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# Toward a New Social Contract Theory in Organization Science

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# **BEBR**

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Theory in Organization Science

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**TOWARD A NEW SOCIAL CONTRACT THEORY IN ORGANIZATION SCIENCE**

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# TOWARD A NEW SOCIAL CONTRACT THEORY IN ORGANIZATION SCIENCE

## ABSTRACT

This paper suggests that strategy research should move beyond a neo-Hobbesian approach to contracting toward a new social contract approach. Work from an agency theory perspective has generated utilitarian insights, but its description of agent behavior is too limited and its assumptions are not a useful guide to productive alliances among firms. Altruism, ethics, goodwill, moral sentiments, and trust need to be placed in the foreground of our vision and society must be seen as the ultimate principal to which both individuals and firms are responsible.

keywords: social contract, agency theory, alliances, opportunism, trust, ethics



A neo-Hobbesian perspective permeates the economics literature. The emphasis on uncertainty and measurement (Alchian & Demsetz, 1972; Barzel, 1982; Eisenhardt, 1985) as critical variables for predicting how both interfirm and intrafirm transactions will be governed can ultimately be traced back to the assumption that some people behave opportunistically. According to Williamson: "opportunism refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse" (1985, p.47). The assumption of opportunism can be found in agency theory (Eisenhardt, 1989; Jensen & Meckling, 1976), transaction costs theory (Williamson, 1985), self-enforcing agreements (Telser, 1980), game-theoretic reputation models and narrow economic (functionalist) definitions of organizational culture and trust (Camerer & Vepsalainen, 1988; Kreps, 1990). It is possible to make the devil an honest man in these works, because it pays to be honest under certain conditions. "Calculative trust", however, is a contradiction in terms (see also Williamson, 1992). A broader view of trust and human behavior is required.

In this paper, trust is defined as an expectation that alleviates the fear that one's exchange partner will act opportunistically (Bradach & Eccles, 1989). Trust is characterized by a cognitive "leap of faith" that reason alone would not anticipate. Even though opportunism is possible, trust prevails. While not totally justifiable or groundable, trust is nonetheless generated and sustained.

Broadening the scope of assumed behavior to include trustworthy conduct has several beneficial consequences. First, a broader perspective suggests new solutions for the problems of incomplete planning, monitoring costs, enforcement costs and dispute settlement that have benefits for both internal and external transactions. Second, a more balanced view of human motivation reunites the strategy field with the field of ethics. We will argue that these two benefits have special relevance for understanding alliance as a strategic option.

## Economic Approaches to Contracting and their Limits

In the absence of opportunism and measurement problems the contractual hazards of "small-numbers bargaining" (e.g., contracting when specialized assets are involved) would disappear. Consider situations which involve imperfect measurement of individual output, the "nonseparabilities problem." Alchian & Demsetz (1972) provide the example of two men loading freight onto a truck. Since observation of the outcome (i.e., the amount of freight loaded at the end of the day) is not sufficient for ascertaining individual productivity, the "classical capitalist firm" and the "manager as monitor" are proposed as solutions to the possibility of shirking or free-riding. Clearly, the measurement problem is intertwined with problems of anticipated opportunism by individual workers whose contribution to total output can not be individually identified. But the neo-Hobbesian approach of organizational economics, with its emphasis on agent self-interest, may lead to monitoring with excessive zeal. Given the long association of strategic management with those who study "human relations" (Dalton, 1959; Mayo, 1945), we should know better. It is a rudimentary management principle that excessive monitoring reduces productivity.

From a neo-Hobbesian perspective, situations in which highly specialized assets are being exchanged in an on-going contractual relationship among firms (Klein, Crawford & Alchian, 1978; Walker & Weber, 1987; Williamson, 1985), are subject to even greater problems than intra-firm contractual agreements. When such exchanges involve bilateral monopoly, they are risky to undertake by definition, because each party runs the risk of being "held-up". The amount that a party could theoretically appropriate is the difference between the first-best value and the second-best value of the asset -- the so-called "quasi-rent". The contractual problems between Fisher-Body and General Motors that ensued once the dies were cast are illustrative, and economists suggest that the eventual merger of Fisher-Body and General Motors was to avoid the contractual incentives to opportunistically appropriate available quasi-rents (Klein, Crawford, & Alchian, 1978).

The solution offered by economists to interorganizational contractual hazards such as imperfect measurement and asset specificity once again boils down to the idea that the firm can mitigate opportunism through incentives, improved monitoring, increased auditing capabilities, and more-refined compensation and dispute-settling mechanisms. The firm thus reduces opportunism at a cost. The alternative strategy of transferring transactions out of the market into the firm reduces various transaction costs, but is attended by a loss of "high-powered" incentives (Williamson, 1985, chapter 6).

Broadening the scope of relationships to the difficult field of strategic alliances (Borys & Jemison, 1989) exacerbates these dilemmas. The problem of interfirm cooperation from transaction costs theory and related perspectives is that alliances take place in a complex environment that precludes the possibility of writing a comprehensive agreement (Williamson, 1975). Real-world coordination difficulties between heterogeneous firms that possess differentiated products, dissimilar production processes, varied financial strategies and organizational structures make complete planning unattainable. The implementation of contractual agreements between firms requires high monitoring costs that can easily dissipate benefits, and enforcement costs are often greater than anticipated with costly court disputes between firms when unforeseen outcomes occur.

It has been argued that these problems are so strong in the case of interfirm alliances, that the solutions of classic industrial economics (Scherer & Ross, 1990) are insufficient. Williamson (1985) and others (Hennart, 1982; Walker & Weber, 1987) provide a persuasive case that internalization (e.g., internal growth, acquisition, merger) is required to overcome the contractual hazards involved in interfirm agreements. Internalization is favored on the grounds of incentive, adaptability, monitoring, reward-refining and dispute-settling capabilities of firms in comparison to contractual arrangements.

Broadening the scope still farther to encompass contractual relationships between firms and states, we find similar problems of the state "monitoring with excessive zeal." Furthermore, there are no restraints on opportunistic behaviors not specifically controlled by contract -- extreme forms of exploitation that endanger the life chances of citizens coming in contact with the firm can result, including environmental degradation and hazardous working conditions (e.g., see Manville Corporation, Chapter 35 in Snyder, Rowe, Mason & Dickel, 1991).

Even in economic models, opportunism is not the only behavior possible. Empirical evidence shows that cooperation is often found in non-repeated games (Sen, 1987), and is even more likely to emerge among self-interested agents in iterated games (Axelrod, 1984). Cooperation is also more likely to occur when knowledge is imperfect, e.g., when cost characteristics of rival firms are not known, or when the game has an indefinite end (Sen, 1987).

We argue in this paper, however, that cooperative behavior can have a quite different explanation than that of the "calculative self-interested man." Egoistic incentives (reputation, reciprocity) are not necessary to create cooperation and altruism (Etzioni, 1988). In fact, examples of unselfish acts are ubiquitous. Long ago, Kropotkin (1924) pointed out the vast amount of mutual aid given in times of need. Etzioni (1988, pp. 52-66) gives more recent evidence of the existence of altruistic behavior; people mail back lost wallets, donate blood and bone marrow to strangers, support public television, and vote, despite the incentive to "free-ride". We in strategy need to keep in mind that managers and workers similarly do not regard transactions in a strictly neutral and instrumental way. Workers feel commitment to their employers; sales people track down needed information over their lunch hour; managers initiate activities without salary incentives. In short, our experience supports a wider view of human behavior than is assumed in a number of the theories that currently dominate strategy research.



Research along the lines of the neo-Hobbesian approach is certainly relevant to strategic management as a scientific and pragmatic field (Barney, 1990; Mahoney, 1992), but broader assumptions are desperately needed. We are particularly concerned that most business students are not instructed carefully on the distinction between an empirical claim and a simplifying premise (Bowie, 1991). The egoistic assumption within agency theory allows for parsimonious models and predictive power. However, egoism is not scientifically established as a universal fact of human nature. This distinction should be emphasized to business students, and both students and theorists need to consider the implications of more realistically portraying human actors. Basing the entire field of strategic management on an allegory of self-interest is an unreflective story; it does not reflect the range of our experience and (we will argue) it helps enact a world not worth living in.

### **Reification of the Mistaken Foundations of Economic Theory**

It is quite ironic that overzealous admirers of the premise of self-interest have made Adam Smith their "guru". A passage written over 110 years ago is still apposite:

The isolation of the theory of political economy is peculiar to our own day. In more recent times, we find this study confounded with the other moral sciences, of which it was an integral part. When the genius of Adam Smith gave [economics] a distinct character, he did not desire to separate it from those branches of knowledge without which it could only remain a bleached plant from the absence of the sunlight of ethics. (Wolowski, 1882, p.23)

Smith (1790) actually champions benevolence, sympathy, and moral sentiments in his writing, though this emphasis tends to be lost in quotations by modern economists and business scholars (for exceptions see Coase, 1976 and Viner, 1991). Sen (1987) notes, for example, that Smith chastised Epicurus for trying to reduce everything to one motivation:

By running up all the different virtues, too, to this one species of propriety, Epicurus indulged a propensity, which is natural to all men, but which philosophers in particular are apt to cultivate with a particular fondness, as the great means of displaying their ingenuity, -- the propensity to account for all appearances from as few principles as possible (Smith, 1790, p.474).

Many modern economists have similarly ignored the human breadth Smith recognized, using him instead as the foundation for narrow assumptions about human behavior. Solow's observation is that:

There is an important element of sheer daredevil athleticism in the attachment of economists ... to the model of greed and rationality. 'Show me anything, anything, and I will produce a model that derives it from greed and rationality.'<sup>1</sup> (1991, p.6).

McPherson is perplexed by the same behavior: "What is odd ... is the desire to derive everything from self-interest as if that were a natural or necessary starting point. It is a peculiar feature of the sociology of the present-day economics profession that this odd ambition should be so prevalent" (1984, pp. 77-78). In fact, Etzioni (1988) reminds us that efforts to explain away altruism have been advanced since the ancient Greeks. It seems that each generation must answer the challenge anew.

It is a particularly important time for U.S. business schools to reconsider the intellectual basis of our research and teaching. Mitchell and Scott (1990) forcefully argue that the ethic of self-interested, outcome-oriented individualism is a contributing factor of American decay. American leaders' lack of stewardship and management abuses of trust have had a devastating effect on American productivity. Productivity and trust are in fact inextricably linked (Ouchi, 1981), as forcefully explained by Arrow:

Now trust has a very important pragmatic value, if nothing else. Trust is an important lubricant of a social system. It is extremely efficient; it saves a lot of trouble to have a fair degree of reliance on other people's word. Unfortunately this is not a commodity which can be bought very easily. If you have to buy it, you already have some doubts about what you've bought. Trust and similar values, loyalty, or truth-telling are examples of what an economist would call 'externalities'. They are goods, they are commodities; they have real practical value; they increase the efficiency of the system, enable you to produce more goods or more of whatever values you hold in

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<sup>1</sup> Allison refers to this as the "'Rationality Theorem': there exists no pattern of activity for which an imaginative analyst cannot write a large number of objective functions such that the pattern of activity maximizes each function" (1971, p.35).

high esteem. But they are not commodities, for which trade on the open market is technically possible or even meaningful (1974, p.23).

The theoretical argument here is that high performance does not require a focus on opportunistic behavior. Stakeholders can see corporate social responsibility as indicating management skill (Freeman, 1984), and firms have an investment in reputation, including the reputation for being socially responsible (Bowman & Haire, 1975; Gatewood & Carroll, 1991; Wood, 1991). Nor is it necessary to argue that apparently altruistic behavior must under closer scrutiny be revealed as reflecting egoistic motives (Piliavin & Charng, 1990).

The critical importance of going beyond classic economic assumptions is that: "**The more people accept the neoclassical paradigm (of economists) as a guide for their behavior, the more the ability to sustain a market economy is undermined**" (Etzioni, 1988, p.250). If all people behaved in the calculative, self-seeking manner described in economic theory, the market economy would collapse (Arrow, 1974). Frank argues, for example, that:

our beliefs about human nature help shape human nature itself. What we think about ourselves and our possibilities determines what we aspire to become; and it shapes what we teach our children, both at home and in the schools. Here the pernicious effects of the self-interest theory has been most disturbing (1988, p. xi).

Macneil (1980) also takes issue with agency theory's quest for a non-institutional, non-contextual, ahistorical explanation of contract, a criticism that has also been articulated in the management literature by Eisenhardt (1989), and in the economics literature by Coase, who chastises modern "blackboard economics" because:

Exchange takes place without any specification of its institutional setting. We have consumers without humanity, firms without organization, and even exchange without markets (1988, p.3).

The alternative Macneil describes is a **new social contract approach**, which can be integrated into the "conversation of mankind" (Habermas, 1979; Kahn, 1990; Mahoney, 1993; McCloskey, 1985; Oakeshott, 1962; Rorty, 1979). The contract continues to be the important means of

"projecting exchange into the future" (1980, p.5) in this much broader perspective on human activity. Macneil's view is new, however, in that it is neither the neoclassical contract of positive economics nor the contract of law. The new social contract approach assumes that "actors pursue two or more goals (utilities): (they) seek pleasure (and hence self-interest), and seek to abide by their moral commitments" (Etzioni, 1988, p.254). The emphasis of this new view is not on individual actions, however, but on the social setting<sup>2</sup>. It is only in a social context that one actor can trust another to abide by moral commitments, a trust that leads to a satisfying exchange relationship. The social relationship is thus the institution which must be society's basic socioeconomic tool.

In this paper, we champion the new social contract approach as a means of uniting strategic management, organizational economics, law and ethics. As the strategy field matures, we have additional capacity to speak in these broader terms. As the economy globalizes and reaches more deeply into human life it is increasingly important that we do so.

### **Impediments to a Broadened Ethical Agenda**

Before considering the new social contract approach we pose the following question: If the attenuation of opportunism and the development of business ethics is at the heart of strategic management problems, then why are they not discussed more in our research and teaching? The answer is that one of the more damaging by-products of logical positivism and the empiricist movement is the assumption that ethical propositions lie outside the purview of science. For some time we have been in the position that social scientists may rationally discuss "means" but not "ends".

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<sup>2</sup> While our main argument is that the social setting informs the study of institutions, we acknowledge that institutional economics also informs our understanding of the social setting. Institutions make people more confident that they can use trust and ethics as alternative ways to structure relationships (Shapiro, 1987; Zucker, 1986). We thank Tom Roehl for this observation.

However, pragmatic philosophers such as Emerson and Dewey soundly reject the Cartesian dualism of ends and means. Dewey (1929) suggests instead a means-ends continuum: we climb a peak only to find other peaks beyond us; no matter when we stop our Sisyphean climb, other peaks remain beyond. Adopting a similar point of view, Emerson wrote:

Causes and effect, means and ends, seed and fruit cannot be severed; for the effect already blooms in the cause, the end preexists in the means, the fruit in the seed. (Quote from Bourgeois, 1984, p. 594).

These philosophical arguments from the beginning of the century are more and more compatible with our globalizing world at the end of the century. Accepting a pragmatic perspective, the key to strategic management must be the journey more than the destination. We must become far more concerned with means than we have been in the past, recognizing the temporal brevity of the ends we can envision.

Without debating here whether it is proper for business school researchers to examine the more philosophical aspects of ethical theory, we do claim that greater attention to the means of conducting business involves "practical" business ethics (Arthur, 1984). Conversation that discusses the criteria that are used in evaluating management-environment interactions on some scale of goodness or badness is inescapable. It is apparent that many academics at present question whether ethics, even in this restricted sense, is a proper subject for strategic management. Our argument is that the ethical beliefs and the ethical practices of managers and workers are part of the data that must be considered in strategy research. What constitutes a "fair employer" is as much a variable of business as is the entropy measure of related diversification.

Positivist philosophers were wrong in asserting that all ethical propositions are meaningless (Sen, 1987), and their legacy has negatively affected strategy research. Every practical ethical problem of the business community is a problem in strategic management research. The strategic

management researcher and the executive of a company each have an unavoidable role as "moralist" - not merely as a describer of moral ideas and ideals, but as the creator and propagator of ideas and ideals, seeking not merely to describe but to change (Boulding, 1953; Schumacher, 1973).

The suppression of normative values may be deemed as "good" by some researchers, but this stance rests on a normative value as well. Myrdal (1970) argues against suppressing value judgments in the interests of science. He also rejects the sharp distinction made between positive and normative theory. His solution to the concerns expressed by positivists and those they have influenced is to suggest that the scientist boldly declare value judgments at the outset of the analysis:

There is no other device for excluding biases in social sciences than to face the valuations and to introduce them as explicitly stated, specific, and sufficiently concretized value premises. ...Emotion and irrationality in science ... acquire their high potency precisely when valuations are kept suppressed or remain concealed in the so-called 'facts' (1944, pp. 1043-1044).

Our argument, to summarize, is that the subject of strategy is intrinsically ethical, which makes research that sidesteps ethics problematic (Nelson, 1991). Anyone who suggests that the best direction for strategic management is toward "disinterested social science" is advocating both an unattainable goal and an unprofitable journey. No such social science is humanly possible. As Giddens notes: "The theories and findings of the social sciences cannot be kept wholly separate from the universe of meaning and action which they are about" (1984, p. xxxiii). We can make our strategy conversation more rational only by facing our valuations, not by evading them. To have evaluation, we cannot eliminate valuation.

A strategy researcher who is writing about important problems thus is writing about things which are of necessity highly charged with moral content. Boulding (1953) contends that most influential writers in social science have been "moralists" (e.g., Adam Smith, Marx, Freud). They knew what they liked and especially what they didn't like, and they had no hesitation in giving their

work a persuasive tone. In this spirit, we agree with Freeman and Gilbert that: "We must put ethics in its rightful place at the very center of discussions about corporate strategy" (1988, p.7).

### Basic Precepts of a New Approach to Social Contracts

Arguments for the importance of ethics in strategy research are not new. A narrow economic view of managerial obligations (Friedman, 1962) is rejected emphatically by Andrews, who regards coming to terms with the morality of choice as perhaps the most strenuous undertaking in strategic management (1980, p. 89). The "Harvard School" also has long argued for a broad definition of strategy that includes "the kind of economic and human organization (the company) is or intends to be, and the nature of the economic and noneconomic contribution it intends to make to its shareholders, employees, customers and communities" (1980, p.18). Recent trends, however, have moved many strategy researchers away from these perspectives toward definitions that are more tractable for empirical research and theoretical modeling.

In trying to reassert the importance of a broad, socially connected definition of strategy for empirical and theoretical work, we find Macneil's commentary on the basis for a "New Social Contract" to be particularly insightful:

The fundamental root, the base, of contract is society. Never has contract occurred without society; never will it occur without society; and never can its functioning be understood isolated from its **particular** society. (1980, p. 1-2)

The implication is that businesses are inextricably bound to each other in a complex web of ongoing interdependencies that would not be possible outside the confines of society.

In many ways the problem of understanding the firm's place in its historical, institutional, social context is analogous to Rousseau's original arguments about the social contract over two centuries ago:

The problem is to find a form of association which will defend and protect with the whole common force the person and the goods of

each associate, and in which each, while uniting himself with all, may still obey himself alone and remain as free as before [i.e., in the original state of nature] (1952 [original 1762], p. 391)

What man loses by the social contract is his natural liberty and an unlimited right to everything he tries to get and succeeds in getting; what he gains is civil liberty and the proprietorship of all he possesses. (1952, p. 393)

The relevant scope of social contracts today involves a complex three cornered set of relationships, outlined by Stopford and Strange (1991) and by Dicken (1993). There is mutual dependence among firms, among states, and between firms and states. In addition to these relations among corporate bodies, are the relationships between individual actors and the firm and the state. Although changing state-state, firm-state, and individual-state relations are of vital importance to business concerns, in outlining the emerging elements of a new social contract our focus will be on individual-firm and firm-firm relations. The general outline of the social contract between businesses and individuals, we argue, is no different from Rousseau's original outline, substituting "the firm" for the pre-feminist use of "man":

The passage from the state of nature to the civil state produces a very remarkable change in [the firm], by substituting justice for instinct in [its] conduct, and giving [its] actions the morality they had formerly lacked. Then only, when the voice of duty takes the place of physical impulses and right of appetite, does [the firm, which] so far had considered only [itself], find that [it] is forced to act on different principles, and to consult ... reason before listening to ... instincts. (1952: 393)

In fact, each individual [firm] may have a particular will contrary or dissimilar to the general will which [it] has as a citizen. [Its] particular interest may speak ... quite differently from the common interest: [its] absolute and naturally independent existence may make [it] look upon what [it] owes to the common cause as a gratuitous contribution, the loss of which will do less harm to others than the payment of it is burdensome to [itself], and [thus] ... [the firm] may wish to enjoy the rights of citizenship without being ready to fulfill the duties of a subject. The continuance of such an injustice could not but prove the undoing of the body politic. (1952, p. 393, emphasis added)



The message is clear: The rights and benefits of participation in the socio-economic context rest on fulfilling the responsibilities of being a part of that context. Similarly, the quid pro quo of organizational involvement is the partial subjugation of individual will. The individual worker must sacrifice immediate self-interest in order to coordinate with others (Barnard, 1938); the manager must be able to articulate a general vision that inspires this subordination of individual will (Barnard, 1938; Simon, 1945; Ulrich & Lake, 1990). Unfortunately, we are in danger of coming to believe recent models of egoistic and atomistic behavior and we are now proceeding to enact a world in accordance with these models -- an amoral world of the "rights of appetite" not worth living in over the short term and unsustainable in the long term.

The "new social contract" that informs and transforms the strategic behaviors/actions of businesses into sustainable, and sustaining entities must take into account emerging changes in the way business is being done in today's world. Complex relational networks (Dicken 1993) within and between firms with an emphasis on flexibility, responsiveness, and innovation call forth **modern contractual relations** (Macneil 1980). Modern contractual relations recognize that in addition to short term discrete contracts, business is involved in a mixture of long term arrangements and agreements, that arise from and depend upon myriad subjective, context dependent, and non-transferable personal relations.

Five precepts form the basis for the new social contracts required to govern these links.

1) Recognition of unity: Macneil (1980) suggests that in a world of stakeholders and constituencies, all the complex economic actors of Adam Smith's Moral Sentiments provide a better story than the simplistic view of principals and agents locked in a world of individual self-interest. Once we relinquish a blackboard world of two dimensional "economic men", recognition of connection becomes vital. In a world of increased interdependence:

One flat tire on a busy superhighway and traffic can be blocked for miles; one defective bolt and an airliner crashes; a gasoline shortage -- shortage, mind

you, not stoppage -- and the whole national economy is thrown into turmoil (Macneil, 1980, p. 104).

With changes in the world economy we must recognize the detrimental effects of "us versus them" thinking that pervades the world of agency theory and perceived zero-sum games; we must, in particular, redefine the boundaries of care. Boulding notes that "almost every organization ... exhibits two faces -- a smiling face which it turns toward its members and a frowning face which it turns to the world outside" (1953, p.10), but this distinction will be increasingly difficult to maintain:

As competition becomes keener we need to remind ourselves and colleagues that management is not a gladiatorial contest, it is rather a process which tries to ensure that all involved -- customers, suppliers, sub-contractors, agents, employees, shareholders -- are satisfied (Davis, 1991, p.101).

In his book The Greening of America, Reich argues more broadly for nothing less than the goal of "species solidarity" (1971, p.419) where harmony is maintained between individual freedom and social consciousness. This is the humanist's perspective (Burrell & Morgan, 1979, p.315; Zald, 1993). From this perspective, lack of social consciousness can be shown to generate distinct economic loss as well as the loss of essential human qualities.

2) Convergent expectations: The sociologist Durkheim (1933) anticipates Boulding's (1953) internal/external distinction by using the terms "mechanical solidarity" (solidarity of likes; more likely to be found **intra**firm) and "organic solidarity" (solidarity of unlikes, the task now required for **inter**firm cooperation). Solidarity is difficult to achieve in a world in which respect for the individual is fragile and perishable (Rorty, 1989); it ultimately hangs by the narrow thread of "convergent expectations" (Arrow, 1974).

The convergence that makes an intellectually understood commonality real are not easy to understand or influence. Long ago Chester Barnard noted that: "Inspiration is necessary to inculcate a sense of unity, and to create common ideals. Emotion rather than intellectual acceptance is required" (1938, p. 293). Ultimately, "the social solidarity making exchange work" (Macneil, 1980,

p. 14) is derived from the "complex webs of interdependence created by the relation itself" (Macneil, 1980, p. 23).

Work on culture and the possibility of positively affecting culture<sup>3</sup> is especially useful here. Culture can be defined as an interdependent set of socially acquired shared understandings, values, ideologies, tacit knowledge, metaphors, stories, specialized language, socialization, myths, symbols, rituals, organizational routines, and systems of belief (Geertz, 1973; O'Reilly, 1989; Pettigrew, 1979; Polanyi, 1958; Wiener, 1988). A strong culture involves the penetration and cohesion of this interdependent set at the sociological, psychological, artificial (e.g., routines and structures) and historical levels (Saffold, 1988; Schein, 1985).

Organizational culture displays both spontaneous and intentional features (Williamson, 1992), and is driven both by intended strategy and emergent strategy (Barney, 1986; Gordon, 1991). Within the firm, culture can be thought of as an emergent process that has as its source a set of deep underlying values (Smircich, 1983). However, in another sense, culture is pragmatically manageable (Van Cauwenbergh & Cool, 1982; Deal & Kennedy, 1982). Intended strategy, for example, may involve the creation of symbols, the management of shared organizational values and the corporate identification process (Trice & Beyer, 1991, 1993).

Organizational culture rarely reaches the depth and richness of anthropological cultures (Allaire & Firsirotu, 1984) and thus may be more adaptive and more easily developed than one would expect given the anthropological metaphor (Wilkins & Dyer, 1988; Wilkins & Ouchi, 1983). The new social contract perspective asserts, however, the importance of attempting to influence culture capable of transcending not only specific organizations, but nation, religion, race and first-hand experience. As our economic and social interactions become increasingly global, we must develop a

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<sup>3</sup> Useful taxonomies of schools of thought in cultural anthropology and organizational culture may be found in Allaire and Firsirotu (1984) and Smircich (1983).

sense of the global society to which we increasingly belong. This sense of the whole must be expressed in convergent expectations -- a narrow thread that can be profoundly influenced by intra and interfirm relationships. To the extent supplying a satisfying exchange relation becomes a part of the strategic management agenda, the possibility of future unity is increased. The "atmosphere" surrounding a transaction (Williamson, 1975) is thus of increasing importance; the exchange process itself must be made an object of value (Knight, 1921).

3) Commitment over Time: Durkheim (1933) suggests that organic solidarity may ultimately be ungroundable, or based on the flimsiest of grounds and yet continues to exist. Similar themes may be found in philosophy (Rorty, 1989), economics (Arrow, 1974), law (Macneil, 1986) and organization theory (Ouchi, 1980). Experience seems to show that generating and sustaining a sense of unity and solidarity requires ongoing cooperative relationships and conversations. The best known examples of the kind of interfirm and intrafirm associations we are talking about involve the Japanese Keiretsu and the Korean Chaebol.<sup>4</sup> The benefits found within these associations are now legendary, and appear to have played a strong role in the phenomenal economic growth of the region:

The network functions like a living organism, excelling at producing products quickly and cheaply. This is why Hong Kong has supplanted Italy as the world's top producer of fashion goods. It is how tiny Taiwanese companies run rings around giants in the personal-computer market (The Economist, November 16th, 1991).

In our view the arguments that the Keiretsu and Chaebol economize on transaction costs and overcome market imperfections (e.g., Chang & Choi, 1988; Leff, 1978) are accurate but incomplete. Asian alliances have been in place over a much longer timeframe than most Western companies

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<sup>4</sup> Observers have pointed out that the basis for these two kinds of cooperation are somewhat different; while some Keiretsu have their roots in long established trading companies, the Chaebol is more firmly rooted in family connections (Oh, 1992). In domestic Chinese owned firms, a similar form of interfirm alliance is apparently more closely linked to individual entrepreneurs (Komiya, 1987). The content of exchange also tends to differ. In Japan, intergroup networks involve cross-shares, loans and joint ventures while in Korea coordination is primarily through banks and government (Orru, Biggart & Hamilton, 1991).

contemplate. They encompass a multifaceted context that is more complex than considered by most Western firms. The result of this framework is that any given exchange is only a small part of the total relationship, and the social context places a constraint on short-term, self-interested behavior. The basis for sustaining interfirm cooperation is social connection among actors that goes beyond legal connections, and recognition that this fabric exists over time (Granovetter, 1985).

Since these forms of alliance are tied to culture, it is foolish to think that Western firms can directly adopt them. The way they function is nevertheless instructive. First, they show there are quite different ways to establish a social context that control the human tendency to maximize self-gain. Second, they illustrate a way of interacting in which the formal contract plays a supporting, rather than a primary, role.

4) Moral criteria: We argue that the spirit of market capitalism is based on the invisible institutions of altruism, ethics, goodwill, morality, and trust (Arrow, 1974; Dore, 1983; Nielsen, 1989), and that the broader cohesion of the global economy, which mixes different forms of economic activity, ultimately requires the same moral base. These invisible institutions are fragile and yet profoundly vital. As Durkheim writes: "Altruism is not ... an agreeable ornament in social life, but it will forever be its fundamental basis. How can we really dispense with it?" (1933, p. 228).

To understand the ethical basis of relationships, both time and connection must be taken into account. In direct contradiction to the basic assumptions of classic economics, a new social contract approach recognizes that:

- 1) one act has implications for other acts in the past and future,
- 2) any given action has implications for many actors (a theme shared by many who have viewed Frank Capra's classic movie, It's a Wonderful Life),
- 3) action outcomes for others ultimately impinge upon the originator of the action.

These assumptions are much more complicated than the assumption of systematic self-serving behavior. Decisions based on these assumptions must be more content specific; they will recognize the unique

nature of the time and the actors involved in the exchange. While theory is thus made more complicated, these assumptions allow the development of a social context that in turn makes it more likely that individuals will make moral (socially serving) decisions.

The old golden rule "do unto others as you would have them do unto you" is not a sufficient guide to moral behavior under the new social contract. The competent, healthy, forceful manager can be lured into thinking "of course I could deal with this if it happened to me." The world in contrast is peopled by a much more diverse set of actors -- old and young, in various states of health and wealth, with a consequently broader range of adaptive ability at any point in time.

The guiding principle of the new social contract can be expressed as a more socially connected variant of the golden rule: do unto to others as one would do unto a loved member of one's own family. The critical ethical stance is to abandon the "faceless" agent (Foucault, 1977). The new golden rule shifts the locus of responsibility and the motivation for action -- it's not what "they" might do to me, but what "I" want to do for those to whom I am related.

Expressing the new golden rule in family terms<sup>5</sup> does not mean a return to paternalistic management. In families, broadly conceived, no one is the patriarch forever. In these complex ties, we have all been subordinate, we have all recognized our own need for sustenance. Evolving family relations also hint at the enormity of the task before us in articulating the new social contract -- for we must admit that we do not always know what to do when interacting with those we love, and we must admit that even in these closest connections we do not always have the will to do what we know we should, or desist from doing what we know we should not do.

5) Participation in a new Dialogue: Recognizing our insufficient ability to generate new social contracts requires that the firm become a nexus of ethical conversation. MacIntyre (1984) argues that the language -- and therefore to some large degree the practice -- of morality today is in a state of grave

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<sup>5</sup> Raghu Garud is also working on the idea that useful guidelines for contractual relations can be expressed in family terms.

disorder; what is needed is a Schumpeterian innovator in the language of morality. As with all innovative activity, sometimes a particular innovation will be a success, other times undesirable and unforeseen consequences will emerge. The important thing is to recognize the need to bring together very different perspectives on the most basic of human motives. The conversation should be unbounded, diverse, undistorted, continuous and at times argumentative (Kahn, 1990; Rorty, 1979). For example, in order to make ethics training effective in organizations, executives must insure that employees feel free to question directives when ethical problems are encountered (Harrington, 1991).

Conversation can provide both the text and context (i.e., information and meaning) for achieving reliable organizational learning and mutually satisfying interfirm and intrafirm transactions (Hurst, 1991). It can mediate the deep level assumptions and the surface-level behavioral manifestations of organizational culture (Fiol, 1991) to construct a new sense of our rights and responsibilities as global citizens. Most important, it reaffirms our unity with one another. The chemist and philosopher Polanyi notes that:

the main reason for which people talk to each other is a desire for company. The torment of solitary confinement is that it deprives one not of information but of conversation, however uninformative. The fostering of good fellowship within small groups of people ... is a direct contribution to the fulfillment of man's purpose and duty as a social being. But the process is also of practical use in making the joint activities of the group more effective (1958, pp. 210-211).

Now we must recognize that the dynamic of "making the group more effective" goes far beyond "good fellowship within small groups of people." Through conversation, we argue, we will more broadly understand our common global fate, and begin to develop a convergent, moral sense of how we can improve our common condition.

### **Nonseparability is the Solution, not the Problem**

Arrow's central insight is that there is a moral and social basis to our contractual institutions. An important corollary is that the individual can not be the central unit of economic analysis, even

though it is imperative to sustain and nurture the individual morality that must inevitably confront collective immorality (Niebuhr, 1960).

The key for developing the new social contract approach is Rousseau's: "with rights and privileges come duties and responsibilities." At the heart of the tension between business and society is the interpretation of what citizenship entails, particularly in the case of externally based transnational corporations that operate too often as "free riders" in local social systems. At issue is whether businesses are shirking their moral obligations as responsible citizens in the name of competition, bargaining, and responsibility to stockholders, and whether individual decision makers are similarly avoiding their duties and responsibilities in pursuing self interest.

Macneil goes right for the heart of agency theory by calling for the "death of principals". The principal-agent view is attacked on two fronts. First, the narrow view of 'economic man' is called into question because "everyone is a mix of selfish and social interests melding in kinship and other social patterns precluding agency-principal differentiation ..." (Macneil, 1980, p.80). Then, Macneil reminds us that the world of organizations is multifaceted:

The constituency with the best claim in the Western world to being a principal (the stockholder) is far from it. We ... find ourselves in a world of agents of contractual relations, rather than agents of principals, relations organized in hierarchical, bureaucratic structures. The hierarchies are subject not to a single constituency brooding over them, but to many constituencies interpenetrating the hierarchy and bureaucracy at all levels (1980, p.79).

Rather than calling for the death of principals, we respond to these observations by calling for the recognition that agency theory and other neo-Hobbesian approaches have been defined far too narrowly. What managers and stockholders have lost sight of is that society is the ultimate principal of economic contracts. Agency theory has mis-specified the ultimate beneficiary of economic behavior, and in the process has undermined the benefits of economic transactions.

Returning to the possibility that one of two men unloading a truck may shirk his responsibilities, we observe that social interaction is more likely to be an efficient corrective than the elaborate



contracting, diligent monitoring and hierarchical organizational forms recommended by agency theory. The people doing the work are close enough to it to make reasonable judgements about realistic effort, and they also have the greatest knowledge of the many reasons (clumsiness, illness, age, heartache, hangover, etc.) why input may vary among workers. In many, though not all, collaborative efforts of our experience, the promise of a sustained and productive working relationship with one's peers is a more effective inducement to effort than legal promises and managerial oversight.

The new social contract approach, in short, directly contradicts agency theory prescriptions (Arrow, 1985). Rather than seeing nonseparability as a problem, connections among individuals and organizations become an intrinsic and necessary part of the social context that help generate moral behavior. Because mutual dependence between exchange partners promotes trust (Shell, 1991), the prescriptions to the strategist will often be exactly the opposite of those made by agency theorists. The most important of these reversals is that possible opportunism from a new contract perspective is more likely to be mitigated by establishing and emphasizing the links in time and space that bind people together. As an important corollary, efforts to establish and maintain links among actors from the new social contract perspective will not have the recurring costs associated with incentives, monitoring, auditing, and dispute settling. Investments in the social context have benefits in the future, because they make it more likely that moral acts will be followed by moral acts (Etzioni, 1988).

## **Conclusion**

By operating with neo-Hobbesian assumptions to assure short-term gains, the firm undermines the longer term benefits of alliance -- not only with other firms, but among its own employees. Contracts that assume the other can not be trusted in the present are unlikely to lead to trust in the future. Therefore attempts to constrain opportunism along the lines suggested by agency theory will have continuing economic as well as human costs.

We need a new contract perspective, and we need to explore the way in which these precepts are incompatible with the dictates of neoclassical economics. The development of a new approach requires an integration of law (Fuller, 1969; Macneil, 1980), economics (Arrow, 1974; McCloskey, 1985), sociology (Durkheim, 1933; Swedborg, 1987) and organization theory (Eisenhardt, 1985; Etzioni, 1988; Ouchi, 1980). Developing an integrative, interdisciplinary approach to strategic management research is imperative if the field is to remain relevant to current and future managers. An interdisciplinary, pluralistic approach is also arguably the best way forward for the intellectual development of the academic field (Bowman, 1990; Huff, 1981; Jemison, 1981; Zajac, 1992).

The compelling reason to develop better understanding of social controls is Etzioni's (1988) argument that moral behavior supported by the social context is likely to beget further moral behavior. The existence of trust gives one reason to trust. Trust builds optimism about others' behavior which can lead to further gains based on mutual cooperation (Orbell & Dawes, 1991). Conversely, distrust begets distrust (Banfield, 1958; Nussbaum, 1989).

In an essay entitled "The Green Fields of the Mind", Bart Giamatti (Renaissance scholar, former President of Yale and former baseball commissioner) noted that "one of our deepest desires is to conserve something of purpose in a world of confusion". We suggest that the vision of a new social contract (Macneil, 1980) enables us to move beyond the neo-Hobbesian view of contract. By developing new ideas about the contractual relationship, the contemporary business school academic and the modern business executive may share similar dreams and hopes of developing and nurturing organic solidarity. In some instances we may continue to view strategy in the narrow economic sense of "a continuing search for rent" (Bowman, 1974, p.47), but in loftier moments we should be persuaded that strategy is also a continuing search for morally satisfying ways of interacting with other human beings.

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