way to coordinate the allocation of resources, any interference with this principle is regarded as a potential threat to efficiency and societal welfare.

Consequently, the supposed distinctiveness of shareholders in relation to a firm can be seen as deeply rooted in an interrelated complex of arguments. This complex is composed of the conception of shareholders as owners of a firm, the contractarian conception of the firm, which is the prevailing view today – not only in economics and management science, but also in law (Blair, 2005)–, the conception of shareholders as residual claimants formalized by principal agent theory, and the resulting considerations of efficiency both on corporate and on societal level. Being mutually enforcing in part, these assumptions and justifications are seldom doubted and constitute the basics of a major part of current dominant corporate governance practice.

**Globalization and Corporate Governance**

Globalization has changed the operating conditions of business in a significant way. These changes are reflected in the business literature to some extent. In particular, the different consequences for corporate governance are discussed: blurring organizational boundaries and increasing importance of knowledge work (Blair, 1995; Bradley et al., 1999; Zingales, 2000), the gaining relevance of implicit contracts and the ongoing replacement of transactions by relations (Boatright, 2009). Common to these analyses is the purely economic perspective.

However, as argued above, besides grave economic implications, globalization not only changes the operating conditions of corporations but also gives rise to a change of the role of the firm. Hence confining the analysis of the implications of these processes for business in general and for corporate governance in particular to purely economic issues necessarily overlooks further reaching consequences, which, in turn, might become highly relevant for the firms themselves.
In a part of the corporate governance literature, the extension of the scope of corporate action beyond purely economic issues is covered. Whereas the relation of corporate governance and corporate social responsibility (CSR) is reflected (Bhimani and Soonawalla, 2005; Jamali et al., 2008), the assumptions underlying traditional corporate governance are barely questioned. Furthermore, beyond the reference to a potential incompatibility of the economic role of the firm and CSR, the rising incapacity of states to sufficiently regulate corporate action is not accounted for (Frynas, 2008) and the firms’ adoption of tasks originally fulfilled by the state is treated uncritically, ignoring the legitimacy problems potentially resulting from such a redistribution of tasks and power.

In the following, the implications of the rapid shift of the division of labor between the economic and the political system for corporate governance will be discussed in detail.

The question arising from the concentration of corporate governance on economic efficiency is whether the principal-agent constellation resulting from the divergence of firm-ownership and control is the only problem threatening the efficiency and thus also the legitimacy of the economic system.

The debate about the purpose of corporations – generating value for shareowners or directly serving the public interest can be traced back to the second decade of the 20th century (Clark, 1916; for an overview see Lichner, 2009). Strongly tied to this topic is the debate about the function of corporate governance dating at least back to a debate between professors Berle and Dodd in the early 1930s (Weiner, 1964). Until today, this debate lives on in the conflicting views of shareholder primacy (Jensen, 2002; Sundaram and Inkpen, 2004) and the stakeholder view (Freeman, 1984) of the firm. Both these positions exist with different facets, stressing different aspects of the relations of corporations and their different stakeholders (including shareowners) and attaching different weight to the respective interests. However, common to the greatest part of these conceptions is the role ascribed to the nation-state: providing a proper regulatory framework.

In the following, three major problems arising from the diminishing steering capacity of states and the changing division of labor between economic and political system will be described: the limited capacity of many states to enforce contracts and provide
for a functioning regulatory framework in every instance; the increasing relevance of negative externalities resulting from the weakening of states; the legitimacy problems arising from the provision of public goods by corporations. Subsequently the core common to these problems will be formulated in terms of a changing allocation of risk away from the state and the society as a whole and towards the individuals.

*Enforcement of contracts*

One of the basic assumptions of the contractarian view of the firm in general and of the theory of corporate governance in particular is the enforceability of contracts. As described above, shareholder primacy implied by the contractarian conception of the firm is justified by the alleged comprehensive protection of a firms stakeholders (except shareowners) through contracts and the legal system (Bradley et al., 1999; Sundaram and Inkpen, 2004), emphasizing the important role the “(...) legal system and the law play in social organizations, especially, the organization of economic activity (...)” and the availability of “(...) police powers of the state (...) used to enforce performance of contracts or to enforce the collection of damages for non-performance” (Jensen and Meckling, 1976).

With states becoming weaker and corporations operating out of the reach of legal enforcement mechanisms, be it in weak states or in undemocratic ones, the option of the legal enforceability of contracts becomes curtailed. Scarcely realizing this fundamental shift, suggestions to respond to this threat to the contractarian view still operate in a pre-globalization logic, postulating some ‘worldwide contracting infrastructure’ on the one hand and suggesting enforcement of contracts by firms themselves on the other hand (Bradley et al., 1999), disregarding potential corporate wrongdoing and severe legitimacy-problems resulting from private corporations taking over state-functions without democratic legitimization.

*Negative Externalities*

A further aspect of the increasingly limited capacity of states to enforce laws relates to externalities. While in the constellation of national economies negative externalities could be limited by laws, this option becomes increasingly unviable. Admitting that the maximization of shareholder value does not maximize social welfare when externalities exist, Jensen (2002, p. 246) explicitely relies on ‘(...) the government in ist
rule-setting function (...)’ to create the conditions necessary to resolve externality problems. However, where no enforcing mechanisms exist (see above), ban or prevention of negative externalities by means of taxation (Pigou, 1932) as well as solutions proposing the internalization of externalities by the allocation of property rights (classical: Coase, 1960; Williamson, 1984) are only viable to a limited degree, since contractual obligations between stakeholders and firms cannot be enforced.

Besides the problem of negative externalities in general, the problem of externalities originating from the properties of traditional corporate governance, i.e. the concentration on shareholder value and its ‘distasteful implications’ (Tirole, 2002), is in particular becoming increasingly urgent in the light of the decreasing steering capacity of states.

Public Goods

Strongly interrelated with these developments is the increasing power of business in general and of multinational enterprises in particular. In opposition to the widespread fear that the power of the state might become too strong and thus hamper the efficiency of markets (Hayek, 2001), nowadays a multitude of tasks assigned to the state in liberal models is fulfilled by business. Corporations engage in the provision of public goods, reaching from schooling and infrastructure and to the administration of rights (Matten and Crane, 2005a) and to engagement in the formulation of international standards (Scherer et al., 2006). This indicates that corporations exert significant power (Coglianese, 2007) without being legitimized and accountable in a democratic manner.

The Individualization of Risk

In traditional corporate governance the exceptional role of shareowners is justified by the risk they bear through investing in corporations (Jensen and Meckling, 1976; Fama and Jensen, 1983). While all stakeholders of a firm are involved in contracts with this firm, only the residual claims of shareowners cannot be sufficiently protected by means of contracts. According to this view an agency problem occurs, rendering the shareowners (principals) vulnerable to the moral hazard of the managers acting as the agents of the shareowners. Therefore additional mechanisms, e.g. corporate governance, are regarded as necessary to protect these claims. Insofar,
corporate governance can be described as a mechanism to protect shareholders from risks, which cannot be made subject to explicit contracts. However, in the light of the shrinking power of states shareholders are not the only group being exposed to risk caused by a corporation.

As described above, firstly the enforceability of contracts is not guaranteed any more in many instances. Therefore the existence of claims vis-à-vis a corporation resulting from any kind of contract must not be seen as a guarantee for the fulfillment of these claims. In this rising disequilibrium of power, claimants often are exposed to the goodwill of corporate actors.

Secondly, different groups of stakeholders are increasingly exposed to risks resulting from externalities generated by corporations, bare of any legal protection.

Thirdly, corporations increasingly engage in the provision of public goods and thereby assume a state-like role. According to Crane and Matten (2008), in some cases corporations should be treated more like states than like private actors. In this situation of democratic deficit individuals thus become exposed to corporate power and need to rely on corporate benevolence.

Summing up, these developments can be interpreted as evidence for a shifting distribution of risk. In functioning democratic states, the compliance with contractual arrangements ideally gets secured by law, the cost of negative externalities are borne by the society as a whole and the provision of public goods is exercised by democratically controlled actors. Due to its democratic legitimization, this power exerted by states is regarded as legitimate by individuals. Thus the state acts as a mechanism minimizing and mitigating risk as well as socializing potential costs for the single citizen. Under conditions of insufficient regulation, many risks that were traditionally attended to by regulatory frameworks and therefore mitigated are becoming virulent for individuals. In other words: the risk gets individualized (Beck, 1992). Traditionally states are seen as responsible for enforcement of legal claims towards corporations, for the protection of citizens by means of laws, for arbitration in conflicts between citizens and corporations and for the provision of public goods. Nowadays, in cases of perceived injustice and harm resulting from corporate action, corporations are addressed directly by affected groups or activists (Spar and La Mure, 2003; Zadek, 2004) and thus their legitimacy gets questioned.
Losing Hold: Corporate Governance and Legitimacy

With the changes described above, legitimacy of corporations, afore taken for granted, is becoming a central concern in need of active management. Legitimacy, as defined by Suchman (1995, p. 574), “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”.

Following the concept of legitimacy proposed by Suchman, legitimacy can be regarded as socially constructed. In the process of social construction (Berger and Luckmann, 1967) legitimacy is ascribed to an entity due to the congruence between the behaviors of this entity and the beliefs of the social group granting legitimacy. As described above, the erosion of national steering capacity and the accompanying increase of corporate power result in the problems of lacking enforceability of contracts, externalities, public goods. Being involved in these problems and often regarded as their causes, the capacity of corporations to gain legitimacy for the most part by generating value – the the mode viable in the pre-globalization era – is diminishing (Palazzo and Scherer, 2006). While under conditions of intact regulatory frameworks and in relatively homogenous environments corporate legitimacy resulted from the economic value generated by corporations (i.e. pragmatic legitimacy) and the taken-for-grantedness of corporations (cognitive legitimacy), these sources of legitimacy are becoming less reliable. Therefore the legitimacy of corporations as organizations and as representatives of the predominant economic order – market economy – is increasingly challenged in several respects and a third type of legitimacy (moral legitimacy) is becoming increasingly relevant (Palazzo & Scherer, 2006). This type of legitimacy rests on the judgment about whether the evaluated activity is “the right thing to do” (Suchman, 1995).

The legitimacy of a firm can be regarded as a consequence of its productivity, competitiveness and viability (Monks and Minow, 1995), which are the concern of the interplay of shareholders, managers and directors in traditional corporate governance. Following the assumption that corporate governance secures market efficiency and therefore maximizes social wealth (O’Sullivan, 2000), it can be described as contributing to the legitimacy of the single firm as well as to the legitimacy of the system of market economy by improving the efficiency both on
company and market level. Insofar, besides the function to guarantee sufficient supply of money for a corporation on the micro-level, corporate governance contributes to the efficiency of the market economy and therefore to its legitimacy.

Legitimacy on the Firm Level: the traditional view

Seen from an institutionalist perspective, legitimacy can be regarded as a necessary condition for organizational survival (Meyer and Rowan, 1977; DiMaggio and Powell, 1983), positively affecting the availability of resources necessary for organizational survival (Pfeffer and Salancik, 1978; Deephouse and Suchman, 2008). In a narrow view, corporate governance can be regarded as one mechanism legitimizing a corporation through the appointment of a corporate board (Hillman and Dalziel, 2003).

In a broader view, corporate governance can be conceived of as a mechanism of risk-reduction or as a mechanism of guarantee, as described by Gomez and Korine (2008). By means of proper corporate governance, a corporation signals sound risk-control towards potential shareholders, thus enhancing their trust in the corporation and minimizing potential transaction costs resulting from the collection of information about eventual risks.

In the light of the rising complexity of organizational environments due to processes of globalization, the management of legitimacy is becoming more and more difficult. Firstly, corporations are often confronted with allegations concerning violations of human rights and labor standards, pollution and other problematic issues (Palazzo and Scherer, 2006) raised by an increasingly sensitized civil society (Doh and Teegen, 2001). Secondly, global activity in heterogeneous environments still advances the problem of corporate legitimacy since corporations on the one hand have to adapt to local conditions (Kostova and Zaheer, 1999) and on the other hand need to keep their identity as an organization. Therefore traditional corporate governance, being adapted to the conditions of the pre-globalization era, is becoming less effective in contributing to organizational legitimacy.

Legitimacy on the Systems Level

Besides the necessity of organizational legitimacy for the survival of an individual firm, legitimacy can be defined as a necessary condition for the sustained stability of
the economic system of market economy as a whole. Assuming that the system of market economy derives its legitimacy from its efficiency in resource allocation (Steinmann and Löhr, 1992), inefficiency on the firm level indirectly threatens the legitimacy of the economic system. Corporate governance as a mechanism to secure firm-level efficiency thus can be regarded as indirectly contributing to the legitimacy of the economic system. This is in line with shareholder primacy view and a contractarian conception of corporate governance emphasizing the special need for protection of shareholders and at the same time the thorough protection of all other stakeholders by enforceable contracts and state regulation (Sundaram and Inkpen, 2004).

As soon as it is conceded that the maximization of share value is not equivalent to maximizing the total social value created by a firm (Blair, 2003), the justification of the privileged relation of shareholders and corporations (e.g. Sundaram and Inkpen, 2004) becomes questionable. As emphasized by the notion of the market as a fragile system, the societal function of the market – contribution to the public good – can be disrupted by the actions of its actors (Dubbink, 2004). Furthermore, it can be argued, that sustained dysfunctions of the market mechanism undermine the conditions for its very existence.

Since the assumptions underlying traditional corporate governance are not valid any more in every case, as shown above, the capacity of corporate governance to contribute to the securing of legitimacy both on firm and on systems level gets increasingly impaired. Corporate legitimacy can be regarded as constituted firstly by corporations themselves, inter alia by corporate governance. Corporate governance can be conceived of as one means to contribute to corporate legitimacy by securing procedural fairness. Fair procedures ‘(…) ensure a fair distribution of outcomes over the long term’ (Gomez and Korine, 2005, p. 741), which is a precondition for the legitimacy of a corporation. Secondly, corporate legitimacy gets constituted by corporate regulation enforced within a regulatory framework (Hillman et al. 2000). The former type of legitimacy, which is safeguarded by fairness of organizational decision processes, can be described as procedural legitimacy. The latter type of legitimacy, which emanates from corporate regulation, can be defined as substantive legitimacy (Coglianese, 2007). In cases in which states are incapable of providing a reliable regulatory framework, substantive legitimacy is weak. Thus, in absence of
substantive legitimacy provided for by a state maintaining the legitimacy of individual firms and of the economic system, requirements for procedural legitimacy and therewith for corporate governance are rising considerably. With weakening law and order, the legitimacy of corporate governance is in decline (Judge et al., 2008). This can be interpreted as a lack of adaptation of corporate governance to the changed conditions described above: while economic efficiency is still safeguarded, corporate governance does not contribute to the attainment of societal welfare any more, and thus legitimacy is threatened. In other words: with changing economic and political conditions, corporate governance is becoming dysfunctional in part. The challenge therefore lies in modifying corporate governance according to these changing conditions.

Basically, this means that the advantages of traditional corporate governance must not be sacrificed while its dysfunctions need to be repaired. The question is how to direct economic efficiency and societal welfare back to convergence?

**IN SEARCH OF NEW PRINCIPLES**

Contesting conceptions of the purpose and objectives of a corporation and therefore of the adequate focus of corporate governance are discussed at least since the second decade of the last century (see above). Moral arguments (Freeman et al., 2004) as well as the reconsideration of theoretical foundations of traditional corporate governance (Blair 2003; Davis et al., 1997) triggered the development of alternative approaches to corporate governance. Each of these alternative approaches can be interpreted as an attempt to remedy specific deficiencies of traditional corporate governance. With the aim to find corporate governance mechanisms able to cope with the challenges resulting from the postnational constellation, in the following, the most influential of these approaches will be analyzed. In particular, their reliance on the legal enforcement of contracts, their potential to limit negative externalities and their capacity to respond to legitimacy gaps resulting from corporate provision of public goods will be explored.

*Team Production Theory*

One attempt to modify corporate governance is team production theory (Blair, 1995; Blair and Stout, 1999). As described above, traditional corporate governance is conceptualized for overcoming the principal-agent problem which is seen as
essentially threatening the efficiency of a corporation defined as a nexus of contracts. Team production theory is based on the definition of organizations as teams (Alchian & Demsetz, 1972), in which team members jointly contribute input to generate output. However, diverging from the conclusions of this initial concept, in team production theory the board’s task is not the protection of a single principal (the shareholder) from the potentially shirking group disposing over the input (the managers). The core argument of team production theory is based on the increasing importance of implicit contracts and the resulting shift of risk towards stakeholders, particularly the employees. These become risk-bearers by (in part irrevocably) investing firm-specific skills in a team production effort – the firm – and thus contributing to value creation. While the risk of shareholders is limited by the amount of money invested, in case of layoff employees can ‘reinvest’ their skills elsewhere only to limited extent due to firm-specificity. Therefore, the adequate focus of corporate governance is seen rather on the mediation of ‘…disputes among team members about the allocation of duties and rewards’ (Blair and Stout, 1999). Aim of this is the motivation of team members to actually contribute to the process of value creation as well as the increase of information available for decision-making on board-level (Osterloh & Frey, 2006).

The credit of this approach to corporate governance lies in taking into account the changing risk-constellation in corporations, dethroning the shareholder as the residual risk-taker and the sole party in need of additional, extra-legal protection. Thus an exclusive reliance on contracts, prevalent in traditional corporate governance, is no condition for the functioning of team production theory. However, regarding the increasing importance of negative externalities, team production theory is constrained by the definition of organizations as teams and the resulting focus on team members. Team members join a team and invest in a project voluntarily, expecting some kind of reward for their investment. From this follows necessarily, that individuals and groups affected by corporate action without making some kind of investment and thereby voluntarily joining a bilateral relation can not be regarded as team members. According to team production theory, risk imposed on them by a corporation thus can not be considered within corporate governance and thus avoidance of negative externalities is limited to the members of the team. Moreover, and connected with the exclusive focus on team members, team production theory does not take into account
the legitimacy gaps resulting from the provision of public goods by private actors. Accordingly, team production theory is capable to respond to the challenges posed by the shifting division of labor between firms and the state only to a limited degree, since only the focus of stakeholder-protection is widened, not taking into account the necessity of increased external control.

Stewardship Theory

In line with the theory of team production, stewardship theory represents a further theoretical critique of the principal-agent theory. Whereas team production theory is based mainly on a critique of the dysfunctionalities of shareholder primacy (Blair, 2003), stewardship theory is based on a critique of the assumptions constitutive for shareholder primacy. The behavioral premise of agency theory is the homo oeconomicus depicting humans as rational utility maximizers, who act opportunistically to maximize individual utility (Jensen & Meckling, 1976). Based on psychological and sociological considerations, this view is shown to disregard the complexities of organizational life and to assume a rather simplistic view on human behavior. Instead, humans and therewith managers are considered intrinsically motivated, responsible and seen as ‘…collective self-actualizers who achieve utility through organizational achievement’ (Davis et al., 1997). If managers are seen as potentially detrimental for a firms goals and not as stewards of organizational interests – and hence as stewards of holders of a firm’s shares – organizational arrangements to overcome the lacking trustworthiness of the managers always impede corporate performance. This assumption can be justified by the potential counterproductivity resulting from control and mistrust (McGregor, 1960) as well as by the information-biasing effects of control as a behavioural strategy (Argyris, 1976). Governance structures aiming at preventing managerial misconduct resulting from an inadequate model of man, which assumes self-serving behaviour of managers, therefore run the risk of working like a self-fulfilling prophecy, creating the evil they are destined to prevent. According to stuardship-theory, if instead both managers and principles (shareowners) behave in a steward-like way, the potential performance of a firm is maximized.

Following from these alternative behavioral assumptions, practical implications of principal agent theory for corporate governance are challenged and alternative ways of steering corporations are recommended. Accordingly, division of the roles of board
members and CEO – the essence of agency-theory oriented dominant corporate governance and seen therein as the mechanism to prevent managerial shirking – does inhibit the effective management of a corporation due to insufficient latitude and lacking facilitation of effective action. Instead, identity of these roles is seen to ‘…provide benefits of unity of direction and of strong command and control…’ to an organization (Donaldson and Davis, 1991).

One credit of stewardship-theory lies in the emphasis on integrity of managerial decision-making. Especially in ethical dilemma-situations, flexibility of decision-making has major advantages in comparison to compliance-based action (Paine, 1994). From the perspective of motivation and efficiency, assuming the integrity of managers seems to be a more prolific approach than expecting misconduct ab initio. However, stewardship theory is not able to compensate for the deficit of substantive legitimacy resulting from the potentially weakening influence of regulation on corporate conduct, the concomitantly increasing corporate power for two reasons. Firstly, the concentration on individual integrity implicitly postulated by steward theory harbors the danger of illegitimacy, a fortiori under conditions of expanding economic and also political power of managers. This is due to the fact that in absence of substantial legitimacy, the requirements for the procedural constitution of legitimacy are rising. The concentration of power in the hands of the management is a step in the opposite direction, since the inclusion of diverse opinions in the process of organizational decision-making is potentially curtailed and thus the creation of procedural legitimacy is impeded. Secondly, the (mostly implicit, for an exception see Donaldson, 1990, p. 378) reliance on regulatory frameworks renders stewardship theory incapable of legitimizing the operations of firms beyond stable regulatory frameworks.

**Stakeholder Democracy**

The contested and value-laden notion of stakeholder democracy (Matten and Crane, 2005b) constitutes a more heterogeneous approach than the ones described before. It basically emphasizes the importance of democratic participation in corporate decision-making for two reasons. One strand of argumentation favors democratic involvement in the steering of corporations due to its contribution to
organizational efficiency. This efficiency-centered line of argument has several distinct facets. From a motivational point of view, participation of stakeholders in organizational decision-making is a means to avoid a ‘hold-up’ problem concerning competitive disadvantages arising from the exclusion of groups crucial for value creation from organizational gains. Active participation is seen to enhance the motivation of employees and thus corporate performance (Driver and Thompson, 2002).

From an informational point of view, involvement of stakeholders is seen as a means to enhance the capacity of a firm for decision-making adequate to the requirements of complex organizational environments. According to Gomez and Korine (2005; 2008), corporate governance developed as a mechanism to secure the consent of the individuals governed by corporate actions. Facing increasing complexity in the organizational environment, the integration of various stakeholders into corporate governance in a democratic way is seen as a way to increase the internal organizational complexity and thus rendering a corporation capable of surviving in this environment. This is in line with cybernetics-oriented considerations. According to Turnbull, open-endedness of hierarchies is flawed due to conflicts of interest resulting from a concentration of power, distortion of communication and a lack of mechanisms for self-control and self-correction (Turnbull, 1994). Furthermore, Gomez and Korine (2008) argue, that corporate governance capable of processing information about a complex environment in a superior way in turn works as a guarantee towards potential suppliers of capital.

A second line of argument demands the inclusion of stakeholders for moral reasons. Based on the debate about the proper corporate objective (see above) and the work of Freeman (1984), besides the shareholders stakeholders can be seen as legitimate beneficiaries of corporations due to their intrinsic value (Donaldson and Preston, 1995).

Dominant corporate governance theory as well as – even with a different focus – team production theory and stewardship theory concentrate on a single authority for organizational decisionmaking. Thus they provide no space for compensating the loss of substantial legitimacy potentially resulting from increasing power of firms and operations beyond functioning regulatory frameworks. In contrast, suggestions to
integrate stakeholders into organizational decisionmaking directly aim at changing decision-processes. Thus stakeholder democracy is one way to modify such processes to that effect that a loss of substantial legitimacy can compensated for by constituting legitimacy in a procedural way. Besides, compared to the theories of corporate governance analyzed before, which are centered on specific decision makers or beneficiaries, this theory provides the flexibility to adjust decision-processes to the requirements of specific situations, which are manifold and dynamic.

FROM CONTRACT TO IMPACT: DETERMINING THE SCOPE OF CORPORATE GOVERNANCE

Conceding that stakeholder democracy has the potential to compensate the loss of legitimacy of firms, two question arise: firstly it becomes necessary to determine which stakeholders need to be included in organizational decision-making to constitute or maintain the legitimacy of corporate action. Secondly, it becomes necessary to conceptualize the role democratic corporate governance can play with respect to the changed legitimatory requirements. The first question will be covered in this section. The argument that shareholders have contractual ties with a firm – even if imperfect ones – is often used to qualify this particular group of stakeholders in contrast to other stakeholders for special protection. This understanding of contractual relations is centered exclusively on explicit contracts and potential limitations of such contracts under specific circumstances. However, this view ignores implicit contracts. Implicit contracts are not formalized but nevertheless vital elements of economic transactions. Taking into account this type of contract besides explicit contracts facilitates the formulation of the relation between firms and different stakeholders in a systematic way. Risk not accounted for in explicit contracts thus becomes conspicuous (Boatright, 2009). Accordingly, the postulation of the corporate obligation to report to shareholders – corporate accountability –, justified in traditional corporate governance theory by the residual risk borne by the shareholders thus appears to be not qualified. It becomes apparent that the exclusive concentration of corporate accountability on shareholders seemingly disregards numerous equally legitimate claims, already under pre-globalization conditions. Taking into account the diminishing steering power of states, the often insufficient enforceability of contracts
and the coincidentally rising economic and political power of corporations, the question of corporate accountability becomes even more urgent. Furthermore, the question is becoming more and more political in addition to its economic relevance. Nevertheless, despite its potential to address numerous legitimate claims towards a corporation, the contractarian view has its limits where relations between a corporation and its stakeholders are unidirectional, i.e. where no exchange relationship of any nature whatsoever exists. Redefining corporate responsibility by extending the notion of property rights to ‘both the legal aspect of property rights and the social conventions that govern (business) behaviors’ (Asher et al., 2005) seems to be a promising way to recognize the importance of a firm’s stakeholders (Blair, 2005). However, the possibility to define all stakeholder relations in terms of contracts and property rights, especially under conditions of cultural heterogeneity and complex global interdependencies, seems to be limited.

Since corporations increasingly take on a political role, it seems adequate to regard them in a similar way as states (Crane and Matten, 2008). This shift of perspective allows to examine the problem of risks not accounted for without referring to regulatory frameworks. According to Keohane (2003, p. 140), there are three normative criteria justifying and necessitating the accountability of an actor towards specific groups: authorization, support, and impact. Authorization defined as the conferring of rights from one entity to another is seen as one normative reason for the duty of the authorized to be accountable to the authorizer. Political as well as financial support are regarded as further justifying obligation of the supported to be accountable vis-à-vis the supporters. The third criterion – impact – is argued to be a further justification for accountability. As argued by Held (2002), actors who become ‘choice-determining’ for others and thus restricting the autonomy of these actors need to be held accountable.

The issue of accountability in dominant corporate governance was exclusively centered on the criterion of support. Shareholders provide financial support for a corporation and in turn the corporation is supposed to be accountable to these shareholders. In the light of the increasing economic and political power of corporations, often exercised unidirectionally, the criterion of impact is becoming increasingly relevant since corporations determine choices of many people. Following Iris Marion Young (2004), countering increasing structural injustice resulting from
social and economic connectedness in a globalized economy necessitates a reformulation of the concept of responsibility. Whereas responsibility usually is conceived of as a past-oriented concept, she proposes the forward-looking concept of political responsibility. Mentioning the case of working conditions in third world countries, which exemplifies the increasing impact of corporations on individuals beyond the moderating power of functioning regulatory frameworks, it is postulated that ‘[b]ecause of the size, reach, and relative influence of such organizations, it makes sense to expect major decision-makers in them to take responsibility for working conditions.’ (Young, 2004, p. 386). This becomes even more important taking into account that corporations not only impact individuals beyond regulatory frameworks but also provide public goods without being legitimized for that in any manner. Consequently, the suggestion to enhance the notion of responsibility can be the basis to formulate the specifications of an extended concept of corporate accountability and of corporate governance transcending mere compliance with external regulation. Such an extension of accountability is regarded to ensure that the rights of individuals affected by corporate action are protected sufficiently (Matten and Crane, 2005a). Considering the central role of corporate governance for securing legitimacy, it becomes clear that corporate governance has to adapt to the changed economic and political operating conditions and responsibilities of corporations.

In the context of the discussion about the nature and limits of the corporate responsibility for stakeholders Goodpaster argues that extending the fiduciary relationship between shareholders and management to an inclusion of stakeholders would represent the transformation of the modern private corporation into a public institution that “probably calls for a corresponding restructuring of corporate governance” (Goodpaster, 1991, p. 66). Firstly, the severity of such a transformation, blurring the traditional corporate goals, prompts him to deny the existence of fiduciary obligations of managers vis-à-vis stakeholders other than shareowners. Secondly, the adverse implications for the efficiency of organizational decision-making – a push “towards paralysis” – are mentioned as a reason for this denial.

However, in the light of the increasingly political nature of corporate action described above (Matten and Crane 2005a; Palazzo and Scherer 2006; Scherer et al. 2006), the first concern loses some of its relevance. In the reverse conclusion, it rather implies
that the governance of corporations increasingly acting beyond national regulatory frameworks and involved in political action requires a revision.

Thus the second concern – considerations of efficiency within extended governance relations – alone cannot be seen as a decisive obstacle for the modification of corporate governance. In contrast, it can be understood as a guideline for the modification of traditional corporate governance.

In summary, it becomes evident that traditional corporate governance as well as alternative conceptions in many instances fall short of taking into account the fundamental changes in the economic as well as in the political sphere. By either concentrating on the performance of corporations (stewardship theory) or limiting the participation in decision-making to a clearly defined target group (team production theory), the contingent legitimate claims vis-à-vis a corporation can not be addressed in a comprehensive way since these claims are assumed to be met by the regulatory framework and not by a corporation itself. Confrontation with this problem can be described as an enormous increase in complexity of decision for corporations. In times of sufficient state regulation economic rationality (i.e. profit-maximizing behaviour) was the only focus necessary for corporate decision-making. Societal welfare was achieved firstly by economic decision-making (via the invisible hand) and secondly by the regulatory framework, setting the side-conditions for the economic activity. However, in situations where regulatory frameworks only work insufficiently, corporations increasingly need to consider societal problems and thus have to be able to switch to social rationality (i.e. concurrent resolution of conflicts; see Habermas, 1984) to maintain or reconstitute their legitimacy.

**CONSTITUTING LEGITIMACY BY DELIBERATION: THE ROLE FOR CORPORATE GOVERNANCE**

In the former part, we have argued that corporations can no longer rely on regulatory frameworks to provide legitimacy. Therefore in the following we propose the opening up of corporate governance structures for communicative processes with to secure legitimacy of corporate actions in cases where states are not able to do so. One way to manage legitimacy of organizations in a procedural communication-based
way is proposed by Palazzo and Scherer (2006). Drawing firstly on the threefold concept of legitimacy by Suchman (1995) described above – pragmatic, cognitive, and moral legitimacy – it is argued that under the conditions of globalization and the post-national constellation the capability of business to constitute pragmatic or cognitive legitimacy is decreasing. Secondly, the authors draw on the concept of deliberative democracy (Habermas, 1998; Dryzek, 1999). In the theory of deliberative democracy, deliberations are conceptualized as a network of negotiations aiming at controlling administrative power by finding rational and fair solutions for problems (Habermas, 1996). In a transfer of this theory from political science to the context of organizations (Palazzo and Scherer, 2006; Scherer and Palazzo, 2007), deliberation is regarded as a means for corporations to compensate for the loss of pragmatic and cognitive legitimacy. Switching to a mode of 'moral reasoning' is regarded as a measure for the constitution of moral legitimacy by means of discursive processes when necessary and appropriate. The process of deliberation is seen as a way to achieve legitimate outcomes by the exchange of good reasons. Thereby an active justification vis-à-vis society replaces the mere reactive isomorphic conformance with societal demands or the strategic manipulation of the perceptions of stakeholders (e.g. by means of instrumental public relations) (Palazzo and Scherer, 2006).

According to Gomez and Korine (2008), corporate governance is the level of a firm where such processes need to take place to safeguard as well as signal the fairness of corporate action. Implicitly referring to the ‘Law of Requisite Variety’ by W. Ross Ashby (1971) and thus arguing by means of the increased capacity of stakeholder democracy to collect and process information (see above), they suggest the increase of the complexity of corporate governance by democratization as a suitable means to tackle the rising complexity of organizational environments and to control major risks in an efficient and credible way. Therewith, the central role of corporate governance for managing environmental complexity and simultaneously signalling the capacity to do so is emphasized.

By means of findings from strategic management theory based on systems-theory, which highlight the relevance of complexity for strategic decision-making (Schreyögg and Steinmann, 1987; Steinmann & Kustermann, 1998), the importance of dialogic processes for the survival of organizations in complex environments can be analyzed in detail. In classical organization science, organizations are conceptionalized as
rational constructs with the purpose of revenue-generation (Taylor, 1911), which are steered by a single authority. The rationality of the organization was concentrated in this single instance — and hence termed monological —, implicitly assuming the a priori correctness of plans as well as the feasibility of these plans. However, this view completely ignores the limits of individual rationality (see Simon, 1948) as well as the complexity and dynamic of organizational environments. In contrast, in modern theory of strategic management, the replacement of strategic planning oriented to a Tailorist monological rationality by a process-oriented dialogical type of rationality (Steinmann and Kustermann, 1998) is advocated. Referring to Juergen Habermas’ the (1984), dialogical rationality can be regarded as the outcome of communicative processes. Such processes can be regarded as a means to contribute to the survival of an organization and to tackle the complexity of organizational environments in a way superior to the monological solution due to the increased capacity to collect and process information. The former type of monological rationality shows parallels to the theoretical foundations of traditional corporate governance. Arguing that ‘multiple objectives is no objective’ (Jensen, 2001), traditional conceptions of corporate governance postulate the necessity of shareholder-value and the resulting single-valued objective function as a condition necessary for the manageability of corporations. However, referring to exactly the mentioned type of monological rationality described above, this position overlooks the limits of rational human behavior as well as the complexity and dynamic of organizational environments.

A deliberation-based conception of corporate governance by contrast can be regarded as analogous to the latter type of dialogical rationality. Accordingly, the requirements for rendering corporate governance qualified to contribute to the constitution of dialogical rationality can be oriented to remarks concerning strategic management in complex environments.

Following that suggestion, it becomes necessary to find an appropriate mode of information collection and processing. At the one extreme, reform of corporate governance rules in favor of stakeholders (Maitland, 2001) and broad democratic deliberation are seen as inhibiting organizational efficiency (Thompson, 2008). While such reforms have the potential to ensure a maximum of legitimacy, they simultaneously harbour the danger of a deadlock inhibiting organizational survival in complex environments. At the other extreme, it is argued that inclusion of diverse
stakeholders enhances organizational efficiency (Deetz, 2007) and simultaneously increases the legitimacy of organizational action. Assuming that the effect of deliberation on organizational efficiency depends on the concrete design of communication practices (Deetz, 2007) and that legitimacy as well as efficiency accounts compete with respect to resources but also complement each other as to the viability of organizations (Aguilera and Cuervo-Cazurra, 2004; Scott, 2001, p. 157), some compromise between efficiency and legitimacy needs to be found. In particular, this means that the right balancing between broad decentralized information acquisition and efficient information processing is necessary.

The processes aiming at opening a corporation for deliberation needs to take place on the operational level of a firm. This is due to reasons of the efficacy of these deliberative processes themselves as well as due to the effects of such processes on organizational efficiency. Drawing on the parallels between the problems of managing legitimacy in complex environments and the systems-theory oriented approaches in strategic management described above, the necessity of organization-wide sensitivity for issues relevant for organizational legitimacy becomes clear. Firstly, on every hierarchical level members of the organization need to be able to identify conflicts with the organizational environment, since early detection of problems allows for early reaction and enhances the flexibility to respond appropriately (Ansoff, 1984; Schreyögg & Steinmann, 1987). Secondly, they need to be authorized and able to make decisions based on dialogue with persons or groups affected by corporate actions in a flexible way to avoid harm and thus potential threats for organizational legitimacy. Furthermore, the necessity for such decentrality follows from the potential threat to organizational efficiency resulting from potential overload of decision capacities and diverging interests on the top decision level.

Though, such decentralized mechanisms alone do not guarantee for a corporation to constitute and maintain legitimacy in a deliberative way. The location of such processes on the level of corporate governance seems to be appropriate for several reasons. Firstly, responsibility needs to be easily localized and identified by shareholders as well as by the general public. Therefore, an identifiable mechanism is necessary to establish and signal trust in the governance of corporations, thereby securing organizational legitimacy. Secondly, the upper echelons in corporations wield the most power – in economic and increasingly also in political respect. On top
management level it is decided whether or not data are signalling strategic threats and fundamental directions in the course of strategic decision making are selected (Schreyögg and Steinmann, 1987), also beyond purely economic considerations.

Thirdly, there is a possibility of failure of deliberative processes on lower levels. Distortions in moral deliberation resulting from the hierarchical structure of firms and causing a diffusion of personal responsibility (Rhee, 2008) cannot be ruled out. Therefore some kind of guarantee equivalent to a court of last resort is necessary to provide the possibility of changing the direction of corporate activity. Fourthly, there is need for a well-defined and designated interface to the discourses of civil society to guarantee the receptivity of a firm for legitimate demands vis-à-vis a corporation. This seems to be the potential role for corporate governance in a framework aiming at a corporation capable of constituting dialogical rationality and therewith legitimacy.

However, to counter negative consequences for organizational efficiency, processes of decision-making concerning the core activities and higher-level processes of deliberation constituting organizational legitimacy have to be decoupled to some extent (Scherer et al., 2008). This means that deliberative processes need to take place parallel to and independent from routine decision processes when appropriate to avoid mutual interference of these two processes beyond the level necessary to safeguard organizational legitimacy.

One practical suggestion pointing in this direction and concerning corporate justice plans and possibilities for stakeholders to contest corporate decisions is mentioned by Parker (2002). However, this solution stipulates access to justice as an ultimate option and is therefore only of limited use under conditions of a weak or absent regulatory framework. A further reaching suggestion concerns the modification of corporate governance structures towards a four-tier system. Within such a system, the interplay of the shareholder meeting, a social or works council, the board of directors, and a corporate senate is regarded as a way to include all legitimate stakeholders in processes of organizational decision-making (Driver and Thompson, 2002) and might lead in the direction of full corporate accountability beyond the boundaries of law. Guide for the design of such a ‘fourth power’ within corporations could be suggestions to connect political decision-making with societal discourses within a ‘chamber of discourses’ (Dryzek and Niemeyer, 2008).
CONCLUSION

Despite being far apart from realization, seemingly there are no less fundamental ways to restore the capacity of corporations in general and of corporate governance in particular to maintain the legitimacy of corporations and of the system of market-economy in a way appropriate to the conditions of heterogeneous complex environments and the increasingly politicized role of business. In the face of fundamental changes in their environment and a shift in the division of labor between the private and the political sphere, corporations are increasingly confronted with the problem of diminishing legitimacy. In the pre-globalization era intact regulatory frameworks guaranteed the congruence of profitmaking and social welfare. Contracts were reliable, negative externalities were limited by law and the provision of public goods was a public task fulfilled by public authorities. With the diminishing of public steering power and the widening of regulation gaps, these assumptions are becoming increasingly unfounded. In many cases, the enforceability of contracts can be doubted. The limitation of negative externalities by state authorities is becoming increasingly difficult due to the global reach of corporate power, the range of many negative externalities transcending national borders and the weakening of national regulatory frameworks. The distinction between the private and the public sphere is blurring because of the fact that corporations often participate or independently engage in the provision of public goods. Summing up, these developments constitute an increase in corporate power and thus a higher risk for those affected by this power. This inter alia results in immensely increased requirements for corporations to maintain and restore their legitimacy. Corporate governance has the potential to secure organizational legitimacy and thereby also the legitimacy of the economic system as a whole, particularly in the light of the strengthening of global civil society. Whereas traditional corporate governance was able to achieve organizational and systems-level legitimacy by protecting the shareholders in a monological way, this does not apply to the current situation of increased economic and political power of corporations in a post-national world. To restore and maintain organizational and systems-level legitimacy, corporate governance needs to open up for contingent legitimate claims towards a corporation. The transfer of the concept of deliberative democracy to the corporate level in general and to corporate governance in particular is a promising way to re-establish legitimacy in a dialogical way. However, the way
towards the democratically accountable corporation is still long. On organizational level, ways need to be found to process and balance legitimate claims towards an organization and organizational efficiency.

On the systems-level another problem might impede the enhancement of corporate accountability: systems-level legitimacy is not completely established by the mere generation of firm-specific legitimacy. The debate about the sphere of influence of business (Human Rights Council, 2008) is exemplary for this incongruence. Even if a firm behaves correctly within a sphere where illegitimate behavior could be attributed to the firm and therefore damage its legitimacy, the firm still might cause illegitimate behavior beyond this sphere, e.g. in complex supply chains, without venturing its individual legitimacy. Each individual firm could take an advantage from opting out of contributing to the legitimacy of the economic system. Therefore systems-level legitimacy can be regarded as a public good and a problem of collective action occurs. Approaches towards resolving this problem could lie in the establishment of schemes of effective self-regulation. Initiatives to foster corporate commitment (for a systematic analysis of different types of commitment see Pies et al., 2009) and thereby facilitate collective action – like the United-Nations Global Compact and the Global Reporting Initiative as well as sector-specific initiatives like the Equator Principles for responsible project financing – point in this direction. Nonetheless, as such initiatives are still far from being widespread and binding, the legitimacy of the economic system is in decline as rising dissatisfaction with capitalism (Globescan, 2009) shows.

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