Review of Managerial Science
https://doi.org/10.1007/s11846-019-00376-x

ORIGINAL PAPER

Single-objective versus multi-objective theories of the firm: using a constitutional perspective to resolve an old debate

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Received: 6 March 2019 / Accepted: 17 December 2019

Abstract
Our article contributes to the recurring debate on whether and how firms in competitive markets should pursue objectives other than purely financial ones. Two competing approaches dominate this debate: one favors profit maximization as a single objective; the other favors multiple, partly social objectives. This debate has been going on for decades without approaching consensus. Our article offers an explanation for this intellectual stalemate and proposes a constitutional perspective that reconciles and improves the two seemingly antagonistic approaches. At the core of our proposed solution lies the distinction between the sub-constitutional level of action (choices *within* constraints) and the constitutional level of rules (choices *among* constraints). Using this distinction, we argue that both single-objective and multi-objective theories of the firm play equally important, but categorically different roles.

Keywords Business ethics · Constitutional economics · Corporate political responsibility · Corporate social responsibility · Stakeholders · Strategic management

JEL Classification A13 · D23 · L21 · M14

1 Introduction

A series of recent publications in leading management journals has rekindled an old debate on the proper role business firms should play in society (de los Reyes et al. 2017; Donaldson and Walsh 2015; Jones and Felps 2013; Linden and Freeman

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2017; Mitchell et al. 2016). Essentially, it revolves around the question of which objective(s) a firm should ideally pursue.

The protagonists of this debate mainly belong to one of two camps. Proponents of a single-objective theory of the firm[1] argue that companies should—with certain restrictions—maximize their profits. In contrast, defendants of a multi-objective theory of the firm maintain that companies should also consider social values, an aspect that goes beyond their private financial interests. Such an orientation implies that the company should consider the concerns of various stakeholders (as opposed to those of shareholders alone); that it should pursue general welfare (as opposed to exclusively pursuing private economic gain); that it should promote sustainability (as opposed to disregarding environmental and social concerns); and that companies should take on some political responsibilities (as opposed to merely economic ones).

Neither approach denies the empirical fact that managers have to consider multiple factors when taking decisions. The fundamental dissent between them concerns a normative question: which of these factors *should* be the guiding criterion by which managers decide how to handle tradeoffs between financial goals and other types of goals? Normative single-objective theories of the firm acknowledge that managers ought to take into account various factors, associated with different values, but merely in order to promote the ultimate end of profit maximization (Jensen 2002; McWilliams and Siegel 2001; Siegel 2009; Sundaram and Inkpen 2004). In contrast to this instrumentalist view, normative multi-objective theories of the firm stipulate that serving different values needs to be understood as an end in itself (Donaldson and Walsh 2015; Mitchell et al. 2016; Scherer and Palazzo 2011).

At first sight, these two contrary positions appear to be irreconcilable. A main argument of single-objective theorists, that “it is logically impossible to maximize in more than one dimension,” (Jensen 2002) is met with the multi-objective theorists’ criticism that the devotion of companies to the narrow objective of making profit is the root cause of many current economic, environmental and societal problems (Donaldson and Walsh 2015; Hahn et al. 2010).

Against the background of these (seemingly) antagonistic views, this article’s aim is to help resolve the debate by offering a conceptual clarification that utilizes the merits of both conventional perspectives while taking into account their limitations. To develop our arguments, we will proceed as follows:

In the next section, we begin by demonstrating how both conventional views rest on different background assumptions, which explains why large parts of the literature talk at cross purposes. By comparison, the multiple-objective approach has its strengths on normative grounds, while the single-objective approach offers strong positive arguments why firms operating in competitive markets find it difficult to deviate from profit-maximizing strategies in favor of other social values. Our conceptual clarification allows us to pinpoint the reasons for this intellectual stalemate and the requirements for any attempt to reconcile and improve both approaches.

[1] When using the term “theory of the firm,” we do not refer to the question why firms as organizations exist at all (Coase 1937). Rather, we use the term to discuss alternative interpretations of what is the “fundamental objective,” or the “purpose” of a firm (Rappaport 1986:1).

In Sect. 3, we outline a possible way out of the intellectual stalemate. Our proposed solution is inspired by the research program of constitutional political economy (Buchanan 1990) and, more specifically, by one of its methodological cornerstones: the distinction between two levels of choice (Buchanan 1987), the sub-constitutional “action level” and the constitutional “rule level.” On both levels, actors can make choices. On the action level, they make choices *within* constraints, while on the constitutional rule level, they choose *among* constraints.

Based on this distinction, we argue in Sect. 4 that both single-objective and multi-objective approaches play equally important, but categorically different roles. This conceptual clarification thus allows for an integration of two previously irreconcilable perspectives, with far-reaching implications concerning the societal functions of business firms—and their respective responsibilities. In particular, we draw a distinction between a firm’s “action responsibility” for its business moves within a given game and its constitutional “ordo responsibility” for its political engagement in (re)forming the rules of its business game. Section 5 briefly summarizes our arguments and identifies some open questions for further research.

2 The two perspectives revisited—and why we need a conceptual clarification

It is generally accepted in academic debates that experts with varying viewpoints will eventually reach a consensus. In this respect, the academic debate between single-objective and multiple-objective approaches is an exception to the rule. For half a century, the exchange of arguments has not brought consensus. Despite serious efforts for mutual understanding, the result has been dissent. Instead of progress towards agreement, the debate is characterized by an intellectual stalemate.

In this section, we want to offer an explanation for why the two approaches have been talking at cross purposes. We take stock of the specific main arguments that have been brought forward in each of the camps, and we reconstruct their underlying background assumptions. In doing so, we will focus on each perspective’s arguments and assumptions that are most relevant to an explanation of their dissent. We will refrain from evaluating which of the two perspectives is right or wrong because this would impede our effort to offer a neutral view on each perspective’s strengths, and to examine how they could mutually reinforce each other. In this sense, it is our aim to offer a “charitable interpretation” (Feldman 1998) of the two perspectives.

For the sake of expositional clarity, we employ a simple textbook version of diagrams for (im)perfect markets. These elementary diagrams are minimally complex and at the same time analytically powerful in the sense that they are sufficient for a better understanding of the respective arguments with their specific strengths and weaknesses.

In the current section, we proceed in three steps. First, we foreground the (often implicit) background assumption of the single-objective approach and take stock of its five main arguments. Second, we foreground the (rather explicit) background assumption of the multi-objective approach and take stock of its main normative

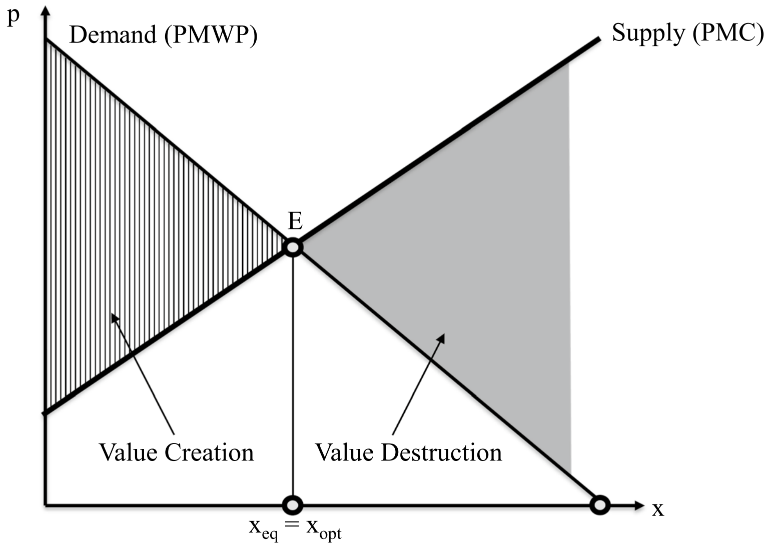

Fig. 1 The logic of action in perfect markets

argument. Third, we explain the intellectual stalemate between both approaches. This explanation will pave the way for our reconciling approach.

2.1 A reconstruction of the single-objective approach

The idea that a business firm should pursue the goal of profit-maximization can best be understood in the context of a perfect market, in which the price reflects all marginal costs and all marginal benefits. Figure 1 helps visualize the most important aspects of such a situation. The supply curve mirrors private firms' marginal costs of production (PMC). The demand curve mirrors private households' marginal willingness to pay (PMWP). The two curves intersect at equilibrium point E. The corresponding quantity is optimal, market-clearing and stable at the same time. It is *optimal* because it maximizes the sum of the consumers' surplus and the producers' surplus (i.e., the striped triangle to the left of point E). It is *market-clearing* because at the equilibrium price, every household that wants to buy at that price finds a firm that wants to sell at that price, and vice versa. Finally, it is *stable* because a perfect market provides an incentive to exchange exactly the equilibrium quantity—neither more nor less.

In a perfect market, the equilibrium price provides both an information signal and an incentive mechanism: it tells market participants what they should do, and it makes them do it. To explain: the vertical lines in the left triangle represent the win–win potential of individual transactions. For each unit of the good that is exchanged, the private marginal willingness to pay exceeds private marginal cost. Therefore, each act of exchange benefits both parties and thus contributes to general welfare. When equilibrium is reached, the process of value creation ends. Further exchange would amount to value destruction, because resources are wasted if the marginal cost of production exceeds the monetarized marginal benefits for consumers. The equilibrium price in a perfect market means that market participants are rewarded for participating in value creation and punished for participating in value destruction. As long as they contribute to exhausting the win–win potential of value creation (the triangle to the left of point E), firms and their exchange partners experience mutual betterment. However, as soon as they start wasting resources through value destruction (the grey triangle to the right of point E), which makes society poorer, they suffer individual disadvantages.

Within this simple framework, it is much easier to understand the specific arguments of the single-objective approach. We identify five main points:

Firstly, single-objective theorists argue that their approach rests on the authority of a long tradition of economic thinking. More specifically, they refer to Adam Smith's idea that in competitive market economies, the participants are collectively better off when they pursue their individual interests, and that market competition orients production towards the needs of consumers (Smith 1776). In line with these ideas, Ludwig von Mises (1996/1949) 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." Milton Friedman famously extended this argument and defended the view that a firm acts in a socially responsible manner when it maximizes private profits (Friedman 1962, 1970). Jensen (2002) made a similar argument: generally, in competitive markets, profit-maximizing firms compete through the services and products they provide to their customers—the consumers. Drawing on these views, we label the first main argument that single-objective theorists rely on as the "*consumer sovereignty argument*." Graphically, it is represented in Fig. 1 by claiming that point E maximizes the common good.

It is important to note that ultimately, this first argument is an ethical, rather than a purely economic argument. It assumes that in perfect markets, the interests of market participants, especially consumers, are most effectively and efficiently served when transactions are coordinated via competitive market prices and when companies accept profits as their fundamental objective. The ultimate criterion for judging the notion of profit maximization is general welfare in its broadest sense, without reducing the concept of welfare to its economic dimension (Boulding 1969; Broome 1999).[2]

According to the second argument of single-objective theorists, in competitive markets it is unlikely for firms to engage systematically (i.e., not sporadically) in activities that do not pay off in economic terms (Kitzmueller and Shimshack 2012; Lyon and Maxwell 2008). Seen from this perspective, normative calls on businesses to base their decisions on goals other than economic ones do not sufficiently account

[2] In fact, individual profit maximization does *not* always maximize social welfare, of course. But—in terms of our framework—this is the result of imperfect markets which we will discuss in greater detail below.

for the limitations imposed by competitive pressures ("ought-implies-can" dictum, cf. Schreck et al. 2019). This view is (often implicitly) reflected in strategic management research on the viability of corporate social responsibility (CSR). In such research, proponents of the "strategic" view of CSR posit that companies should consider CSR only insofar as it pays off (Husted and De Jesus 2006; Siegel 2009). As McWilliams and Siegel (2001: 125) put it succinctly, "to maximize profit, the firm should offer precisely that level of CSR for which the increased revenue (from increased demand) equals the higher cost (of using resources to provide CSR)." Because this second argument focuses on the relation between competition and non-economic goals, we label it as the "*competition argument*." Graphically, it is represented in Fig. 1 by claiming that competition transforms the profit motive into a systemic imperative that drives firms to the equilibrium in point E, since firms that deviate from the according behavior would experience competitive disadvantages. The basic idea is that firms cannot afford to ignore the disciplinary force of market competition.

The third argument brought forward by proponents of a single-objective theory of the firm comes from the managerial perspective. Seen from this angle, managerial decision-making needs a clear orientation so that managers can align their decisions with the goals of the company. Confronted with various alternative courses of action, managers need one single-valued performance measure in order to decide which way to go. For example, if the corporate objective function is limited to maximizing economic value, it offers clear guidance. As such it has been championed by many management scholars, including those who support the shareholder value concept (Rappaport 1986). Note that the argument here is that the evaluation criterion is unambiguous. This, of course, does not imply that in practice managers always and easily know what actions to take in order to increase profits.

If, however, the objective function is extended to other values apart from purely economic ones, managers will have no guidance on how to deal with the tradeoffs that inevitably arise from having to tackle competing values. On that basis, the proponents of wealth-maximization argue that stakeholder claims may be important but only to the extent that they enhance the long-run economic value of the firm (Jensen 2002; Siegel 2009; Sundaram and Inkpen 2004). Given that this argument focuses on the problem of managerial decision-making, we label it as the "*managerial orientation argument*." Graphically, it is represented in Fig. 1 by claiming that a clear focus on marginal profit tells managers to move on in the right direction as long as marginal revenue exceeds marginal cost and stop exactly at point E in order to avoid that marginal profit turns negative.

The fourth argument goes back directly to Milton Friedman (1962, 1970). He pointed out the principal-agent-relationship between the owners and managers of a firm. While the *managerial orientation argument* makes the case that managers who want to run a firm efficiently need a clear decision criterion, Friedman made the case that managers might want to pursue their private interests and that therefore a clear-cut criterion is needed in order to evaluate their performance. Seen in this light, profit maximization is part of a functional governance structure within the firm. It helps to hold managers accountable for their decisions and leadership.

We call this governance idea the *"argument of fiduciary obligation."*[3] Graphically, it is represented in Fig. 1 by claiming that unresolved conflicts between principals and agents due to too many degrees of freedom for managers would interfere with the market logic of reaching point E. Historically, this argument revives Immanuel Kant's (1784/1999) point of view that "the private use of reason may … often be very narrowly restricted" in order to avoid "harming the affairs" for which "a person … in a civic post or office" is "partly responsible". The argument of fiduciary obligation can thus be interpreted as a necessary, albeit not sufficient condition for improving general welfare. The core idea is that it would harm the functioning of society at large if—for whatever reasons—a mandatee were granted a moral right to violate the interests of her mandator, thus jeopardizing the institution of delegation.

The fifth argument has been articulated by Boatright (1999). He criticizes what he calls the "Moral Manager Model," i.e. the idea that managers should trade off their firm's profit for the common good. He holds that this idea will meet resistance by managers who surely are reluctant to sacrifice their personal career. Boatright (1999) concludes: "[I]f the Moral Manager Model describes the aim of business ethics, then we are fighting a losing battle." We label this hint to the self-interest of managers as the "*personal career argument."* It mirrors the second argument in the sense that not only organizations, but also managers within organizations cannot afford to ignore the disciplinary force of market competition. Graphically, it is represented in Fig. 1 by claiming that deviations from point E are not only dangerous for the survival of the firms, but also dangerous for the individual job prospects of managers.

In summary, the proponents of single-objective theories of the firm bring forward five important arguments to advocate their approach. The first of these arguments is clearly normative in that it implies that companies *should not* deviate from equilibrium; while the last four are positive in that they imply that companies *cannot* deviate from equilibrium. From an ethical point of view, such a focus on equilibrium is only justified in case of perfect markets. This takes for granted a situation in which the market equilibrium is also the social optimum of general welfare. Thus, we formulate

Argument 1: The main arguments of single-objective theories of the firm presuppose the assumption of perfect markets.

2.2 A reconstruction of the multiple-objective approach

In contrast to the arguments that single-objective theorists put forward, the proponents of a multi-objective theory of the firm argue that corporate profit-seeking is responsible for many of today's societal problems, ranging from climate change and environmental pollution to corruption, poverty, human rights violations and

[3] To be sure, the fiduciary argument has been widely criticized on various grounds (Hart and Zingales 2017; Stout 2012). Note, however, that the aim of this section is neither to criticize nor to defend single-objective or multi-objective theories. The aim of this section is to analyze each perspective's arguments and background assumptions in order to explore opportunities to resolve the debate between them.

financial crises. In view of such serious market failures, various scholars advocate the idea that companies ought to extend their conventional objectives beyond mere profit maximization in order to contribute to improving general welfare. On those grounds, the advocates of this argument favor normative models of the multi-objective, rather than the single-objective firm.

Multiple objectives typically include making profit as well as meeting certain environmental and social standards—an idea reflected in concepts such as the "triple bottom line" (Elkington 1997), or "social value" creation (Hall et al. 2015; Husted and De Jesus 2006). The same idea is mirrored in calls on companies to meet the demands of different stakeholders, rather than exclusively those of shareholders. In this vein, a main argument put forward by normative stakeholder theory (Donaldson and Preston 1995) is that companies should consider the legitimate claims of different stakeholders even if this may lead to lower profits (e.g., Ulrich 2009).

More recently, a number of scholars in the fields of ethics and management have made the case for a normative multi-objective theory of the firm. For example, while acknowledging some strengths of neo-classical economics, Donaldson and Walsh (2015) posit that the purpose of business should be to "optimize collective value," which they define as the "agglomeration of the business participants' benefits" (Donaldson and Walsh 2015). Similarly, Jones and Felps (2013) propose that firms ought to enhance "stakeholder happiness." In much the same vein, Mitchell et al. (2016) argue that general welfare is multi-dimensional, which is why companies should adopt multiple objectives in order to maximize their contribution to it. Along the same line, de los Reyes et al. (2017) advocate that firms should engage in norm-making or adopt an ethical framework for norm-taking in order to re-balance their profit orientation for the sake of normative stakeholder demands. Furthermore, Scherer and Palazzo (2007; 2011) argue for an extension of the corporate objective function. They stipulate that in modern societies the conventional division of labor between rule-setting governmental institutions and rule-following corporations has become obsolete. In line with other proponents of that idea (Driver and Thompson 2002; Gomez and Korine 2008; Parker 2002), they call for a "democratic reform of corporate governance" (Scherer and Palazzo 2011) in order to enable firms to take economic as well as political responsibilities.

Although these multi-objective theories of the firm come in various forms, they are united by the call for companies to morally reorient their priorities and to at least partly sacrifice profits for the sake of other, non-financial goals. This preference of non-financial goals over profits has a long tradition in the discussion on business responsibilities. As Henry Manne put it in his early definition of CSR: "To qualify as socially responsible corporate action, a business expenditure or activity must be one for which the marginal returns to the corporation are less than the returns available from some alternative expenditure." (Manne and Wallich 1972: 4)

To be sure, we are not arguing that multi-objective theories of the firm assume that the pursuit of non-financial goals always requires sacrificing profits. But our analysis focuses on these instances because the debate that we are referring to is only relevant when financial and other goals stand in conflict with each other. Clearly, if the different values a company needs to weigh against each other are complementary or at least do not clash, there is no need to set priorities. The crux of the debate lies in the question of how companies can handle *competing* objectives: how can management choose between different goals if a decision that serves one goal actually undermines the other? Obviously, when two different objectives converge—for example, when taking into account social or environmental aspects is profitable—there is no tradeoff to consider (Ambec and Lanoie 2008; Barnett and Salomon 2012; Brammer and Millington 2008). In contrast to such "win–win" cases, the situations that the debate concerns involve a tradeoff, which means that a company needs to give priority to either making profit or pursuing a different goal but cannot do both. In these situations, if the concepts of collective value, or stakeholder happiness, etc. are meant to mean more than just profits, maximizing along these dimensions must be different from maximizing profits. Hence we conclude that multi-objective theories call for companies facing a tradeoff to at least partly sacrifice profits for the sake of other, non-financial goals.[4]

In terms of our simple textbook framework, the main arguments of multi-objective theories of the firm are tailored to situations of *imperfect* markets and thus draw attention to the many cases in which a firm's profit-maximization does not improve, but may actually harm, general welfare (Jones and Felps 2013). This is not to say that multi-objective theories of the firm can be *reduced* to the notion of imperfect markets. But their value and normative strength can be well-appreciated by reconstructing one of their main arguments in terms of market failure. In imperfect markets, the equilibrium that results from the interaction between supply and demand is not optimal for general welfare: profit-maximizing companies fail to do what is socially desirable, and the main ethical argument is that they ought to leave the equilibrium in order to bring the market outcomes closer to the social optimum of general welfare. A market with positive or negative externalities is a case in point.[5] Figure 2 illustrates these relationships.[6]

In the case of negative externalities, the social marginal cost (SMC) is higher than the private marginal cost (PMC). A classic example of this situation is environmental pollution. Here, a market interaction of two parties (consumers, producers) harms a third party (all people with an interest in the natural environment). People not directly involved in the market transaction suffer due to negative externalities

[4] To quote Manne once more: "Without this feature as a starting point we are left with nothing significantly different from Adam Smith's unseen hand, which, by virtue of selfish individual behavior, guides all economic resources to their socially optimal use." (Manne and Wallich 1972: 4).

[5] Since our understanding of "general welfare" and "social optimum" rests on both economic and non-economic reasons, our analysis assumes a broad conceptualization of externalities in the sense of positive or negative (material and immaterial) effects on human flourishing.

[6] Sometimes, it is not the quantity but the quality of products that meets ethical criticism. A graphic analysis of such problems would require a different model and hence a different diagram. However, the logic of our argument would remain the same: It would (1) demonstrate a gap between market equilibrium and social optimum, and it would (2) raise the crucial question how to bridge this gap. Hence we think it is appropriate to settle for the analytically most simple exposition of imperfect markets.—In likewise fashion, it is possible to handle another limitation of our model. Here, we concentrate on the firms' output markets. With regard to input markets, e.g. for labor, our analysis could be applied accordingly. The moral reorientation of priorities, proposed by multi-objective theories of the firm, would then not refer to the supply curve but to the demand curve.

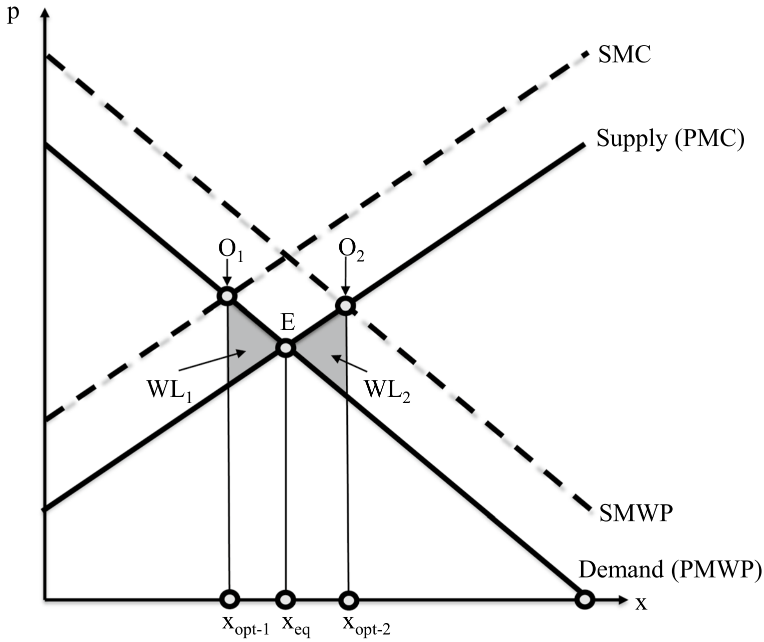

Fig. 2 The logic of action in imperfect markets

that arise in the production of the good being traded. In this case, the intersection of demand and supply still defines the equilibrium (Point E), but the social optimum moves to point O_1. The optimal quantity of exchange (x_{opt-1}) is smaller than the equilibrium quantity (x_{eq}). Put differently, to the extent that the cost of pollution is not factored into the market price of the product, the production and consumption of this product will be excessive. The resulting welfare loss (WL_1) is represented by the grey triangle to the left of point E.

In the opposite case of positive externalities, the social marginal willingness to pay (SMWP) is larger than the private marginal willingness to pay (PMWP). To illustrate this situation, think of a product the aesthetic quality of which gives delight even to people who do not buy it. Many aspects of product safety and reducing risks to third parties are also examples of this case. Here, the intersection of demand and supply still defines the equilibrium (Point E), but the optimum now moves to point O_2. The optimal quantity of exchange (x_{opt-2}) is larger than the equilibrium quantity (x_{eq}). Put differently, to the extent that the societal impact of aesthetic pleasure or improved safety is not factored into the market price of the product, the production and consumption of that product are sub-optimally low. The resulting welfare loss (WL_2) is represented by the grey triangle to the right of point E.

Generally speaking, multi-objective theorists argue that firms should not restrict themselves to maximizing profit and should also pursue further goals. They base this argument on a number of reasons. Firstly, negative externalities harm people whose interests should not be ignored. This is in line with the interpretation of CSR as a firm's obligation to "do no harm" (Windsor 2012). Secondly, positive externalities benefit people whose interests should be taken into consideration. This is in line with the interpretation of CSR as a firm's obligation to "do good" (cf. McWilliams and Siegel 2001). The occurrence of potentially negative or potentially positive externalities is the primary reason for the objections that proponents of multi-objective theories of the firm raise to the general win–win orientation of single-objective theories (Dyllick and Hockerts 2002). Under such conditions, the critics claim, profit maximization amounts to disregard of and even disrespect for third parties. More specifically, they argue that in reality win–win situations are rare with regard to both positive and negative externalities, so firms can do good or mitigate harm all too rarely when they constrict their strategy to profit-making. The underlying idea is that firms should assume social responsibilities and factor into their strategy the effects they may exert on third parties. In economic terms: they should internalize external effects, which would necessarily require a motive beyond pure profit maximization.

In summary, normative multi-objective theories of the firm share the conviction that in order to solve some of today's most urging social and environmental problems, business objectives should not be narrowed to exclusively financial concerns. The underlying reason is that imperfect markets misdirect firm behavior and that therefore firms should correct the respective disincentives via pursuing multiple objectives beyond profit-making. We label this idea as the *"market failure argument."* Thus, we formulate

Argument 2: The main arguments of multi-objective theories of the firm presuppose the assumption of imperfect markets.

2.3 Intellectual stalemate: the need for a conceptual clarification

Our sketch of the two approaches reveals that both have their merits and limitations. The main strength of the single-objective approach is that it offers companies an unambiguous, implementable decision criterion that can be expected to deliver socially desirable results when markets are healthy. Its main shortcoming is, however, that it fails to justify companies' responsibilities in cases of market failures. As Mitchell et al. (2016) argue, profit-maximizing firms are often seen as the cause of, rather than the solution to, undesirable market outcomes, so in their view, neo-classical economics "arguably fails to deliver on its social welfare promises." On these grounds, critics have challenged one of the most important premises of single-objective theories of the firm; namely, that private profit-maximization leads to socially optimal market outcomes (see also Newbert 2017; Stout 2012). Summarizing these criticisms, Donaldson and Walsh (2015) described neo-classical economic theory metaphorically as a "beleaguered straw man."

The current situation is characterized by a two-sided embarrassment of *mutual* criticism: On the one hand, single-objective theories are ill-prepared to counter the normative argument, raised by their opponents, that under imperfect market conditions profit-maximizing behavior misses the societal optimum by exerting too much harm or by providing too little benefits to third parties. On the other hand, multi-objective theories are ill-prepared to counter the five arguments raised by their opponents.

Reflecting on this state of affairs, it might be helpful to translate the respective arguments and counter-arguments as follows. (1) The single-objective approach rests on a "win–win" argument: that profit-seeking is good for the firm via enhancing consumer sovereignty and general welfare. (2) Given market failures, proponents of the multiple-objective approach rightly argue that the market provision of consumer sovereignty does not guarantee general welfare. From their point of view, profit maximization leads to "win–win–lose" outcomes: profitable for the firm (first element: "win"), beneficial to its contract partners (second element: "win"), but harmful for third parties that are not directly involved in the market transaction (third element: "lose"). (3) In the case of market failures, proponents of the multiple-objective approach identify a tradeoff between the firm's profit and the regard and respect for the well-being of third parties. Within this tradeoff, they propose a normative re-balancing. This amounts to a "lose–win–win" outcome. Social and environmental goals are meant to correct the harmful effects of profit-seeking. Less financial gain is thought necessary to improve general welfare. (4) Against such "lose–win–win" arguments, proponents of the single-objective approach can point to numerous considerations. Even if they (have to) concede that in cases of market failure profit maximization no longer guarantees a general welfare optimum, they still can rely on the four positive arguments of "competition," "managerial orientation," "fiduciary obligation" and "personal career" in order to raise doubts about the desirability and even the feasibility of the multiple-objectives approach.

The current debate is in a state of intellectual stalemate because given the choice between "win–win–lose" and "lose–win–win" outcomes, it is very difficult to take sides. Summarizing our findings to this point, we formulate:

> **Argument 3:** Proponents of single-objective and multiple-objective theories of the firm tend to talk at cross purposes because the relevant background assumptions differ. In particular, the normative drive of the multiple-objective approach seems to be incompatible with the positive reservations of the single-objective approach. Seen from this perspective, the strength of one approach turns out to be the weakness of the other.

3 Overcoming the stalemate: a proposed solution from the vantage point of constitutional political economy

In this section, we propose a conceptual clarification on how to overcome the clash between single-objective and multi-objective approaches. Our aim is to offer a remedy to each perspective's weaknesses while leveraging on their respective strengths.

3.1 Two levels of choice: moves in a game versus rules of a game

To reconcile the two seemingly antagonistic theoretical camps discussed in the previous section, we draw on a constitutional perspective. The angle we propose is inspired by the contractarian approach that James Buchanan delineated in his research program of constitutional political economy (Buchanan 1990).

Contractarian approaches to business in general and to business ethics in particular have been proposed before, most prominently in the works of Thomas Donaldson and Thomas Dunfee, who developed the Integrative Social Contracts Theory (ISCT, cf. Donaldson and Dunfee 1994; 1999). In contrast to ISCT, the purpose of our approach is not to determine whether certain norms can be ethically *justified*, but to propose a workable way of *implementing* certain norms in competitive market economies (Schreck et al. 2019).

To that end, we intend to leverage James Buchanan's approach and one of its methodological cornerstones in order to draw a distinction between two levels of choice: the sub-constitutional action level and the constitutional level of rules (Buchanan 1987; 1991), which we will describe in detail below. One of the basic assumptions of contractarian approaches is that the members of a society may have an interest to submit voluntarily to binding rules of behavior—in other words, to a social contract. As David Gauthier has so eloquently put it: "Rational constraints on the pursuit of interest have themselves a foundation in the interest they constrain. Duty overrides advantage, but the acceptance of duty is truly advantageous" (Gauthier 1986). Furthermore, it is important to note that agents who negotiate a social contract have a broader concept of self-interest, since they take into consideration the potential effects of incentives in the long run, both on their individual well-being and on society. In this sense one can say that the reason for having rules is to enable the rule of reason (Brennan and Buchanan 1985).

According to this social contract perspective, the choices that the members of a contractually bound community have are located on two categorically different levels (Buchanan 1987; Vanberg 1986; 2007). On the sub-constitutional action level, actors (i.e., individuals or organizations) are participants in a "game" that they play by choosing their moves within a given set of rules; and as players they (try to) make choices that pursue whatever they may regard as their best private interest. The set of available actions from which they can choose is limited by a social contract, so certain types of behavior such as theft, coercive power or deception are excluded from these options. Within these boundaries, however, choice is solely determined by subjective self-interest as perceived by the players themselves.

In contrast, the constitutional level corresponds to the rules of the game, i.e., the institutional incentives that the game provides. These rules constrain the set of alternatives from which agents can choose on the action level. They stipulate which actions are allowed, and which ones are not. In the short run, such constraints may be exogenously imposed on the actors, as is the case with codified law. But in the long run, actors can influence the constraints themselves, e.g. by exit or voice (Hirschman 1970). Actors can participate in the establishment or reformation of their institutional arrangements. Here, the relevant choice constraints are not limited to formal rules, and they may have emerged from different sources. According to Buchanan (1990), the "constraints that restrict the set of feasible choice options may be imposed by nature, by history, by a sequence of past choices, by other persons, by laws and institutional arrangements, or even by custom and convention."

Using the metaphor of a "game," the crucial difference is between the moves and the rules of a game. We thus have to distinguish between (1) playing a game by choosing one's moves within given rules and (2) changing the game by reforming the rules. On the sub-constitutional action level, players make choices *within* given constraints. On the constitutional rule level, they choose *among* constraints. The first type of choice amounts to playing a game within given rules, the second type to changing the game by reforming the rules. The first type means to choose one's moves *in* a game, the second to choose the rules *for* a game.

Equipped with this categorical distinction, we can formulate

> **Argument 4:** In defining business responsibilities, large parts of the literature on both single-objective and multi-objective theories tend to ignore the constitutional level that we highlighted, where the rules of a game are formed and reformed. Both types of theories are inclined to concentrate on the sub-constitutional action level, i.e. the moves in a game.

3.2 The point of tension reconsidered: stability and optimality

We will now revisit the debate on the corporate objectives firms ought to pursue in the context of the previous discussion. As explained, the arguments underlying single-objective theories of the firm are strongest under the assumption of perfect markets, but they tend to disregard the normative dimension of the problem. The "normative dimension" refers to the "optimality aspect," as we termed it; namely, to the fact that in imperfect markets profit-maximizing firm behavior leads to undesirable, suboptimal ("win–win–lose") results. Conversely, multi-objective theories of the firm focus on instances of imperfect markets, and they argue that companies ought to correct these imperfections. As a consequence, these theories disregard the positive dimension of the problem or the "stability aspect" as we termed it; namely, that profit maximization is incentive-compatible for firms and managers (as reflected in the four positive arguments we labelled "competition," "managerial orientation," "fiduciary obligation" and "personal career"). Therefore, it is questionable whether the proposed normative ("lose–win–win") results are feasible. While the aspect of stability is one of the main strengths of single-objective theories, the aspect of optimality is their weakness. With multi-objective theories it is exactly the other way round: the aspect of social optimality is one of their main strengths, while the aspect of stability is their weakness.

The intellectual stalemate between these two positions can be re-formulated as follows: single-objective theorists assert that under perfect market conditions stability warrants optimality. Multi-objective theorists consider this assertion flawed and in turn assert that under imperfect market conditions stability lacks optimality. The latter theorists in fact argue that both positive and negative externalities need to be taken into account and that firms should care about the socially desirable optimum (Heath 2014; Jones and Felps 2013).

Single-objective theorists, on the other hand, regard the assertions of multi-objective theorists as flawed and posit that under imperfect market conditions it is optimality that lacks stability. They claim that it would be unrealistic (and even dysfunctional) to expect firms and managers to act against their self-interest (Jensen 2002; Sundaram and Inkpen 2004).

In this debate, multi-objective theorists argue that the normative dimension *should* dominate the positive dimension, while single-objective theorists argue that the positive dimension *in fact* dominates the normative dimension. Furthermore, multi-objective theorists argue that firms *should* act differently, while single-objective theorists counter-argue that firms *cannot* behave differently.

The way out of this stalemate becomes clear once one realizes that both camps tend to focus on the moves within a game and thus fail to see the role that companies can play on the constitutional level where the rules of the game are defined. Consequently, from a constitutional perspective, it is possible to reconcile the contradictions between the two positions. Although both theories are incompatible when limited to a single level (the sub-constitutional action level), once they are placed in a constitutional two-level framework that distinguishes between the moves and rules of a game, it becomes possible to combine their strengths and eliminate their weaknesses and thus their (seeming) incompatibility.

> **Argument 5:** Instead of choosing between "win–win–lose" and "lose–win–win" outcomes, the constitutional perspective draws attention to firm behavior that brings about institutional change in favor of "win–win–win" outcomes that combine optimality with stability.

Faced with the intellectual stalemate between single-objective and multiple-objective theories of the firm, the "constitutional way of thinking" (Buchanan 2003) prompts a new question that is conceptually different. This question does not address directly the moves *in* a given game but rather the rules *of* the game: is it possible to design a mode of institutional reform that shifts the equilibrium towards the social optimum? This question takes seriously the argument of multiple-objective theories that it is socially desirable to strive to approach the optimum rather than the equilibrium, i.e. to avoid "win–win–lose" outcomes. At the same time, it also takes seriously the argument of single-objective theories that all you can realistically ask of firms and managers that operate under competitive pressure is to approach the equilibrium, i.e. to avoid "lose–win–win" outcomes. In contrast to the one-level approach, the constitutional two-level perspective liberates firms from the tradeoff of having to choose between striving for the optimum or striving for the equilibrium. Indeed, institutional reforms that bring the equilibrium closer to the optimum are a superior alternative to either choice. This alternative brings about "win–win–win" outcomes, thus avoiding the contradiction between the firm's self-interest and the self-interest of third parties, fully acknowledging the moral point of view that both aspects are equally important. Put differently, the normative stimulus of multiple-objective theories (to take care of the third "win" in "win–win–win" outcomes) and the positive stimulus of single-objective theories (to take care of the first "win" in "win–win–win" outcomes) are not necessarily in conflict. They are not substitutes. From a constitutional perspective, they can rather complement each other.

In the next section, we want to draw several conclusions that immediately follow from our proposed change in perspective.

4 Implications for normative business ethics: institutional reform and corporate objectives

One of the last section's central results was that if markets fail, any proposed solution has first to take place on the constitutional level that then reorients the action level. What remained open is who should bring about such institutional reform. So who is responsible for (re)forming the rules of the game when market equilibrium and social optimum fall apart?

The economic textbook answer is: the state. Moreover, many proponents of the single-objective approach seem to agree with this answer. For instance, Jensen (2002) writes: "Resolving externality … problems is the legitimate domain of the government in its rule-setting function." In effect, proponents of the single-objective approach often confine business responsibilities to the action level, and they advocate a narrow conception of these responsibilities.

In contrast, advocates of the multiple-objective approach typically argue that improving market outcomes is a responsibility of market participants, especially of business firms, who are requested to take into account societal concerns with general welfare and to re-balance their individual profit orientation accordingly. Therefore, although they broaden the concept of business responsibilities by calling for an integration of other than purely financial objectives into the decision logic, they still often confine business responsibilities to the action level.

As long as both perspectives focus on the action level, the whole dissent is about whether to apply a narrow or a broad conception of business responsibility on the action level. Judged by our conceptual clarification, both perspectives miss an important point by fading out the constitutional level as an arena of corporate engagement.

Applying a two-level conception as outlined above may help both approaches overcome these limitations. In order to focus on the core of the matter, it is advisable to draw a distinction between two kinds of responsibility: (1) a sub-constitutional responsibility with regard to choosing one's moves in a given business game, which we call "action responsibility," and (2) a constitutional responsibility with regard to (re)forming the rules of a business game, which we call "ordo responsibility."[7] This distinction helps us to convey the central message of this article.

4.1 Who is responsible for changing the rules of the game? A plea for corporate "ordo responsibility"

If markets are healthy in that the social optimum is stable, it is legitimate to confine business responsibilities to narrow action responsibilities. But if markets fail in that

[7] "Ordo" is the Latin word for institutional order, the framework of rules, and thus captures nicely the crucial distinction we want to draw between the action level of a game (choices among moves with given rules) and the constitutional level (choices among rules for improving the game). For the concept of "ordo responsibility", see Beckmann and Pies (2016). For a discussion of a classic precursor, see Pies (2017).

they lead managers to make choices that are far from serving the public interest of society as a whole (Brenkert and Beauchamp 2010; Donaldson et al. 2007; Vogel 2005), we propose it is a *business responsibility* to seek reform on the constitutional level. This proposition can be justified with reference to the central arguments of both single-objective and multi-objective approaches alike.

If we take seriously the arguments of single-objective proponents, it is often the case that morality cannot simply be "added" to the managerial decision logic. One problem with such an understanding of moral responsibility is that if "being moral" leads to competitive disadvantages, then morality has few chances of becoming a lasting principle of decision-making for managers and firms (Homann 2002; Weber 1930/2002). In the same vein, thinking that profits should be traded off against ethical values leaves managers with no clear guidance how to decide (Jensen 2002).

If we, however, also take seriously the arguments in favor of a corporate social responsibility brought forward by multi-objective proponents, society is not well served if firms faced with market failures pursue profit maximization at the expense of social values. Hence, the only way to maintain the normative idea of corporate responsibility without discarding the positive arguments of the single-objective approach is to *overcome* the tradeoffs that exist on the action level. *Instead of choosing between "win–win–lose" and "lose–win–win" outcomes, the superior alternative is to help create, via rule reform, the institutional preconditions for "win–win–win" outcomes.*

This can be achieved when an appropriate norm is implemented on the constitutional level such that its incentive effects reorient the action level. For example, (self-)regulation, industry standards, and introducing or raising taxes can exclude undesired behaviors or make them less attractive in financial terms. In this sense, constitutional change (with regard to the rules of a game) affects sub-constitutional decision making (with regard to the moves in a game). Constitutional reform thus can help to overcome tradeoffs between financial and social values on the action level by translating the ethical aspiration into the profitable choice (we will discuss examples in the next section).

If constitutional change is successful, no company (and no manager) has to suffer competitive disadvantages from abiding by moral norms because the constitutional level is collectively binding. This means that responsible behavior by one firm can no longer be exploited by less scrupulous firms. As a result, when a desirable norm can be implemented on the constitutional level, companies (and managers) in competitive markets will be more likely to adhere to it on the action level.

Hence, in order to enforce socially desirable company behavior in light of market failures, it is important to strive for a collectively binding solution that overcomes tradeoffs between financial and other values. While endorsing the normative ends of multi-objective theories of the firm, the means we suggest in response to market failures are in line with the single-objective approach. Rather than playing differently in an otherwise unaltered game, we propose companies should try to change the rules of the game so that the logic of profit generation does not collide with other social norms. This would allow companies to continue to apply a profit-maximizing logic in their daily decision-making (on the action level) and simultaneously pursue goals other than purely economic ones (on the constitutional level) (Homann 1994). The main idea is to institutionally reconcile private profit maximization with pursuing general welfare.

Our two-level approach thus offers a specific suggestion on how companies can serve what Donaldson and Walsh (2015) call a "focal" and a "contextual" purpose. According to their proposed theory of business, a firm's *focal* purpose is to generate profits by serving customer needs; we locate this purpose on the action level. While a firm's *contextual* purpose refers to serve society as a whole, we locate this purpose on the constitutional level where companies can participate in processes of public discussion and political negotiation, thus engaging in norm-implementation without risking their competitiveness.

In summary, we can formulate

> **Argument 6:** The appropriate solution to problems of market failures is to complement a narrow conception of "action responsibility" with the idea of "ordo responsibility," thus combining the strengths of both single-objective theories and multiple-objective theories while avoiding their respective weaknesses.

To be sure, although we acknowledge profit-maximization as a legitimate decision-rule on the action level, we are not advocating laissez-faire. When markets fail, in the sense that competition provides incentives for sub-optimal behavior due to positive or negative externalities, we reckon managers *do* bear a social responsibility. This conclusion follows from our effort to account for the well-justified market failure argument. As we argued, this responsibility cannot mean that the corporate objective function ought to be extended to include non-economic (i.e. "social") goals. Nevertheless, companies must not be blind to the negative effects they have on society. For that reason, what we suggest here is not a re*duction*, but a re*direction* of corporate responsibility. While on the action level managers may be limited in what they can do in keeping with this responsibility, on the constitutional level their scope for action is greater. Consequently, we posit that the obligation of companies to consider multi-valued objectives translates into an obligation to push for constitutional reform in the case of market failures. Such a strategy allows companies to consider ethical concerns on the constitutional level without risking their market position on the action level.

4.2 Does the constitutional activity of rule-making require a motivational switch?

In this section, we want to emphasize the assumption of "behavioral symmetry," which is an important characteristic of the constitutional perspective, and we want to argue why this assumption is also appropriate for organizations, although Buchanan invented it for natural persons, not for legal persons.

"Behavioral symmetry" means that the same model of prudent self-interest should be applied across the border that separates business from politics. Confronted with the traditional notion of benevolent politicians and benevolent bureaucrats, Buchanan insisted that an approach which analytically aims at comparing institutional arrangements should not assume that people behave essentially differently in the spheres of market and state. For him, it was a matter of sound methodology to employ the same behavioral assumptions across borders. In this sense, Brennan and Buchanan (1985, chapters III and IV) vehemently opposed the "myth of benevolence" and instead marshalled an "argument for symmetry." Along these lines, James Buchanan (1987) wrote in his Nobel Lecture: "The differences in the predicted results stemming from market and political interaction stem from differences in the structures of these two institutional settings rather than from any switch in the motives of persons as they move between institutional roles."

We think that it is possible and even advisable to transfer this argument from natural persons to legal persons, from individuals to corporate firms. Of course, we use metaphorical language when we ascribe a profit motive to corporate firms. While individuals have motives, organizations do not. Nevertheless, it makes sense to assume that corporate firms are driven by a strong profit orientation due to competitive pressure. Markets provide a powerful feedback mechanism that strongly selects against firms that incur losses (Alchian 1950). In this sense, profit orientation is an integral part of the organizational DNA of a successful business firm. We may even say that profit is the overriding goal of a firm, even if we keep in mind that due to market competition profit orientation is a systemic imperative, and that from a societal perspective the goal of firms may be regarded as a means for channeling firm behavior.[8] That is why we interpret firms as commissioners of society. Their mission is to earn profit via value creation that raises general welfare.

In the business sphere, no motivational switch is required in order to make sure that firms prefer win–win outcomes to win–lose outcomes. The underlying reason is straightforward: Win–lose outcomes are bad (for) business. If your interaction partners do not benefit, your business model is likely not successful in the short run and certainly not sustainable in the long run. Therefore, it is prudent for firms to include the diverse interests of their interaction partners in the organizational definition of self-interest. This self-interest of the firm in respecting and fostering the self-interest of, e.g., its workers, customers and suppliers could be called "instrumental empathy."

By analogy, the same reasoning holds when we turn from the action level of business behavior to the rule level of constitutional activities. In the political sphere, no motivational switch is required in order to make sure that firms prefer win–win–win outcomes to win–win–lose (or even lose–win–win) outcomes. Again, the underlying reason is straightforward: Win–win–lose outcomes are bad (for) politics. If third parties are harmed, your business model will meet political resistance, and you run the danger of losing your "license to operate." Therefore, there is a prudence basis for enlarging the reach of "instrumental empathy" beyond customer friendliness.

[8] We would like to reiterate that our assumption of profits as the overriding corporate goal is a methodological ascription, not an ontological statement. We neither claim that companies have motives in an empirical sense; nor that all companies, let alone founders and managers, are predominantly driven by the desire to make money. What we argue is that for the sake of theoretical consistency, it is legitimate and useful to make this assumption (cf. also Schreck et al. 2019).

At the constitutional level, firms are well advised to respect, regard and foster the diverse interests of *all* stakeholders and to take into account whatever they regard as legitimate or illegitimate. When engaging in rule-making activities, it is therefore prudent for firms to be sensitive to moral desiderata, e.g. with regard to human rights (and the human interest in animal rights and in avoiding environmental degradation). In this respect, we would argue against the call for democratization of business firms (Scherer and Palazzo 2011), i.e. for a drastic change in the internal governance structure, in order to bring about a motivational switch they hold to be necessary for firms to act on the constitutional level as rule-makers. Arguably, such a drastic change is neither necessary nor desirable (Hielscher et al. 2014; Sabadoz and Singer 2017).

In this respect, it is important to note that the recent literature on "Political CSR", "Corporate Citizenship", "Ethical Lobbying" or "Responsible Lobbying" tends to duplicate the frontline (and stalemate) between single-objective and multiple-objective theories of the firm in discussing whether corporate political activity should conform with or deviate from profit maximizing behavior. As a case in point, Lock and Seele (2016: 418) call for "*deliberative lobbying*" in the sense that they normatively expect business firms which engage in the political sphere "to make noninstrumental, nonopportunistic decisions focused on the solution of public issues" (p. 418). We hold that our concept of "ordo responsibility" with its emphasis on "behavioral symmetry" and "instrumental empathy" might help to inform and even redirect this literature from morally calling for motivational switches towards securing improved institutional incentives for corporate political activities.

Our main thoughts here lead us to formulate

> **Argument 7:** The constitutional activity of rule-making by firms does not require a motivational switch. It is a natural property of enlightened self-interest that assuming "ordo responsibility," i.e. taking part in politically (re)defining the rules of a game, provides a stronger incentive for enlarging instrumental empathy than choosing the moves in a given business game.

The notion that companies may have an interest in supporting socially beneficial rule changes prompts an obvious question: If the assumption of an "ordo responsibility" is in the companies' own interest—why don't they automatically assume such responsibility? Why does it take an ethical approach to convince companies to further their self-interest by means of ordo responsibility?

To see the role that ethics can play here, let us reconsider our main argument. We argued that on both the action and the constitutional levels, there are business opportunities that are desirable in an ethical sense. But despite the similarities of these opportunities across both levels, there is one crucial difference. Companies have long specialized in exploiting business opportunities on the action level, e.g. by means of product or process innovations. But engagement on the constitutional level is fundamentally non-trivial for companies because it requires "non-market strategies" (den Hond et al. 2014) which involve political processes and thus require categorically different competencies than conventional market interactions. In the political sphere, rule-finding discourses and rule-setting processes require

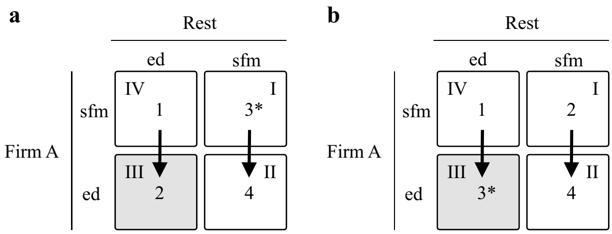

Fig. 3 Two alternative situations

cooperation with other companies (Velamuri et al. 2017), with NGOs and the public sector (Ashraf et al. 2017; Caldwell et al. 2017; Quélin et al. 2017; Rivera-Santos et al. 2017)—that is, cooperation with stakeholders who have very different cultures, traditions, and decision logics and who not only hold different views but even speak different languages. To identify potentially profitable and beneficial rule changes, and to competently translate the different languages involved here, presupposes various governance and discourse-related competences (Pies et al. 2010). Consequently, we see it as a major task of business ethics to specify and communicate the management competencies it takes for companies (and their leadership) to live up to their "ordo responsibility," since this has not (yet) become mainstream in the theory and practice of business administration. The next two sections aim at providing the necessary insights for learning (and teaching) how to take "ordo responsibility".

4.3 When is it attractive for firms to assume "ordo responsibility"?—The prospect of collective self-commitment

We have just argued that, *on the action level*, single-objective theories are right to defend profits as the guiding criterion for managerial decisions. We also argued that managers have a responsibility to reflect on undesired market outcomes while recognizing that they are unable to enforce single-handedly, as it were, the social optimum on the action level. We labelled this responsibility a company's "ordo responsibility:" If markets fail, management should seek to reform the rules of the game *on the constitutional level* in order to align the equilibrium with the social optimum of general welfare.

The (normative) call on companies to assume "ordo responsibility" on the constitutional level raises the (positive) question of whether firms are actually willing and able to engage in such behavior. To address this question, we distinguish two different classes of situations, as is illustrated in Fig. 3.

Figure 3a depicts a situation in which there is potential for changing the rules of the game in a way that will bring the equilibrium closer to the social optimum *and* benefit firms. That is, a win–win–win rule change is possible. As an example, let us consider a market in which companies trade wood with very low sustainability standards. This state of affairs falls short of the socially desired optimum because excessive deforestation has a wide range of economically and environmentally undesirable effects. In short, it lacks sustainability.

Figure 3a is a game-theoretical reformulation of Fig. 2. The equilibrium point E in Fig. 2 corresponds to the grey cell III in Fig. 3a, while the social optimum O_1 in Fig. 2 corresponds to cell I in Fig. 3a, marked by a star. In this game, a representative firm (A) plays against all other firms in the same industry, i.e. the rest of the group (Rest). The numbers refer to firm A's ordinal payoffs, which represent its self-interest in playing the game. At the sub-constitutional action level, firm A has a clear choice: either to follow the common practice of excessive deforestation (*ed*), or to switch to a sustainable forest management (*sfm*), avoiding excessive deforestation. As the two downward-pointing arrows make clear, firm A has a dominant strategy: to keep with the undesirable practice of excessive deforestation. To do so yields a higher payoff in both cases, i.e. irrespective of whether the competitors (Rest) choose *ed* or *sfm*. If they choose *ed*, deforestation is the only way for firm A to escape the worst case scenario of cell IV. If they choose *sfm*, deforestation is a sure way for firm A to acquire a competitive advantage and reach the best case scenario of cell II.

Since firm A is representative of the whole group of firms, what is true for A is also true for the rest of the group. Hence, no company of this industry branch has an interest in individually deviating from its best reply strategy. Since all choose *ed*, the equilibrium solution in this game is the strategy combination in cell III, marked by a star. Compared with cell I, cell III is Pareto inferior. This nicely captures the central insight of Fig. 2: stability trumps optimality.

Seen from a constitutional perspective, the game depicted in Fig. 3a shows that the overall situation would be improved if *all* companies adhered to higher sustainability standards. From their joint point of view, deforestation amounts to collective self-damage, an outcome all of them would like to avoid. However, within this game, the optimal solution (cell I) is not feasible. It is made impossible by disincentives, the consequence of which is that sustainable behavior on a purely individual basis would lead to competitive disadvantages.

Given this state of market failure, the game has to be changed in order to make the optimal solution feasible. This requires a switch from the sub-constitutional level of choosing moves within a given game to the constitutional level of choosing rules for a better game. In the improved game, the equilibrium migrates from cell III to cell I. In the new situation, all companies commit to a sustainable forestation policy and provide themselves with a collective assurance that the desired sustainability standard will be enforced so that deviating companies suffer sanctions. Hence, company A, representative of the industry branch, would have no longer an incentive to engage in excessive deforestation. Finally, all companies follow suit and are therefore better off because sustainable forest management secures the basis of existence of the entire industry. As this example shows, in some situations submitting to a collective rule can create a win–win–win potential which all firms can benefit from.

To realize such potential for improvement, firms can enter the political arena and engage in institutional reform in order to create for themselves better incentives for changing their behavior in the business arena. This means that firms can play a political meta game in which, through self-regulation, they redefine the rules of the

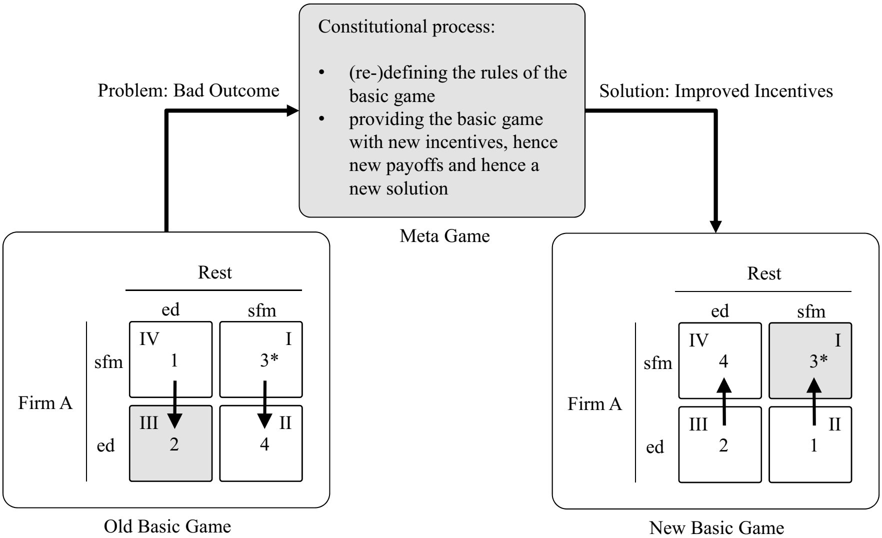

Fig. 4 The constitutional two-level model: the meta game reforms the basic game

basic game of economic value creation. Figure 4 helps clarify this idea: it depicts a process of constitutional learning that starts with the old basic game, progresses to the higher (meta) level of rule reformation, and ends with a new basic game (Pies et al. 2009). While in the old basic game the potential for win–win–win outcomes has already been exhausted, the meta game creates a new potential for such improvements. It is exactly this advantage of the new basic game over the old one that can make it attractive for firms to enter the meta game in order to provide themselves with better incentives for their basic game: better rules lead to new moves with better outcomes. In this sense, constitutional change is value creating.

In practice, companies have already begun to engage in initiatives that are aimed at changing the rules of the game by agreeing to new, collectively binding standards. A case in point is the standard that the Forest Stewardship Council (FSC) prescribes in order "to promote environmentally sound, socially beneficial and economically prosperous management of the world's forests".[9] Examples from other industries include Siemens' "collective action program" or the B20 Collective Action Hub.[10] A common characteristic of such initiatives is that they understand morally undesirable business practices at the action level as a joint problem, and they aim at offering joint solutions for this problem in the form of collectively binding standards.

In terms of Fig. 4, if a new standard becomes collectively binding, the payoffs in cells II and IV switch places. Violating the standard individually becomes the worst-case scenario (payoff 1), while compliant companies gain a comparative advantage

[9] https://us.fsc.org/en-us/what-we-do/mission-and-vision.

[10] Examples include http://www.siemens.com/about/sustainability/en/core-topics/collective-action/.; www.collective-action.com.

over competitors that do not comply with the standard (payoff 4). The institutional change implied by the introduction of an industry-wide standard involves changing the incentives. Now the dominant strategy is to (at least partly) internalize the external effect, so finally all firms contribute to the solution in cell I, marked by a star. In relation to Fig. 2, this means that the new equilibrium is no longer at point E. The collectively negotiated standard brings the new equilibrium closer to O_1 if a negative externality has to be addressed, and closer to O_2 if the goal is to internalize a positive externality. In terms of Fig. 3a, the equilibrium shifts from cell III to cell I and brings about a "win–win–win" outcome.

This clearly shows that enlightened self-interest is a *conditio sine qua non* for the behavior of firms, both in the business sector as well as in the political sector. Against this background, we formulate

> **Argument 8:** Enlightened self-interest is not only sufficient but also necessary for firms to engage in constitutionally transforming win–win–lose outcomes into win–win–win outcomes, thus assuming "ordo responsibility."

4.4 The limits of "ordo responsibility"

"Ordo responsibility" is no panacea. It is a specific concept for addressing market failures if a single nation state does not (or even cannot) solve these problems satisfactorily. It is a revelation that firms may have an enlightened self-interest in improving the rules of the business games they play—an interest in constitutionally transforming win–win–lose outcomes into win–win–win outcomes. From our point of view, the concept of "ordo responsibility" has its merits, but it also has its limits.[11] These limits are met when a rule change that brings the equilibrium closer to the social optimum would leave firms worse off. In this case, companies have no interest in bringing about institutional reforms even though that would be desirable from society's perspective. For example, let us consider the monopolist that has no interest in introducing competition (although in most cases competition is socially desirable), the producer of landmines who has nothing to win from a worldwide ban on landmines (although society would be better off if landmines didn't exist), the manufacturer of counterfeits who would not benefit from the strict enforcement of intellectual property rights (although they are key to functioning markets) or, finally, the tobacco company that has nothing to gain from higher taxes on cigarettes that aim at reducing tobacco consumption (although such reduction would improve general welfare via positive health effects).

Figure 3b captures such instances. It depicts a situation in which all firms in a specific industry are happy with the status quo and have no interest to promote institutional reform. The situation and the profit-maximizing calculus are similar to

[11] We thank an anonymous reviewer for pointing out limits that refer to all kinds of contracts, including endogenously set rules in the market. *Ex ante* defined rules are systematically incomplete and cannot account for all *ex post* contingencies. Hence, ordo-responsibility entails the responsibility to continuously reflect on the rules' adequateness and seek reform where necessary. Sometimes, the incompleteness of rules even justifies the call for companies to compensate for regulatory deficits (Homann 1995: 17–25).

the situation represented in Fig. 3a. The only difference is that in Fig. 3b, companies prefer the equilibrium (point E in Fig. 2 = cell III in Fig. 3b) over the societal optimum (point O_1 or O_2 in Fig. 2 = cell I in Fig. 3b). That is, no company has an interest in a rule change that would make the social optimum the equilibrium. Here, firms have neither an incentive to deviate from the equilibrium single-handedly, nor an interest in constitutional reform that would change their business game.

This means that in all cases represented by Fig. 3b, the concept of "ordo responsibility" cannot be applied. Expecting companies to voluntarily establish and submit themselves to a new rule that is favorable to society but unfavorable to themselves would be asking too much. Clearly, if profit maximization is a firm's dominant motive, there is little chance that this firm will push for changes of such kind. From the perspective of normative business ethics, this raises the question of how rules that are desirable from the viewpoint of society but undesirable from the viewpoint of companies can nevertheless be implemented. We discern two possible avenues along which normative business ethics may argue: (1) it can call for companies to change their objectives; (2) alternatively, it can accept that the concept of corporate political responsibility has certain limitations.

In our view, the proponents of a multi-objective theory of the firm are advocates of the first possibility. The logic behind expecting companies to change their objectives is that if the traditional corporate objective of profit-maximization prevents firms from engaging in socially desirable reforms on the constitutional level, the alternative lies in "modifying the corporate objective itself" (Jones and Felps 2013). Accordingly, various authors have proposed that in order to fulfill their role as participants in rule-setting processes, companies have to abandon their traditional self-concept as purely economic agents and view themselves more broadly as "political actors" (Scherer and Palazzo 2011; Scherer et al. 2016), "citizens" (Matten and Crane 2005; Moon et al. 2005; Ulrich 2009) or promoters of "stakeholder happiness" (Jones and Felps 2013). As already noted, (Lock and Seele 2016) is another case in point.

Whether the prospects of such expectations being met are positive or not is ultimately an empirical question. In our view, although this possibility may sound appealing in theory, empirical evidence warrants caution. As the examples of monopolies, landmines, counterfeits and the tobacco trade demonstrate, socially desirable changes in the rules of the market often have to be implemented against the wishes or at any rate without the support of the companies that are negatively affected by these rules (Hillman et al. 2004; Vogel 2010).

Sometimes companies may even act in socially undesirable ways on the constitutional level. One example is the lobbying that tobacco companies have engaged in to prevent governments from imposing stricter regulations on the tobacco trade (Neuman et al. 2002; Saloojee and Dagli 2000). Another example is the tactic that oil-producing firms have used; namely, funding studies that appear to refute the findings of scientific research on the effects that anthropogenic emissions of carbon dioxide have on climate change (Frumhoff et al. 2015). In view of such empirical evidence, we stipulate that if companies have few or no incentives to change the rules of the game, it is simply unlikely that they will try to do so, even if changing the rules is desirable from the viewpoint of society. It would thus be naïve to assume that all societal problems can be solved so that everybody benefits. Sometimes, a few actors will have to lose a little, to allow the majority of citizens to win a lot.

On the basis of that principle, in the cases that Fig. 3b represents, the second possibility seems more promising. The concept of "ordo responsibility" is a powerful tool for prompting companies to commit to policies that foster general welfare. However, it is no universal weapon, so business ethics should acknowledge this concept's limitations. These limitations are marked by a lack of business interest in rule changes. In our view, in such circumstances business ethics should not expect companies to help push the equilibrium closer to the social optimum. Although we certainly do not argue that institutional reforms should be abandoned in such cases, we do argue that companies are very unlikely to promote such changes.

> **Argument 9:** The concept of "ordo responsibility" reaches its limits where a socially desired rule change would leave companies worse off.

For that reason, the role of other societal groups such as the state, political parties, NGOs, consumer representatives and other special-interest groups that would support such reforms is very important (Mena and Waeger 2014). In a dynamic perspective, these actors can initiate learning processes so that changing the rules might *become* the interest of companies over time (Shevchenko et al. 2016). For instance, a number of different actors can determine whether the discrepancy between market equilibrium and social optimum becomes a public issue and whether it poses risks to the market position of the companies involved. These actors would include stakeholders that are directly affected by positive or negative externalities, their advocates, and the media (Bosse and Coughlan 2016). If any of these actors succeeds in making the discrepancy between equilibrium and optimum a public issue (or in making it more likely that it will become a public issue in the future), prudent managers will seek ways to preserve the relationships of trust that have been established between their companies and these stakeholders and to avoid the reputational costs of scandals, which might jeopardize these relationships and the according reputation capital. In sum, firms might learn in the course of time to form an interest in constitutional change because even if their payoff might be reduced as a result of reforms, it might be even further reduced if no such reforms took place or if they were delayed.

4.5 Normative ethics and the constitutional concept of "ordo responsibility"

With the concept of "ordo responsibility," we have proposed a constitutional approach to business ethics. Some critics may argue that because of its focus on self-interest and prudence, this concept does not represent an *ethical* position, but rather a kind of 'social technology.'

Since Aristotle's Nicomachean Ethics, it is widely accepted that the ultimate goal of ethics is to contribute to Eudaimonia, or human flourishing. On a modern interpretation, the goal of ethics is to improve everybody's prospects for productive peace and fulfilled lives. We accept this goal of ethics in a quasi-axiomatic way. Consequently, it is not our goal to justify why child labor or slavery are illegitimate practices, why the natural environment should be preserved, or why we need to fight sexual harassment, racism and other forms of discrimination at the workplace.

What we are interested in is not how to justify ethical values and ideals, but how to come closer to their actual realization in life. Inspired by Hegel's (1807/2010) anti-utopian criticism of the "perennial 'ought'" (p. 220) and his warning against the danger of being "led into error by intellectual fantasies which merely *ought* to be" (p. 220), we believe that whether a norm *can* be justified also depends on whether it can be implemented. With the goal of implementation in mind, we employ prudential arguments because if we take seriously the arguments of the single-objective theories of the firm, we need to acknowledge that it is very unlikely that companies under competitive pressure will systematically give priority to other than financial goals. Despite the reliance on self-interest and prudential arguments, we believe that our approach can make a strong contribution to normative business ethics. Our constitutional approach points out that—not always, but—very often companies have an interest to help solve the most urgent moral problems, including child labor, corruption, environmental pollution, and sexual harassment. Implementing this interest, however, requires a switch to the constitutional level if "action responsibility" runs into tradeoffs. In this sense, one may call our approach of "ordo responsibility" a social technology, but one that is committed to the universal goals of normative ethics and is thus inseparable from normative ethics.

> **Argument 10:** Despite its reliance on self-interest and prudence, the constitutional approach offers a contribution to normative business ethics by pointing to "ordo responsibility" as a new option for realizing moral desiderata

While the arguments above indicate that our approach does contribute to normative business ethics, we would like to emphasize that it entails a weak form of normativity. The constitutional concept of "ordo responsibility" aligns itself with multiple-objective theories of the firm in arguing that cases of market failure should be taken seriously by all business actors involved. However, to make their point, multiple-objective theories of the firm often invoke a strong concept of normativity. Typically, they claim that firms are morally obliged to avoid win–win–lose outcomes, even if this amounts to lose–win–win outcomes. In fact, strong normativity is an integral part of these approaches, since the whole argument of re-balancing profit with societal welfare rests on the notion that there is an overriding duty that firms should carry out, even if this means to sacrifice profit when faced with tradeoff situations.

In contrast, the constitutional concept of "ordo responsibility" employs a weak notion of normativity. It encourages firms to improve the equilibria of market processes. It does so with recourse to prudence arguments of enlightened self-interest. However, it does not aim at morally obliging them to sacrifice profit. Here, normativity is not meant to postulate duties that firms have to carry out. Instead, normativity is understood and employed as a heuristic device for improving self-interested decisions.

The concept of "ordo responsibility" is normative in encouraging moral behavior, but it is only weakly normative (and anti-utopian) in abstaining from postulating strong moral obligations that cannot strictly be met by firms acting under

Normative Debate: What should be the objective of the firm?

	Single-objective theory of the firm	Multi-objective theory of the firm
Main normative claim	Managers ought to consider profits as the guiding decision criterion	Managers ought to consider multiple (private, social) values as the guiding decision criterion
Alleged strengths	- enhances social welfare (*consumer sovereignty argument*) - accounts for competitive pressures (*competition argument*) - offers managers an unambiguous decision criterion (*managerial orientation argument*) - profit maximization as a governance instrument (*argument of fiduciary obligation*) - managers face career risks when they fail to prioritize profits (*personal career argument*)	- acknowledges cases of market failure - strengthens the role of companies in solving social problems - is better suited to enhance all stakeholders' welfare than single-objective theories
Alleged weaknesses	- does not account for cases of market failures - thus fails to deliver on its social welfare promises	- may actually decrease social welfare - is unrealistic because it ignores competitive pressures - fails to offer managers an unambiguous decision criterion

	Constitutional perspective (inspired by Buchanan's constitutional political economy)
Main normative claim	Resolves debate by distinguishing between the action and the rule level; and assigning two different roles to single- and multi-objective theories of the firm
Action level (basic game)	- profits ought to be the guiding decision criterion when market assumptions hold - obligation to reflect upon validity of *consumer sovereignty argument* - if private and social values collide (trade-off between profits & morality), obligation to seek solutions on the rule level
Rule level (meta game)	Companies have the responsibility to participate in the process of forming and reforming the rules of the basic game so that - legitimate claims (based on multiple values) can be weighted and considered; - companies benefit from rule changes: either by increasing profits, or by avoiding a decrease in profits; - incentives on the action level are changed such that companies will internalize negative (or provide positive) externalities without suffering competitive disadvantages; - the new incentive structure legitimizes companies' focus on profits on the action level.

Fig. 5 Summary of the main arguments

competitive market pressures. In our view, this 'weak' concept of normativity constitutes a *strength* of the proposed concept as it avoids moral appeals that lack incentive compatibility. Instead, it provides intellectual orientation for realizing morally superior win–win–win outcomes.

Against this background, we can formulate

> **Argument 11:** Broad conceptions of "action responsibility" tend to invoke a strong notion of normativity. Faced with non-compliant behavior by firms, their theory strategy is to search for normative grounds that allow even stronger claims for morally obliging duties. In contrast, we favor to combine a narrow conception of "action responsibility" with a narrow conception of "ordo responsibility" that employs a weak notion of normativity. The theoretical goal is not to oblige but to encourage firms to increase the general welfare on a strict prudence basis of enlightened self-interest.

5 Summary and outlook

Figure 5 summarizes the main arguments to this point. Having identified a clash between single-objective and multi-objective theories of the firm, we proposed a way to reconcile these two approaches. The constitutional perspective we applied for that purpose distinguishes between two levels: the sub-constitutional level of action, on which the moves in a game take place (that is, actors make choices *within* constraints), and the constitutional level of rules, on which changes in the institutional framework of a game can be made (that is, actors make choices *among* constraints). Our core argument is that this distinction makes it possible to combine the strengths of both single-objective and multi-objective approaches and to avoid their weaknesses.

The approach we proposed has important implications for future research. In particular, empirical research may identify and analyze cases in which companies have successfully assumed "ordo responsibility." In contrast to instances of undesirable corporate lobbying (Hillman et al. 2004; Vogel 2010), a better understanding of best practice examples could help clarify the conditions under which companies manage to go beyond their action-level interests and take into account a broader set of social values. So far it remains largely unexplored how companies have successfully contributed to the establishment of collectively binding rules that benefited both market participants and society as a whole.

Such knowledge would be of very high practical relevance, because even when there is a potential for "win–win–win" rule changes, this does not necessarily mean that this potential will translate into actual changes. While it may be in the interest of companies to change the rules, they may be unable to commit to such changes due to practical dilemmas: changing the norm-enforcing institutions or establishing new ones is costly, so for individual firms it may make sense not to comply with the restrictive rules to which competitors submit. This means that the problem in the basic game—the dilemma between wanting to change the rules and refraining from changing the rules—is then replicated in the meta game. Consequently, what hinders firms from finding a solution on the action level is reproduced on the rule level and thus hinders them from improving their basic game. This problem has become known as a "second-order free-rider problem" (Kosfeld et al. 2009).

Although second-order dilemmas are an obstacle to changing the rules in a socially desirable manner, there are ways to overcome them. Theoretical and empirical research on the emergence of institutions through collective action (Brown et al. 2005; Ostrom 1990) has identified factors that make it more likely that the members of a social group commit themselves to win–win–win rules. More recently, this research has been extended by extensive experimental work on endogenous institution formation (Isaac and Norton 2013; Lindenberg 2014; Sutter et al. 2010). We believe that future research could investigate how exactly firms, together with various stakeholders, can be successful in overcoming second-order dilemmas.

Acknowledgements We acknowledge comments from Juliane Reinicke, Andreas Suchanek, Dominik van Aaken, participants of the Strategic Management Society Annual Meeting 2016, and the 2017 Zicklin Center Normative Business Ethics Workshop at the Wharton School, and the Academy of Management Annual Meeting 2018. We would also like to thank two anonymous reviewers for their valuable suggestions and helpful criticisms that were very conducive to improving the form and substance of this article.

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