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# Competitive Markets, Corporate Firms, and New Governance - An Ordonomic Conceptualization

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*Abstract*

The purpose of this article is to develop an ordonomic conceptualization of corporate citizenship and new governance that (a) provides a framework for positively explaining the political participation of companies in new governance processes and (b) does not weaken but instead strengthens the functional role of corporations as economic actors in the market system of value creation. To this end, we develop our ordonomic approach in a critical discussion of Milton Friedman's stance on the social responsibility of business in three steps. (1) The ordonomic perspective on the economics ethics of competitive markets argues that the social responsibility of business does not lie in maximizing profits but in addressing societal needs through the mutually advantageous creation of value. (2) The ordonomic approach to the business ethics of corporate actors claims that corporate firms can use moral commitments as a factor of production. (3) The ordonomic perspective on the process ethics of new governance holds that companies can act not only as economic actors but also participate as political and moral actors by taking ordo-responsibility in processes of new governance. This role of corporate citizens in the new governance does not weaken but, instead, strengthens the role of business firms as economic agents for value creation.

*Key Words:* New Governance; Corporate Citizenship; Value Creation; Economic Ethics; Business Ethics; Process Ethics; Ordonomics; Stakeholder Theory; Sustainability; Aristotle; Milton Friedman; Corporate Social Responsibility

*JEL Classification:* A 12; D 02; D 63; M 14

*Kurzfassung*

Dieser Beitrag entwickelt eine ordonomische Konzeptualisierung von „Corporate Citizenship“ und „New Governance“, die (a) ein positives Erklärungsschema bietet für die politische Partizipation von Unternehmen an New-Governance-Prozessen und die (b) zugleich die gesellschaftliche Funktion von Unternehmen als wirtschaftlichen Akteuren im System marktlicher Wertschöpfung nicht schwächt, sondern sogar prononciert. Dieses Argument wird in einer kritischen Diskussion von Milton Friedmans Position zur gesellschaftlichen Verantwortung von Unternehmen in drei Schritten entwickelt. (1) Die ordonomische Wirtschaftsethik wettbewerblich verfasster Märkte macht geltend, dass die gesellschaftliche Verantwortung von Unternehmen nicht darin besteht, ihre Gewinne zu maximieren, sondern darin, gesellschaftliche Probleme durch wechselseitige vorteilhafte Wertschöpfung zu adressieren. (2) Die ordonomische Unternehmensethik korporativer Akteure argumentiert, dass Unternehmen für ihre Wertschöpfung Moral als Produktionsfaktor einsetzen können und müssen. (3) Die ordonomische Prozessethik für den Bereich der New Governance thematisiert, dass Unternehmen nicht nur als wirtschaftliche Akteure, sondern auch als moralische und politische Akteure handeln können, indem sie in New-Governance-Prozessen Ordnungsverantwortung übernehmen. Dieses Verständnis von Corporate Citizenship läuft nicht darauf hinaus, die wirtschaftliche Funktion von Unternehmen zu schwächen, sondern prononciert vielmehr die gesellschaftliche Funktion von Unternehmen als Wertschöpfungsagenten.

*Schlagwörter:* New Governance; Corporate Citizenship; Wertschöpfung; Wirtschaftsethik; Unternehmensethik; Prozessethik; Ordonomik; Stakeholder-Theorie; Nachhaltigkeit; Aristoteles; Milton Friedman; Corporate Social Responsibility

*JEL-Klassifizierung:* A 12; D 02; D 63; M 14

# Competitive Markets, Corporate Firms, and New Governance— An Ordonomic Conceptualization

Ingo Pies, Markus Beckmann, and Stefan Hielscher

## *Introduction*

(1) It used to be that the business of business was business. In the age of globalization, however, this does not seem so true or even obvious. Companies increasingly engage in a broad spectrum of activities that are far removed from those discussed in traditional management textbooks. Corporations participate in public-private partnerships with the purpose of jointly providing public goods (cf. Edwards and Zadek, 2003). They engage in forms of cross-sector cooperation for settling disputes and creating commonly accepted rules. A case in point is the Forest Stewardship Council (cf. Hollenhorst and Johnson, 2005). Transnational companies implement corporate codes of conduct that contribute to “upholding labor standards in third world countries” (Frenkel and Scott, 2002; p. 30). Other corporations play an active part in political initiatives such as the Oslo-based Extractive Industries Transparency Initiative (cf. Eigen, 2006).

(2) Two closely related concepts, each of which emphasizes the seemingly changing role of business in society, have gained prominence in the academic literature: the idea of new governance and the notion of corporate citizenship.

*New governance* refers to the changing *process* of societal coordination and cooperation between states, civil society organizations, and the private business sector. The concept deals with the development of rule-making and rule-implementation on a global scale, which is seen as “no longer a task managed by the state alone” (Scherer, Palazzo, and Baumann, 2006; p. 505). In the new governance, business firms, especially transnational corporations, together with civil-society organizations and government actors, “participate in the formulation and implementation of rules in policy areas that were once the sole responsibility of the state” (ibid).

Closely related to the work on new governance is the discussion about *corporate citizenship*. While “new governance” is focused on a process level, “corporate citizenship” focuses on the *actor* level and looks at the role of business corporations as societal actors. According to Moon, Crane, and Matten (2005; p. 448), the concept of corporate citizenship is based on the idea that corporations “act ‘as if’ they were metaphorically citizens in that their engagement in society resembles that of citizens.” Moon, Crane, and Matten identify two dimensions along which corporations fill this citizenship role. First, corporate citizenship “describes the role of the corporation in administering citizenship rights for individuals” (Matten and Crane, 2005; p. 173). Second, “corporations can participate in governing” (Moon, Crane, and Matten, 2005, p. 444) thus “contributing to societal governance” (p. 440).

New governance and corporate citizenship are thus closely related. In fact, the literature discusses the changing role of business and new governance processes as two sides of the same coin. As Palazzo and Scherer (2006; p. 76) argue, the new “politicization of the corporation is an unavoidable result of the changing interplay of economy, government and civil society in a globalizing world.” Similarly, Matten and Crane (2005; p. 172) suggest that the corporate administration of citizenship rights is a reaction to a failure of traditional state

governance.<sup>1</sup> According to Moon, Crane, and Matten (2005; p. 448), “in their engagement in ‘new governance’ ..., corporations are sharing in the *doing* of government ‘like’ citizens.”

(3) The link between new governance and corporate citizenship seems obvious at first glance, but becomes a little less so upon closer inspection. In particular, it is not clear why companies would participate as corporate citizens in new governance processes. As Matten and Crane (2005; p. 174) observe, the ideas of corporate citizenship and of new governance suggest that corporations “have taken over considerable responsibility from governments.” But why would companies accept such additional responsibility? A central argument put forward by new governance advocates is that companies need to adopt a new corporate role in order to “fill the vacuum of global governance” (Scherer and Palazzo, 2008; p. 425). As Scherer and Palazzo (2008; p. 414) argue, the “global framework of rules is fragile and incomplete. Therefore, business firms have an additional political responsibility to contribute to the development and proper working of global governance.”

According to Scherer and Palazzo (2008; p. 414), taking on this additional political responsibility is necessary because under the conditions of poor state regulation, the “sole emphasis on economic rationality will not contribute to public welfare, but rather may worsen the situation.” At the same time, Palazzo and Scherer (2006), as well as Scherer and Palazzo (2007), argue that the political participation of companies in new governance processes raises issues of legitimacy. In addressing this issue, Palazzo and Scherer (2006) advocate a “communicative framework” that seeks to politicize the corporation.<sup>2</sup> As Scherer and Palazzo (2008; p. 426) explain, corporations become politicized in two ways. First, “they operate with an enlarged understanding of responsibility and help to solve political problems in cooperation with state actors and civil society actors.” Second, “they submit their growing power and political engagement to democratic processes of control and legitimacy.”

(4) Prominent advocates of corporate citizenship and new governance thus argue for a fundamental change in business’s role in society. However, although work on this topic has led to valuable research and the discovery of important empirical phenomena, two critical questions remain unanswered, one with regard to positive analysis and one having to do with normative analysis.

In terms of *positive* analysis, a conceptualization of corporate citizenship and new governance needs to be able to explain *why* companies would engage in tasks such as rule-making and the administration of rights in situations where state-centric governance is ineffective. Scherer and Palazzo (2008; p. 414) may be right when they argue that “in as much as the state apparatus does not work perfectly, there is a demand for business to be socially responsible,” but simply identifying this *societal* demand does not explain why individual companies would step in to meet it (see also Boatright, 2009; p. 7). In fact, the literature on public goods is rife with examples of societal demands that have not been addressed, by corporations or anyone else. The critical issue here would appear to be one of incentives

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<sup>1</sup> Matten and Crane (2005; p. 172, emphasis in original) hold: “Where *government ceases to administer citizenship*, this leaves open space for corporations to enter (or not to enter) the arena as administrators of citizenship. ... Corporations also enter the arena where *government has not as yet administered citizenship rights*. This is particularly the case in developing countries. Globalization raises awareness of these ‘vacuums’ and exposes western MNCs in particular to charges that they are ‘responsible’ in some way for administering citizenship rights in such situations.”

<sup>2</sup> Palazzo and Scherer (2006; p. 81) explain that a “discursive approach to organizational legitimacy leads to a politicized concept of CSR.”

and yet, in at least some of the literature, there is a certain normativistic tendency to simply call for extended responsibility on the part of the business community without acknowledging the role of incentives and the issue of implementation. But, as van Oosterhout (2005; p. 678) points out, “why should [corporations] ... assume such extensive responsibilities if there is nothing in it for them?” This is a question that any *positive* theory of new governance and corporate citizenship needs to take seriously: Since companies *do* engage in new governance processes, a theoretical conceptualization must be able to explain *why*.

In terms of *normative* analysis, the work on new governance and corporate citizenship raises a second critical question, one closely related to the issue of implementation. That is, it is not clear how some of the normative concepts that call on corporations to engage in “a continuous process of deliberative discourse” and that call for the corporation to take a political role can be reconciled with firms’ economic role in the market system of value creation. The normative calls to transform the corporation’s role in society could result in a risk of unintentionally undermining the market system and weakening the functional role of the business firm as an economic actor (cf. Boatright, 2009; p. 8). Scherer, Palazzo, and Baumann (2006; p. 524) are not unaware of this risk. In their outlook on further research, they write:

[I]t seems that the economic concept of the firm and the political role of the firm as advanced here are antagonists. However, our case is not to abandon market society or to reject the economic objective of the firm. Instead, we take the imperatives of market competition and the price system as a precondition of efficient coordination in modern societies.

Despite this reference to the importance of market competition, however, Scherer, Palazzo, and Baumann fail to explain how the politicization of corporations would leave their economic role in competitive markets unscathed. In fact, they state that “much work must still be carried out in order to completely understand the implications of politically embedded ... corporate citizenship.”

(5) The purpose of this article is to develop an ordonomic conceptualization of corporate citizenship and new governance that (a) provides a framework for positively explaining the political participation of companies in new governance processes and (b) does not weaken but instead strengthens the functional role of corporations as economic actors in the market system of value creation. We show that the logic behind win-win-processes of new governance is the same logic that characterizes the daily business of economic value creation.

The ordonomic research program that we draw on in this article is still fairly young.<sup>3</sup> Instead of presenting the ordonomic perspective in a theoretical, rather abstract way, we de-

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<sup>3</sup> The “ordonomic” approach builds upon the German tradition of an “economic theory of morality” (Hermann and Pies, 1994) that was originally restricted in a more narrow sense to discussing matters of business and economic ethics. Ordonomics advances the “economic theory of morality” to a general social and organizational theory that takes a rational-choice perspective on the analysis of interdependencies between institutions and ideas or, more specifically, on the analysis of interdependencies between social structure and semantics. In ordonomics, “social structure” (institutions) refers to the incentive properties of formal and informal rule arrangements, whereas “semantics” (ideas) refers to the terminology of public and organizational discourse and the underlying thought categories that determine how people perceive, describe, and evaluate social interactions and, in particular, social conflicts. The ordonomic approach is interested in interdependencies between ideas (semantics) and institutions (social structure), i.e., in the question of how certain mental models and ways of interpreting social reality shape our thinking and communication and, vice versa, how our thinking and communication shape the social rules that coordinate human interactions and thus ultimately channel our behavior. For an application of the ordonomic approach to corporate citizenship, see Pies, Hielscher, and Beckmann (2009). For a comprehensive overview of applications of the ordonomic approach to the domain of business and economic ethics, see Pies

velop our conceptual framework presented in this article in a critical discussion of Milton Friedman's classical position. There are two reasons why Friedman (1970) provides a useful starting point for our analysis. First, the Friedman position is well-known in the debate about business in society. Second, the ordonomic approach can use Friedman to focus attention on an important, but less often discussed, methodological standard: business ethics theory should not start from the exceptional case of corporate scandals or economic crises, but have a firm foundation in the normal case of mutually advantageous value creation.

We develop our argument in several steps. In the first three steps, we critically discuss the Friedman position and apply the ordonomic perspective to three types of ethics: (1) the ethics of competitive markets (economic ethics), (2) the ethics of the corporate firm (business ethics), and (3) the ethics of new governance (process ethics).

In the first step (1), we look at the economic system of competitive markets. Here, we start with the proposition that business firms are economic actors with the societal mandate to solve social problems through value creation. From an ordonomic point of view, this is the domain of "economic ethics" (as a win-win heuristics for the economic system).

In the second step (2), we focus on the core business of business. Here, our proposition is that corporate firms as economic actors fulfill their societal mandate of value creation with the help of moral commitments. The idea is that companies can use moral commitments as a factor of production, since day-to-day value creation requires an institutional management of social dilemma structures. From an ordonomic point of view, this is the domain of "business ethics" (as a win-win heuristics for corporate actors).

Third (3), we look at the new governance. Here, our proposition is that business firms as economic actors fulfill their societal mandate of value creation by employing moral commitments in political processes of finding and setting rules for market competition. From an ordonomic perspective, this is the domain of "process ethics" (as a win-win heuristics for new governance processes). We show that from an ordonomic perspective, the role of corporate citizens in new governance processes is just win-win oriented value creation writ large. Because it lays the groundwork for value creation, participating in political rule-setting processes and rule-finding discourse does not weaken, but instead strengthens the firm economically, thus providing an incentive to so engage.

After thus specifying the societal role of the business firm from three different perspectives, the fourth step (4) concludes and briefly discusses some implications of our argument.

### *1. Competitive Markets and the Ordonomic Approach to Economic Ethics*

According to Milton Friedman (1970), profit maximization is an ethical obligation of business corporations: "The social responsibility of business is to increase its profits." This unapologetic dictum has provoked sharp reactions and strong disapproval. To *constructively* criticize it, however, we begin by asking how Friedman's argument looks from an ordonomic perspective.

From an ordonomic point of view, the question as to whether the profit principle can be justified needs to be answered from the system perspective of economic ethics. According to such a system perspective, the profit principle can only be justified if it fulfills a desirable

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(2009a) and (2009b). For a more general discussion of the ordonomic methodology, see Pies, Beckmann, and Hielscher (2009) as well as Beckmann (2009).

social function in the economic system. The ordonomic approach to economic ethics starts with the awareness that on a system level, certain, possibly all, aggregate manifestations, for example, aggregate growth rates, (un-)employment, or innovation, are the *unintended* social results of the intentional behavior of many individual actors (cf. Becker, 1976, 1993; Coleman, 1990; pp. 1–23; Popper, [1945] 1966, Ch. 14; pp. 89–99). This is particularly true in the case of competitive markets. The ordonomic perspective highlights that given a functional institutional framework, the pursuit of self-interest in the marketplace can lead to highly desirable social results. In functioning competitive markets, profit seeking by competing firms is a key driver for innovation, growth, and economic prosperity (Baumol, 2002). Profits signal that a company has successfully created value. That is, in a competitive market system, a company can make a profit only if customers are willing to pay more for its product than the cost of producing that product. Profits are thus an epiphenomenon of successful value creation. In short, making a profit is evidence that a company is giving more to society than it is taking from it. Seen this way, profits are an important incentive in motivating companies to best fulfill their *raison d'être* as societal actors: to organize the creation of value (cf. Mises, [1951] 2008; pp. 7 et passim; Jensen, 2002; p. 239).

Seen from this perspective of value creation, it is now possible—and, arguably, necessary—to address Friedman's profit-as-ethical-obligation position not by flatly rejecting it, but by stating it more *precisely*. From an ordonomic perspective, companies have a societal mandate to create value. This is, of course, not a new idea. As early as 1949, Ludwig von Mises ([1949] 1996; p. 217) made the case that “the owners of the material factors of production and the entrepreneurs are virtually mandataries or trustees of the consumers, revocably appointed by an election daily repeated.” The ordonomic idea is that companies are agents with a mandate to create value for consumers and, in a substantial extension of von Mises's position, for other stakeholders, too.

To systematically understand the societal purpose of business, therefore, requires starting the analysis by looking at the economic ethics of competitive markets, a perspective that, in contrast to Friedman, does *not* claim that the “social responsibility of business is to increase its profits.” Profits are simply not an end but just a, albeit powerful, means. As a result, ordonomics reconstructs Friedman's famous dictum and argues: “*The social responsibility of business is to solve societal problems through value creation.*”

It might not be immediately obvious why redefining the societal purpose of business in terms of value creation is so important. Yet, in fact, doing so is absolutely vital for understanding the limitations of Friedman's argument. The fundamental point is that the profit maximization Friedman argues for *does* induce companies to fulfill their societal mandate, but *only under very specific conditions*. If and only if the institutional framework of the market is perfect do companies automatically fulfill—possibly without knowing or even intending it—their societal mandate of value creation by maximizing profits. However, as soon as the market becomes less than perfect, Friedman's position is not only imprecise but outright misleading. By focusing on profits instead of value creation, Friedman restricts his argument to fairly idealized conditions and as a consequence, he is not able to deal with the case when institutional conditions in a market are deficient and adequate rules need to be created in order to harness the profit motive for societal value creation. Friedman presupposes perfect “moral markets” (Boatright, 1999), but in so doing fails to reflect the conditionality of his argument.



## 2. Corporate Firms and the Ordonomic Approach to Business Ethics

Milton Friedman (1970; p. 122) argues that companies best fulfill their moral obligation to society by maximizing their profits and he thus strongly opposes the “doctrine” of corporate “social responsibility” and sees no need for a systematic preoccupation with business ethics. Yet, contrary to Friedman’s (implicit) assumptions, companies never operate within a perfect, i.e., complete, framework of functioning formal institutions; the formal institutional rules of any competitive market as well as the contracts between market participants are always incomplete.

This necessary incompleteness of institutions and contracts provides the jumping-off point for the ordonomic approach to business ethics and yet the ordonomic perspective is fully aware that situational conflicts between profit and morality cannot be solved by simply giving morality supremacy over profit. Any approach to business ethics that situationally suspends the profit principle will be in conflict with the ordonomic perspective of economic ethics as discussed above, not to mention the way competitive markets actually work.

To guarantee compatibility between business ethics and economic ethics and thus to ensure that business ethics is compatible with the real-world market system, we believe that business ethics must be thoroughly grounded in economic ethics, i.e., business ethics must be founded on the fact that companies are societal agents for mutually advantageous value creation. Starting from the idea of value creation, the ordonomic approach to business ethics focuses on how corporate firms can use moral commitments to create a functional framework for win-win interactions with their stakeholders.

We argue that business ethics are relevant to economic value creation because formal institutions and private contracts are always necessarily incomplete. One fundamental consequence of this incompleteness is that any company first needs to be viewed as a “moral actor” before it will be able to successfully fulfill its societal mandate of mutually advantageous value creation. In an ideal world of costless, complete, and perfectly enforceable contracts, even anonymous players could cooperatively interact to create value. However, in the “real” world, no player in the marketplace—including employees, customers, suppliers, creditors, and debtors—is willing to cooperate with a firm unless the player knows or believes that the company is trustworthy and reliable. This is why any company that wishes to engage in societal value creation needs to first constitute itself as a moral actor of integrity. The corporation needs to provide itself with an organizational framework in which it can build up its corporate “character,” reputation, and perceived trustworthiness. *Taking seriously the idea of value creation as the realization of win-win solutions with interaction partners, a corporation’s license to operate is—properly understood—in effect a license to co-operate.*

An important implication of value creation as the starting point for an ordonomic approach to business ethics is that companies can use moral commitments as a systematic *factor of production*. The underlying idea is that prudent moral commitments can trigger a powerful win-win outcome for the company by convincing its stakeholders of its reliability (and even its “goodness”), thus inducing them into a productive cooperation that would not be possible in the absence of such trust. In short, moral commitments can be a factor of production in that they signal that the firm is interested and considerate of others, a signal that can be immensely important to the firm’s successful value creation.

It is important to note that the ordonomic win-win perspective is not theoretical wishful thinking. On the contrary, it is routine practice of any company to create value by taking

into account the interests of others. As John Mackey (2006) put it, business is indeed a “win-win-win-win” constellation for all actors involved in the value creating interactions: for the investors, employees, customers, and suppliers. Otherwise, none of these stakeholders would cooperate with the company in the first place. Businesses do use moral commitments and they do take into consideration the interests of their stakeholders and of the communities in which they operate.

Interestingly, the idea of “moral commitments as a factor of production” is not alien to Milton Friedman. In fact, Friedman (1970) himself explicitly talks about the fact that companies can play an active role in providing amenities to their communities, for example, in order to create favorable conditions for the social process of value creation.<sup>4</sup> Yet, Friedman adamantly refuses to view such corporate strategies as acts of “responsibility” or of “moral commitment.” His point is that at the end of the day such corporate behavior is not motivated morally but purely as a means to generate more profit.<sup>5</sup> From an ordonomic perspective, this is a fundamental flaw in Friedman’s position. His argument rests on a serious—although popular—misconception. Ultimately, Friedman conceptualizes the role of the firm in terms of an implicit tradeoff between profit seeking and the moral consideration of the interests of others. His argument suggests that a corporate strategy cannot be called “socially responsible” if it eventually serves the profit principle. By claiming that corporate behavior can be *either* morally motivated *or* just a “cloak” for profit-oriented “expenditures that are entirely justified in its own self-interest,” Friedman draws on popular semantics that see morality as some sort of sacrifice. According to such trade-off thinking, “true” morality necessarily requires some sacrifice of self-interest.

However, a semantics that understands moral commitments as a sacrifice is out of touch with the real-world social structure of functioning markets. To think of morality in this fashion is a win-lose way of looking at it. Such semantics therefore fail to do justice to the “mutualistic” win-win logic inherent in the mutually advantageous processes of market-based value creation (cf. Hazlitt, [1964] 1994, Ch. 13). As a result, Friedman’s attempt to justify the profit principle runs the risk of backfiring. His argument actually does a disservice to the legitimacy of the profit principle in two ways. First, Friedman, ironically and inadvertently, perpetrates the prevailing view that the pursuit of profit has no moral value. It thus appears that Friedman is unintentionally denying the moral quality of genuine value creation. Second, *within* companies, the Friedman position does not offer a powerful heuristic for guiding the process of creating value. His rhetoric obscures the fact that moral commitments do not have to be a sacrifice but can be a valuable investment. A win-lose semantics falls short of constructively guiding those processes that aim at finding creative ways for using moral commitments as a factor of production.

In a nutshell, the ordonomic criticism of Friedman’s argument with regard to business ethics (that the pursuit of self-interest has no moral quality) unintentionally—and unnecessarily—runs the danger of undermining his argument with regard to economic ethics (that the pursuit of self-interest *does* have a moral quality).

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<sup>4</sup> Friedman (1970; p. 124) argues that “it may well be in the long run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government.”

<sup>5</sup> Friedman (1970; p. 124) contends: “Of course, in practice the doctrine of social responsibility is frequently a cloak for actions that are justified on other grounds rather than a reason for those actions. ... In each of these ... cases, there is a strong temptation to rationalize these actions as an exercise of ‘social responsibility’. [Yet, in effect, they are simply] expenditures [of the corporation] that are entirely justified in its own self-interest.”

### 3. New Governance and the Ordonomic Approach to Process Ethics

Milton Friedman develops his justification of profit maximization in an idealized world where markets are embedded in a perfect institutional framework. In this capitalistic Eden, creating and implementing rules is the exclusive responsibility of government. For Friedman, the state's primary role is to promote the common good through an adequate institutional order and, moreover, state government is seen as the *only* authority that can legitimately set and enforce rules. According to Friedman (1962; p. 15), it is *government* that serves as the “forum for determining the ‘rules of the game’ and as an umpire to interpret and to enforce the rules decided on.” Friedman thus promotes a clear division of labor: the state is the exclusive *rule-maker*; business firms, in contrast, are mere *rule-takers* who optimize their individual moves “within the rules of the game” (Friedman, 1962; p. 133).<sup>6</sup>

Contrary to Friedman's idealized assumptions, however, corporations often do operate within a context where situational conflicts between profit and morality arise because the institutional framework is deficient. Take the example of companies that are stuck in a quagmire of corruption (cf. Pies, 2008). In the case of endemic corruption, companies are collectively trapped in a social dilemma. It is a *social* dilemma not because the companies cause harm to society in general, but because they also collectively harm each other. Endemic corruption amounts to collective self-damage for the companies involved—they are forced to pay expensive bribes, they run the risk of serious damages to their reputation, they exist in fear of judicial sanctions—and at the same time, no company gains any individual competitive advantage as all firms in its sector are engaged in dealing with corruption. In this case, the “basic game” of business competition is heavily characterized by perverse incentives. Consequently, individual profit maximization *within* the existing rules of the basic game does not enable companies to adequately fulfill their societal function of value creation.

The case of corruption illustrates an important point: in the face of dysfunctional incentives and deficient rules in the basic game, companies can be faced with moral conflicts that are not solvable by simply changing their own behavior. For example, if a company makes an individual decision to fight against endemic corruption in its industry sector, it runs the risk of suffering severe competitive disadvantage without even coming close to solving the social dilemma of corruption at the group level. In this situation, we suggest a change of perspective that will reveal more constructive options for solving the problem. If dysfunctional incentives drive a race-to-the-bottom competition in the basic game, then companies can fulfill their societal mandate of value creation only by taking *ordo-responsibility*, i.e., by contributing to reforming the rules of the game (cf. Beckmann and Pies, 2008a and 2008b).

The idea of *ordo-responsibility* highlights that in many instances it is important to distinguish between two levels of responsibility: “within-game responsibility” and “context-of-game responsibility.” We hold that companies can—and judged by their own self-interest *should*—take responsibility for the shared *order* of the game if the basic game is defunct. In short, companies trapped in a social dilemma have a strong self-interest in overcoming this dilemma and thus playing a better game.

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<sup>6</sup> Friedman (1962; p. 27) indeed feels that *only* government can provide market interactions with functional rules. He contends (emphasis added): “The role of government just considered is to do *something that the market cannot do for itself*, namely, to determine, arbitrate, and enforce *the rules of the game*.”

Companies can take ordo-responsibility on two levels (Figure 1). In the *meta-game*, companies can take responsibility for the order of institutional rules (social structure). The meta-game concerns the societal rule-setting processes that form and reform the institutional framework governing the basic game. In this meta-game, companies can take *governance responsibility*: they can contribute to establishing functional commitments and thus to creating the necessary conditions for mutually advantageous value creation in the basic game. There are manifold instruments companies can use here, including industry codes of conduct, public-private partnerships, and cross-sectoral alliances (cf. Buttkeireit, 2009). In the case of corruption, they can cooperate with organizations such as Transparency International and work collectively toward a sector-wide integrity pact.

The second level on which companies can take ordo-responsibility is in the societal meta-meta game. In this meta-meta-game, companies can take responsibility for the “order of thought” and the paradigms that shape public discourse (semantics). The purpose of this meta-meta game is to enable a common rule-finding discourse. The point is that the players in a *meta-game* will never agree to institutional reforms and binding commitments unless they first concur that these new rules are necessary and desirable. From an ordonomic perspective, creating such an awareness of common interests is what discourse in the societal meta-meta-game is about. What is a useful focal point for such discourse? The ordonomic answer is straightforward: mutually advantageous value creation. Accordingly, companies can take *discourse responsibility* and contribute to identifying common interests. To this end, companies may organize multi-stakeholder dialogues, participate in learning networks like the UN Global Compact, become active members in their industry associations, or contribute to parliamentary hearings and public debates.

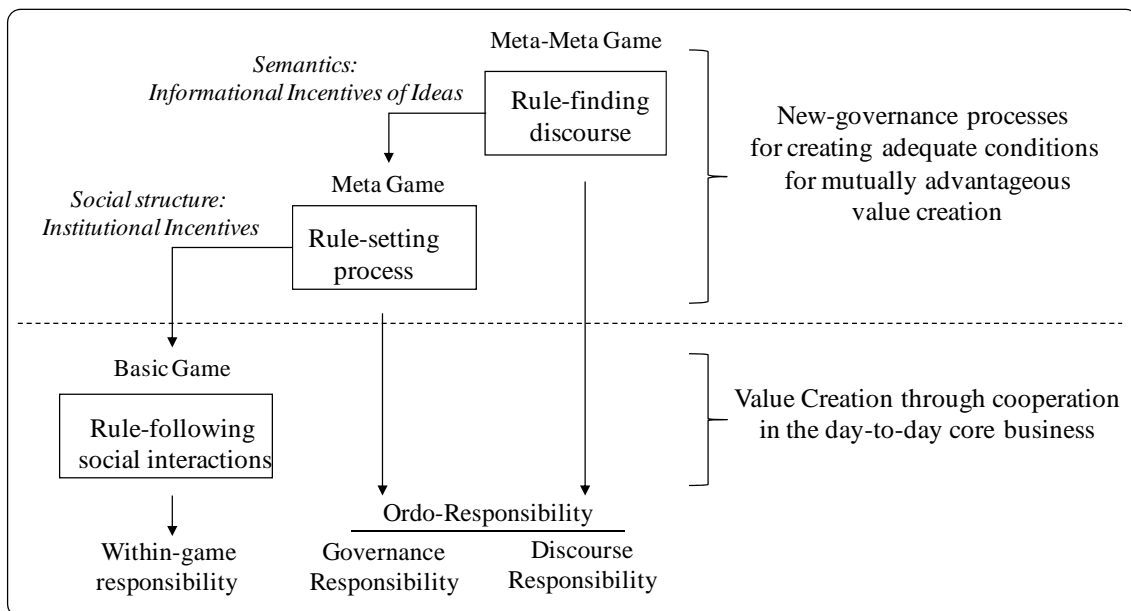


Figure 1: The ordonomic perspective on the new governance

Figure 1 illustrates how the ordonomic perspective can be enlarged to include a “process ethics” for the new governance. Focused on the idea of mutually advantageous value creation, process ethics serves as a win-win heuristics for new governance processes. We hold that in addition to creating value in their day-to-day activities, businesses can—and, judged by their own self-interest, should—participate in the new governance. By contributing to

rule-setting processes (meta-game) and rule-finding discourse, they can improve the conditions for business so as to make it a mutually advantageous basic game. From the perspective of process ethics, it makes sense to view corporations as no longer merely economic actors, but also as political and moral actors, in short, as *corporate citizens*.

In his classic criticism of “corporate social responsibility,” Milton Friedman strongly opposes the idea that corporations can play a constructive role as political actors. In his view, it is the exclusive task of the government to establish the rules of the societal game. Present-day scholars such as Henderson (2001, 2004), Jensen (2002), Sundaram and Inkpen (2004), and Vanberg (2007) agree. However, from an ordonomic point of view, all these scholars miss two critical points. First, in a globalizing economy, companies increasingly operate in contexts where the state either fails to set adequate rules or falls short of enforcing them. And second, in many cases, these regulatory vacuums negatively affect the companies themselves. In effect, companies have a vested interest in functioning rules of the game. New governance processes that harness this interest may benefit not only the company but also society at large.

The ordonomic perspective of process ethics is critical of Friedman’s heuristics for two reasons. First, Friedman employs here a “methodological nationalism” (Beck, 2002; pp. 84 ff.) that advocates idealized notions of the nation-state and, ultimately, handicaps societal learning processes. This makes it difficult to develop a constructive understanding of the new governance as a system that does not always view corporations as part of the problem, but can just as often see them as part of the solution. Second, Friedman’s position has nothing to offer when it comes to preparing (future) managers for the real-life challenges of the new governance and yet, in this age of globalization, these new governance processes are becoming increasingly important for societal self-organization. What is more, new governance processes are becoming ever more relevant for the strategic management of businesses: in the face of regulatory deficits, they allow corporations to sustain, extend, and invest in an environment conducive to value creation and profit realization: *The competence to take on ordo-responsibility—through corporate citizenship in processes of new governance—is increasingly important for managers to earn and secure their companies’ license to (co)operate and thus to foster successful value creation.*

#### 4. Economic Ethics, Business Ethics, and Process Ethics in Perspective: Summary and Outlook

(1) In this article, the ordonomic approach is developed in a critical discussion of Milton Friedman’s stance on the social responsibility of business. The key propositions can be summarized as follows. (a) The ordonomic perspective on the economics ethics of competitive markets argues that the social responsibility of business does not lie in maximizing profits but in addressing societal needs through the mutually advantageous creation of value. (b) The ordonomic approach to the business ethics of corporate actors claims that corporate firms can use moral commitments as a factor of production. (c) Finally, the ordonomic perspective on the process ethics of new governance holds that companies can act not only as economic actors but also participate as political and moral actors, i.e. as corporate citizens, by taking ordo-responsibility in processes of new governance.

Our analysis of Milton Friedman’s position finds that three elements of his argument can be criticized and, indeed, be stated more precisely by taking an ordonomic perspective. However, we also believe that Friedman’s position is still extremely relevant today in that it

can serve to create awareness of an important methodological standard for building theory in the field of business ethics. Friedman develops his approach to business ethics not from the exceptional case of corporate scandals or economic crises, but from the systematic win-win logic that characterizes the *normal case* of successful value creation within a market economy.

There is an important lesson to be learned here. To understand the paradigmatic *raison d'être* of business in society, it makes sense to *start* the analysis with a rather idealized concept of the market system. In theory building, one often needs to start with the abstract on the road to a more practical statement. In a way, Friedman's problem is that his argument is not abstract enough and that he fails to appreciate value creation as justifying the profit principle. Still, Friedman does state that one has to explain the functionality of profits in terms of the more general win-win logic of competitive markets.

The relevance of this methodological argument can best be illustrated by looking at alternative approaches to business ethics that start their theory building by observing a situational conflict between profit and moral objectives, then (mis-)take this conflict to be the general rule, consequently losing sight of the important case of mutually advantageous value creation. When an approach to business ethics fails to acknowledge the societal function of businesses as agents for value creation, it runs the risk of jeopardizing its compatibility with the market economy and of advocating policies that ultimately threaten to undermine the societal purpose of the business firm.

Our ordonomic conceptualization aims at understanding the business firm as an *economic* agent for value creation. More specifically, we hold that corporate citizenship and the participation of business firms in processes of new governance need not be seen as a fundamental change in the business of business. Rather, the ordonomic approach to process ethics maintains that in many cases companies can fulfill their societal mandate of value creation only if they learn to participate constructively in the new governance processes of rule-finding and rule-setting. Put differently, we conceptualize new governance as a domain in which companies extend their win-win strategy of managing social dilemmas through moral commitments to problems that traditionally have been within the purview of the state. Our point is that this economic win-win strategy has not changed and that it can be applied to political spheres, too. In our ordonomic view, corporate citizenship does not weaken but, instead, strengthens the role of business firms as economic actors in their capacity to fulfill their societal mandate of value creation: In the face of poor regulatory frameworks, companies need to adopt a political role in new governance in order to better fulfill their role as economic actors. By participating in processes of new governance, business firms, as corporate citizens, conduct themselves in the political sphere just the same as they do in their day-to-day business: they engage in individual and collective commitments that improve the rules of the economic game. In a nutshell, the ordonomic understanding is that *the role of corporate citizens in processes of new governance is just win-win oriented value creation writ large*.

(2) It is somewhat unusual to distinguish between economic ethics, business ethics, and process ethics. However, the fruitfulness of such an ordonomic approach lies in its ability to shed new light on important problems that have a specific significance of their own and thus deserve to be distinguished. For each domain, we illustrate the analytical power of the ordonomic approach with innovative insights. These insights concern the interdependencies

between social structure and semantics, which illustrate the specific perspective of the ordonomic approach.<sup>7</sup> To illustrate, we briefly discuss three examples.

- a) *Economic Ethics*. The ordonomic approach interprets economic ethics as a system ethics of market competition. From this perspective, ordonomics views competition as an instrument of social cooperation. This leads to a new understanding of value creation, from which it is possible to critically assess the literature on stakeholder theory: The strength of this literature is that it aids in understanding the challenge of value creation as a question of managing social relationships. From an ordonomic point of view, however, there is also a significant weakness in this literature. Traditional stakeholder theory fails to take into account *all* social relationship that matter for the process of value creation. Its biggest blind spot is its neglect of competitors as relevant stakeholders. From an ordonomic perspective, this is a problem because stakeholder theory tends to overlook the importance of collective commitments among competitors entered into to overcome social dilemmas.
- b) *Business Ethics*. The ordonomic approach interprets business ethics as an organizational ethics of corporate actors. From this perspective, ordonomics offers a conceptual framework for understanding corporate citizenship. This framework can best be illustrated by an analogy from the Aristotelian approach to ethics. According to Aristotle, one can realize oneself—in the sense of self-perfection—both as a person and as a citizen through acquiring virtue by habit. Ordonomics, in turn, argues that a corporate actor can realize itself—in the sense of self-perfection—both as a person and as a citizen through acquiring virtue by moral self-commitments: the corporate constitution shapes the organization’s “character.” Just as Aristotle argues that the individual is rewarded for his or her moral virtues by social recognition, ordonomics holds that an organization is rewarded for being a trustworthy interaction partner by productive cooperation with its stakeholders. Aristotle argues that a human being needs the respect of the community for his or her self-development as a person; ordonomics maintains that moral commitments are necessary for endowing an organization with a “license to co-operate,” which is crucial for productive interactions with partners. Aristotle argues that moral virtues are conducive to self-perfection; ordonomics claims that moral commitments are conducive for the self-perfection of the business firm as a societal agent of value creation. In the Aristotelian case, the actor is rewarded with greater happiness (eudaimonia); in the ordonomic case, the actor is rewarded with higher profit. Taking the analogy one step further: for Aristotle, virtue qualifies the person to be a political citizen of the polis; ordonomics argues that the “virtue” of moral commitments qualifies the organization to become a political actor, or a corporate citizen, meaning that the firm acquires the right to constructively participate in rule-finding discourses and rule-setting processes.
- c) *Process Ethics*. The ordonomic approach interprets process ethics as an ethics for new governance. Thus, ordonomics provides a fresh perspective on the debate over sustainability. We hold that sustainability is a normative concept well suited for political processes, especially at the global level. The heuristic quality of this concept can be summarized in three points. First, in contrast to traditional normative con-

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<sup>7</sup> Economic approaches primarily deal with an analysis of social structures. Philosophical approaches primarily deal with semantics. What makes ordonomics special is a theory perspective that focuses on interdependencies—and, more specifically, even on discrepancies—between social structures *and* semantics.

cepts such as justice, solidarity, or responsibility, sustainability is a cosmopolitan category *sui generis*. Instead of extending a normative idea from small groups to ever more encompassing social contexts, sustainability starts at the global level and then can be applied to regional, national, or even local contexts. Second, the semantics of sustainability provides a new heuristic quality. To ask from without whether social results can be qualified as “just” or “solidary” is to employ a normative outcome criterion that is external to the social process. In contrast, the procedural criterion of sustainability addresses the potential for self-continuation of a social process. It asks from within whether a development can be prolonged in the future and thus draws on an internal criterion. Third, the semantics of sustainability discourages taking perceived tradeoffs at face value and instead encourages critically reflecting on how seemingly conflicting aims can be reconciled. Take the case of the 1970s discussion that in large part saw ecological and economic objectives as incompatible. In contrast, the semantics of sustainability takes a long-term view and focuses on the conditions under which ecological, social, and economic objectives can be harnessed to mutually advance each other. Thus, the sustainability semantics is a powerful heuristic for reforming social structures. This illustrates the constructive interplay of ideas and institutions that is necessary for the societal learning processes of new governance.



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