

# *Centesimus Annus* and a Multi-Disciplinary Perspective on the Nature of the Firm

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1. The Encyclical *Centesimus Annus* offers a comprehensive ethical framework for defining the objectives and nature of enterprise. It focuses not only on the priority of labour, but also addresses the issues of property, responsibility of investors, corporate governance, markets and profit.
2. These orientations remain, however, at the level of general principles. We may ask ourselves how they relate to recent debates on the nature of the firm, both from sociological, economic and juridical perspectives. Two issues deserve special attention:
  - a. the development of neo-institutional models of thinking about the nature of the firm. These models are more compatible with Catholic Social Teaching than the neo-classical model, but they also illustrate some remaining difficulties to put the ethical ideals of Social Teaching (e.g. of workers' participation) into practice.
  - b. the relevance of collective agency and responsibility, both from a managerial and a juridical point of view, for defining the moral quality of business conduct, has not been taken into account in the ethical reflections of Catholic Social Teaching, as it should be.

Both issues are interwoven, as an institutional approach to the firm, especially in a sociological perspective, leads unavoidably to issues of corporate agency and responsibility. Consequently, I will treat the two topics together. I distinguish, on the other hand, methodologically between sociological, economic and juridical approaches that may complement the way of thinking about enterprise in Church Social Teaching.

## **1. Sociological approach: from organisation to institution.**

In popular language the concept of an enterprise (*Unternehmen*, *onderneming*) is a complex one. An enterprise is first of all an economic entity (a firm) in which goods or services are profitably produced and/or traded at private risk and initiative (I exclude public enterprises here for the sake of brevity). It involves, secondly, a typical network of relationships regarding ownership of the means of production and of the goods produced, regarding the organised participation of hired labour and management, and of all other "stakeholders". Thirdly, this entity has some juridical form and moral personhood, e.g. as a corporation or a "société anonyme", with its specific regulations of accountability in civil and penal law.

Before entering into the specific debate it is important to realise that, in every-day discourse and action, a triple tension or even contradiction appears in the common perception of enterprise. We will meet these common "conflicts of interpretation" throughout the following analysis:

- a. The enterprise as a socio-economic entity (firm) and as a juridical entity (corporation). Many people may be members of the former without having any access to the latter and vice versa;
- b. Profit as an overriding aim and criterion of the existence of enterprises versus the pursuit of other goals (continuity, prestige, power, etc.);
- c. The relationship between capital, management and labor regarding ownership and control over the enterprise and its realised products.

Because of these inherent tensions, the definition of the moral status of enterprise cannot remain limited to a purely technical and analytic discourse. It necessarily involves a number of moral choices and orientations regarding the preferred form of economic organisation in our society.

A first way to clarify the nature of enterprise is to transcend the oversimplified vision of the firm as only a profit-maximising device. Of course, the creation of profit is and remains a necessary and worthy motive of all private enterprises - profit is and should be the bottom line for evaluating an enterprise's efficiency -. And, of course, all enterprises appear in the final instance as commodities on the market: as goods which can be sold and purchased at any moment. As such they seem like "expendable tools", instruments which can continuously be assembled and disassembled, under the impulses of investment alternatives.

This picture of enterprise is correct, but it shows only part of social reality. Sociologists, such as Philip Selznick in his classic **Leadership in Administration** (1957) have stressed

the fact that enterprises as social realities cannot be limited to the purely instrumental level of the efficient, profit-maximising organization. Theoretically and practically, they may have been conceived that way at their start by investors and management. But as time passes, and relationships evolve inside and outside the firm, participants inevitably start to endorse other motives and values than the only profit motive, which may relativise or eventually even override the latter. They find social prestige and a new status by identifying with the firm, they appreciate the possibilities it offers for establishing social contact and wielding power, and they enjoy membership in the specific corporate culture of which they have become a part. As a result, continuity of the firm, including cultivation of its quality label and good name, may become an overriding goal of entrepreneurship. Instead of a merely instrumental entity (the "expendable tool"), the enterprise has become an institution for its participants, being valued for its own sake. Its goal definition has become more complex than simply maximation of profit, combining

the pursuit of a sufficient amount of profit with other desirable ends such as long term continuity, social prestige, taking distance from competitors, exerting political influence as a corporation, etc.

The above argument is an empirical one, and not a normative; however, it includes an implicit critique of those theories of enterprise which can only appreciate its functioning as a profit-maximising mechanism, and consider all other goal-attainment as a disfunction.

As we know, recent developments in economic theory have tended to confirm this institutional approach to enterprises (See, e. g., Coase and Williamson in Putterman, 1986). Contrary to the neo-classical view which clung to the purely instrumental character of enterprises, speaking of them in terms of "empty boxes" or of "islands of conscious power in an ocean" of free and competitive exchange, institutional economists have stressed the economic meaning of enterprises as cooperative structures with a certain amount of continuity. Enterprises save considerably on transaction costs and reduce uncertainty, by keeping stock of a complex combination of valuable information and know how to a degree that surpasses the capacities of individual agents on the market. Consequently, it is not only a cumbersome sociological fact of life, but also a matter of economic good sense, that the primary goal of profit-maximising is balanced with the goals of avoidance of transaction costs and of maintenance of a continuous pool of sensible information by all stakeholders involved.

The institutionalisation of enterprises as a source of social and economic value has a double aspect:

A. On the one hand it involves routinisation of decisionmaking processes, and processing of data and output to a level that surpasses the action range and controlling capacities of the individuals working in it. Here we find the basis for transcending methodological individualism in defining accountability. As soon as the product of a firm is not any longer retraceable to the autonomous intervention of one or a number of individual agents, but is the outcome of team work, including group decisions and a collective decisionmaking process, the acceptance of social responsibility should also occur as a collective agent. Rather than philosophical considerations on the analogy between physical persons and collectivities, this pragmatic criterion should orientate our judgment. Individual and collective responsibility are not contrary, but complementary to each other. Insofar as institutionalisation and routinisation processes occur in the firm, a collective intention emerges in the process, with its specific moral qualities and failures, which should be addressed at the appropriate, i.e. social, corporate, level. The principles of collective accountability of firms, as put forward by P. French are therefore the logical outcome of the sociological reading of the firm's nature as an institution (French, 1984).

B. On the other hand, however, institutionalisation is not only a fate which the participants have to accept blindly. It also becomes the object of systematic management with a view of enhancing the quality of corporate culture. This was the meaning of Selznick's "leadership", meaning a type of management which surpasses the technical qualities that

are required for maximizing efficiency of organisations, by involving political and social skills that are necessary to increase the overall value of a (large) institution. As C. McCoy has described (McCoy, 1985), such leadership involves a systematic reflection and formation policy on the levels of collective self interest of the firm, collective responsiveness, and long term vision (product planning and quality control). The practices of moral audit and of socio-ethical analysis of enterprises emerge as the necessary expressions of this positive approach to the institutionalization process.

## **2. Economic property rights**

In the previous paragraph we already introduced some institutional economics in order to overcome the classical opposition between the profit motive and other goals of enterprise, and to evaluate the institutional aspect in its own right. But what about the third type of conflict, which involves capital and labour, and their respective property claims? At this point, the economic theory of property rights may shed some light.

Economic property rights are not identical with juridical ones. Barzel defines the former as follows:

"Property rights of individuals over assets consist of the rights, or the powers, to consume, obtain income from, and alienate these assets. Obtaining income from and alienating assets require exchange; exchange is the mutual ceding of rights. Legal rights, as a rule, enhance economic rights, but the former are neither necessary nor sufficient for the existence of the latter" (Barzel, 1989, p.2).

Three conclusions can be drawn from this approach:

- a. The above mentioned transaction costs are costs related to the protection or transfer of economic property rights;
- b. Economic property rights (contrary to most juridical rights) are not constant over time; they fluctuate according to changing power relationships between different claimants of a particular good;
- c. Because of their complexity, many goods (and services) will be the object of many different types of "owners" or claimants (e.g. the ownership of a flat, or a firm).

In this latter case, a number of contracts will be drawn between the parties involved to minimise uncertainty, market variability and free riding. Such contracts will tend to respect the following basic rules:

- The greater a party's inclination to affect the mean income an asset can generate, the greater is the share of the residual (income) that party assumes (Barzel, p. 6)

- As a transactor's ability to affect the outcome of an aspect of a transaction increases, the transactor will assume more responsibility for the associated variability; that is, she or he will tend to assume a greater share of, and thus become more of a residual claimant to, the attributes she or he can affect. (Barzel, p. 42).

These rules do not a priori define, of course, who is the residual claimant of, e.g. an enterprise. It can be the major shareholder, or the producer-owner, or a CEO, or a group of workers. Several forms of divided ownership or co-ownership of a complex property such as a firm may be feasible. The property rights model does suggest, however, that both the cooperative type and the single owner-entrepreneur type are extreme forms of ownership of a complex good. The former type will only be sustainable when the good, on the one hand, is complex enough not to be split up between individual parties or rented, and on the other hand, is easy enough to control by all parties involved so as to exclude massive free riding and horizon problems. Not many goods (or enterprises) may show this combination of qualities. The single owner-entrepreneur will inevitably run into insurmountable problems of information gathering and control, once his enterprise has grown beyond a certain scale.

Consequently, it seems reasonable that a third type of property rights delination will emerge, namely the association, in which different components of the common property are controlled by the different groups of claimants (including e.g. shareholders and creditors, management, employees, representatives of the public). Property rights are divided in such a way that the loss of transaction costs and production costs is minimalised for all parties involved, and variability (of outputs and of corresponding responsibility) is ascribed as correctly as possible to the different parties.

The distribution of property shares between the parties can hardly be an equal one: factors of hierarchical control and of unequal control of the variability of production and transaction will inevitably lead to an unequal distribution of property. Does this imply that workers are always the losing party in the process, while shareholders and management are natural contenders for ultimate control over enterprises? For most institutional economists, this seems to be the logical outcome, indeed, since labour usually does not influence most of the variability in reaching the ultimate result of an enterprise. On average, more depends of the ability of management to handle complex information flows, and of the shareholders acceptance to take financial risks. The average employee, on the contrary, appears as a rather stable cost and asset, which is often reasonably easy to replace once gone, but harder to change or to involve in risk-sharing while on the job. Therefore, participative ownership of firms involving labour and capital on an equal basis, does not seem to be a very likely structure of enterprise ownership according to property rights analysis. (One should add here a further handicap of employees in co-ownership of their firm, namely that they, unlike most shareholders, cannot spread their risks in co-owning their company).

However, to the degree that employees deviate from this ideal type of the stable and rigid executive work force (e.g. that they are highly qualified, hard to replace, that the

variability of their output is structurally high) they may be in a better position to claim part of the residual income, and, consequently, to become co-owners of the firm. It is evident, then, that such a strong position will often be open for a minority of "strong" employees only. Consequently, in most cases the issue of co-ownership of the firm will unavoidably tend to divide the workers.

### **3. Questions of corporate law**

Questions of property rights and of accountability, of course, also call for a juridical approach. In this paragraph, I will do so, using as a frame of reference Belgian law. Belgian law, like French, Dutch, and to some extent also German law, stands within the continental tradition of Napoleonic law, which is quite different from the Anglo-saxon tradition. Consequently, the following statements on the juridical status of enterprises do not apply without further qualification to the American or British corporation, although many parallels can be drawn.

Two important considerations emerge with regard to our subject in the context of Belgian law:

- a. There exists no unified concept of enterprise throughout the different codes of law. Different proposals have lately been made by law scholars to correct this inconsistency.
- b. The penal code does not allow for legal persons to be punished. A specific concept of corporate accountability, including specific corporate sanctions, is urgently needed.

#### **3.1. The "great divide" between property and functioning.**

In the Napoleonic tradition, a fundamental distinction is maintained between the Civil Code, in which questions of ownership of goods are regulated, and other branches of law, such as social law, economic law, commercial law, in which the functioning of firms and of economic relationships is defined. In the first context, enterprise, as a specific subject and object of property, does not appear: only persons exist for the Civil Code, be they physical or legal ones. If an enterprise is a legal person, it is represented by its "organs" being the assembly of shareholders, and the delegate directors they have appointed.

In the second context, enterprises are treated as firms, i.e. as technical production units, which are defined by economic and social criteria (and not juridical ownership as such!). Here, one can treat employees and management, customers and suppliers in their own right.

This cleavage is due to the historical (and ideological) fact that the Napoleonic tradition (in reaction against the pré-modern conceptions of common property and of feudalism) starts from the presupposition that all property belongs to individuals. The model of property is the undivided and absolute control which a single physical person exerts over

a single object belonging to his domain. "Undivided" means that all aspects of property, including use, usufruct, disposal and control, should be in the hands of one and the same person. "Absolute" means that only the respect for the equal liberty of other property-owners does limit the autonomy of the owner.

In this perspective, an enterprise ideally appears as a single "object" which belongs to a physical person, the owner-entrepreneur, who alone enjoys all property rights over it.

To the extent that economic reality forced the law to formally recognize the existence of economic associations in which different parties jointly exert varying property rights, without possibility to continuously divide the claims between them, the company (naamloze vennootschap, société anonyme) emerges. This is a legal person, a fictional individual for the law and analogous to it, which becomes subject of specific rights and duties, including the right of ownership over the collective assets of the association. But the ultimate control and property claims over this legal person reside with the physical persons which are the shareholders of the company. They may delegate responsibilities of direction and management to other physical persons who will then act in the name of the company (so called organ theory). Other participants, such as employees, creditors, suppliers, public authorities, consumers, do not have any guaranteed access to the organs of the legal person. They remain outside its juridical property structure.

Two sorts of proposals have recently been made by law scholars in order to arrive at a more unified concept of enterprise in the body of law:

a. F. Van Neste, professor of law at UFSIA, suggests to introduce a new concept of property in addition to the well known types of private and public property, namely: social property. "Social property implies that the dominion of certain things or immaterial goods is divided and limited to the realisation of certain ends, being bound to social interests such as production or the deliverance of services" (Van Neste, 1991, p.292).

Treating enterprises as social property would not imply nationalisation or state control. Only could the different dimensions of ownership (use, usufruct, disposal, control) legally be granted to different persons, and could owners be obliged to respect the common interest of enterprises, rather than exclusively pursuing their particular ends.

b. W. Van Gerven, professor of law at the Catholic University of Leuven, and a former judge of the European Court at Luxembourg, defends a less radical way of reform. While equally stressing the fact that the Napoleonic approach to property is outdated, he prefers to change the concept of enterprise within the context of economic and commercial law (the functioning of enterprise) rather than altering the Civil Code (property). The enterprise as a socio-economic reality should be recognised and regulated as such by the law, apart from its property structure. This enterprise should be defined by the law as a community of interests, having common and specific social and economic goals; in case of conflict the protection

of those common goals has to receive a certain priority over the pursuit of private gains by some members.

(e.g. Van Gerven has criticised the sale of profitable firms against the will of employees, at the sole benefit of shareholders; he has equally justified the occupation of the firm by employees to block such a move).

The primary responsibility for protecting the common interest, according to Van Gerven, rests with the executive directors of the company and with the major shareholders; for some measures, obligatory consultation of employees and due information of smaller shareholders have to be guaranteed.

### **3.2. "Societas puniri non potest?"**

Accepting accountability for damages is an essential component of ownership. To the degree that damages are the result of corporate action according to standard operating procedures, involving team decisions and execution, the accountability should be accepted by the company as a whole. (To the degree individual persons have caused the damage by wilful neglect or by consciously deviating from operating procedures, their personal responsibility is at stake, of course. Collective and individual responsibility are to be invoked in an complementary, non exclusive way.)

Moreover, when criminal neglect or intent is at stake, sanctions should not be limited to reparation of damages but include penal measures. Specific penal sanctions should be provided for corporate criminal actions.

It is mostly at the last point that Belgian penal law remains deficient up to date (see case in annex). An enterprise, being a legal person, can be obliged to pay for damages following civil law. If the "subjective intent" of the person needs to be proved (did the company act as a "good family father" trying to avoid damage, or not?) judges have been creative in deriving corporate intent by analysing the behavior of its "organs" (official actions of directors, operating procedures). In civil law, the Court knows the "corporate internal decisionmaking structures" of French, and uses analogical concepts to May's "vicarious agency" and Werhane's "collective secondary action".

The remaining deficiency resides in penal law, however. Here, Belgian law has followed the classic principle that associations cannot commit crimes (*societas delinquere non potest*). Criminal behavior should be imputed to individual persons and individual bad intention. In the jurisprudence of the Court de Cassation (Supreme Court) this principle was later qualified (1962): associations can commit crimes, but they cannot be punished as such (*societas delinquere, sed non puniri potest*). This means that companies which are held responsible of criminal action can be punished indirectly through sanctioning of the physical persons which represent them. Publication sanctions, confiscation, closure, etc. are possible measures to be applied.

The problem remains, however, to prove that those physical persons are also freely and consciously involved in taking the corporate decisions that lead to the criminal act. As is evident in many recent court proceedings on environmental law infractions, the accused individual managers and directors have been successful in shifting the blame to unknown others, so that they are generally acquitted, and the company with them.

In this perspective, several law scholars, including Colaes and Deruyck, argue that the traditional principle should be reversed: associations can be criminally pursued and punished as such, as they can be held to repair damages. Specific corporate sanctions should be foreseen which apply to the company as a whole: prohibitions to draw specific contracts, temporary or permanent closure, financial sanctions, types of custodial care, obligation to accomplish public services, etc.

Through this new development of penal law, the persecution of individual representatives of the firm will no longer be necessary to punish the company; individuals will only be sanctioned in a complementary way if their individual bad intentions have been proved. As for civil court cases, corporate intention will be deduced from the corporate decisionmaking structure in its standard operating procedures: was the failure the result of collective processes of negotiation and team decisions? Or was it due to the individual initiative of a person deviating from usual company procedure? Or a combination of both? Moreover, company management can be held responsible to take the necessary measures of training and control of personnel in order to prevent criminal behavior, or to prohibit its recurrence. We may expect that this new insight may enter soon into Belgian penal law.

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Annex:

**A CASE IN POINT: The benzene leaks at AMOCO FINA, Antwerp**

In March 1989 the Chamber 25bis of the Penal Court (Correctionele rechtbank) at Antwerp started hearing witnesses in the case of Amoco Fina. It was alleged that unhealthy working conditions, i.e. exposure to excessive amounts of benzene, had led to the death of at least one employee, possibly causing damage to the health of several others.

Amoco Fina Antwerp, which is part of a larger corporation, was using benzene in its alclate production line (additives for lubricating oil). Benzene, which is toxic and causes cancer, was leaking on the floor out of defective pipelines, and also spreading in damped form throughout the plant. The controlling physician of APRIM services (labour health service, arbeidsgeneeskundige dienst) who visited AMOCO FINA weekly since January 1978, had been warning the director of the plant since December 1978 that excessive benzene concentrations were causing a serious health threat to all employees. (Years later, in April 1985, top concentrations of 420 ppm were measured at the plant by an independent inquiry, whereas the legal limit lies at 25ppm). He advised to close down the production line temporarily in order to be able to repair the leaks.

The engineer in charge of safety regulations, Mr Nicolaas D., refused to act on the advise of the physician, arguing that the chances of dying from leucemia (which can be caused

by benzene poisoning) were smaller than the chance of a deadly accident in every-day traffic.

In 1980 the same physician discovered a first case of leucemia among employees which he linked to benzene poisoning. The victim, F. Vermeulen, died in September 1981. Significant changes in the blood composition of other employees were found during subsequent health tests, also among those working in the administration offices outside the production line. When the physician wanted to report his findings to the Fund for Labour-related Diseases (Fonds voor Beroepsziekten), he was opposed by the director of the plant, Mr. H., who argued that such action would cause panic among the employees. The same H. also refused to inform the members of the plant committee which is legally required to supervise health and safety measures (Comité voor Veiligheid, Gezondheid en Verfraaiing van de werkplaats). He did ask to its superiors in AMOCO FINA, Naperville USA, however, if they would allow benzene to be replaced by an alternative product in the production line, but this was refused because of the extra cost involved.

After a new plant director had been appointed, benzene measuring were executed by Amoco Fina's own research lab; these findings, however, were never disclosed to the physician nor to the employees. Finally, an independent inquiry by APRIM in April 1985 revealed the above mentioned excessive concentrations. In August of the same year the production line was finally closed. Many other employees had become intoxicated in the mean time, engineer Nicolas D. being one of them.

In 1989, five persons were accused before the Court of involuntary injuries and involuntary manslaughter: the director H. and his successor, the safety engineer Nicolas D., the head of the research laboratory of AMOCO FINA, and a delegate administrator (afgevaardigde beheerder). Because of procedural arguments, the Court did not come to a conclusion. The case was referred to the Court of Appeal, which heard the case in October 1992 (10th chamber) and expressed a verdict on March 26, 1993. Although neither the correctness of the facts nor the criminal character of them were put into doubt, the Court had to acquit all the accused because it could not ascertain that the accused individuals had the due authority to take the decisions required for avoiding the benzene health hazard. The public defense had not been able to offer a clear organigram of Amoco Fina, including its offices in the USA and Switzerland, showing that the accused, rather than any other member of the multinational, were to blame.

The Amoco Fina case is not an isolated one. In 1992, representatives of Belgian Refining Corporation (BRC), of Petrochim, and of Finaneste were equally acquitted by the Antwerp Court of Appeal (7th and 8th Chambers) on the same basis.