Partial Privatization and Improved Corporate Performance — A Reflection on the Efficiencies of Corporate Social Responsibility

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Stavros Gadinis's article[1] examines whether disclosure regulations under securities laws serve as an effective monitoring tool available to minority investors in partially privatized companies. However, it seems that his inquiry is not limited to this specific question but rather touches some of the most challenging dilemmas of modern corporate law. As I suggest in this short comment, there are two key quandaries which the article explicitly or implicitly reflects upon, which may be articulated by asking the following questions: What is corporate law all about? What is the purpose of the corporation in the modern era and what should be its focal points and duties, and those of its officers?

But first, let me begin with the explicit claims that Gadinis makes in his article. Gadinis begins his analysis with an observation and a question. He notes the improving performance of partially privatized companies that has been observed in Greece and elsewhere, and the corollary puzzle — how do private investors succeed in influencing the "locked" state-appointed managers whom they cannot fire? Commenting on the unavailability to investors of such a direct monitoring tool in partially private companies, Gadinis hypothesizes that investors can rely only on the company disclosures system required by securities laws. However, a detailed examination of the documents containing public disclosures of the three largest partially privatized companies in Greece outside the banking sector — OTE, the largest telecommunications company; PPC, the largest energy company, and OPAP, the largest gaming company — reveals, according to Gadinis, potential inefficiencies.

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1 Stavros Gadinis, *Can Company Disclosures Discipline State-Appointed Managers? Evidence from Greek Privatizations*, 13 Theoretical Inquiries L. 525 (2012).

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Such an examination also discloses a potential for corruption, waste, and mismanagement, as is evident from the continuous payouts to the two corporate stakeholders — labor and suppliers — that typically serve as political allies. In other words, even the disclosure requirements do not stop these payments from being made. But since these companies still demonstrate improvement in their total performance, the question arises: How do partially privatized corporations maximize value for their stockholders while raising payments to other stakeholders? Gadinis suggests that "although in theory the interests of governing politicians as controlling shareholders and minority investors are antithetical, in practice they may fall in line with one another."[2] However, this notion is not developed in the article and Gadinis himself admits that "a more nuanced theoretical account of the effects of partial privatization is necessary, before we can assess its benefits and costs."[3]

This comment will offer a possible explanation to the above-mentioned puzzle, based on Gadinis's unique method (but with a different interpretation to it), a method which supplies an excellent analyzing tool and is one of the article's most interesting innovations and contributions in my eye. Gadinis offers an approach of "disaggregation" — disaggregating partially privatized firms into their constituencies — especially focusing on suppliers and workers, towards which politicians are biased. This approach is taken in order to expose the potential inefficiencies existing in the partially privatized companies with their continuous political favoritism. Gadinis argues that by getting qualitative data about the way companies handle suppliers (who can "bribe" politicians) and employees (the politicians' electorate), we can better understand whether management priorities, after privatization, serve political goals or cater to the interests of private investors. According to this comment, however, considering the total positive performance of the examined corporation, such a method — even when revealing high payments to suppliers and employees after privatizations — can explain in many circumstances the *efficiencies* of such companies, as well as the efficiencies of "traditional" business corporations.

While I agree with Gadinis that payments to the various stakeholders may help us in understanding why politicians, suppliers, and employees did not resist the privatization process (as all of them are not immediately threatened by it), this finding is not sufficient to explain the root-cause of the observed excess *total* performance after partial privatization, as well as the managers' dominant and daily focal point. After all, Gadinis's main finding is that all three companies experience improved performance after partial privatization — their net sales and profits rise and their labor productivity increases.

2 *Id.* at 561.
3 *Id.* at 562.

If that is so and the total prosperity gained is positive to *every* constituency, Gadinis's "fragmented" method is an indication of the efficiencies of the "shared value" hypothesis rather than an indication of exploitations and externalities. *It is more reasonable, thus, to assume that the higher profitability and the market orientation — and not political orientation — were in fact the managers' first choice*. In that sense, the disclosure requirement under securities laws indirectly strengthened a financial component (the shareholders' interest) and synthesized it into the considerations of the firm's managers, even if it did not necessarily function as a direct monitoring tool that prevents managers from considering other constituencies, including political interests.[4] After all, managers know that shareholders, even if they are minority ones, will not invest a dime without expecting gains.

In other words, it appears that above all, the partial privatization process created a "bigger pie," to which dominant stakeholders — such as private investors, suppliers, and workers — contributed, and from which they could obtain a bigger slice. If that is true, and assuming that there are no post-privatization losses for other stakeholders, such as customers and bondholders, and that there is no environmental harm, a stronger case may be made for the conclusion that *profit maximization* was, in fact, the dominant and preliminary outcome of the privatization process. Two questions, then, remain — how come profitability did not seem to be affected from the continuation of corruption, and more important, what is the source of the post partial privatization benefit and what were the factors that motivated the partially privatized managers to pursue it?

An inquiry into these questions is most fruitfully undertaken by adding the "corporate social responsibility" concept to the discussion. This concept calls for integration of business and social considerations into the corporation's daily life, and it has evolved considerably in the business and legal literature during the past few years. The synthesis of social and economic variables in corporate officers' decision making can be easily examined in the hybrid enterprises, created by the partial privatization process, which blur the line between for-profit and nonprofit organizations, and between the social purpose of state organizations and the business goals of business corporations. However, such integration is not unique to these hybrid enterprises; the same is true with regard to "purely" private or publicly held business corporations in this era as well. Modern business corporations have gradually discovered the public demand for — and the opportunities hidden in — integrating the interests of

4 *Id.* at 562 ("While higher-quality disclosures may confer other benefits to state-run companies, they do not seem to discourage their managers from pursuing politically motivated objectives").

the constituency "team" of shareholders, bondholders, employees, suppliers, governments, and others such as environmental protection constituencies.[5] In that sense, the Greece partial-privatization process may serve as laboratory evidence concerning the outcome of integrating business and social concerns.

Today, no one can ignore the prevalence of a new tenet that calls for an integrated and more holistic purpose for the corporation, one that influences its managers' orientation and motivation.[6] Instead of the traditional theory that narrowly emphasized shareholder and market supremacy, a new theory has emerged, one that balances and considers the integrated or shared value of all of the corporations' dominant stakeholders and better describes and justifies the purpose of modern corporations — especially those corporations with a significant social-economic position. (The Gadinis study analyzes two dominant utilities corporations and one that is in the business of sports gaming, which are mainly social activities.) After all, companies are just mechanisms by which diverse parties are brought together to utilize a set of resources, as Ronald H. Coase has taught.[7]

From this fundamental observation it will be appropriate to draw conclusions by analyzing the interests of all other constituencies, including employees and suppliers. Accordingly, if we want to study the motivation of managers and make descriptive and normative assumptions about their market, or political orientation (or maybe even a combination of both), it will be useful to assess how these managers coordinate, balance, integrate, and deal with the various parties involved in the corporation's daily activities, which may also serve to shape or influence their motivations and activities. Again, evidence showing that managers serve the interests of employees and suppliers does not necessarily run counter to the argument that they minimize or relinquish their

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5 See, for example, the reference to the social responsibility policies of the three partially privatized companies analyzed by Gadinis: *Corporate Responsibility*, OTE, http://www.ote.gr/portal/page/portal/OTEGR/CorporateSocialResponsibility/OurCRProgram (last visited Sept. 29, 2012); *Corporate Social Responsibility*, PPC, http://www.dei.gr/Default.aspx?id=31394&nt=19&lang=2 (last visited Sept. 29, 2012); *OPAP Corporate Social Responsibility (CSR)*, OPAP, http://www.opap.gr/en/web/corporate.opap.gr/49 (last visited Sept. 29, 2012).

6 As an indication of this trend, see the cover page of a recent issue of *Forbes* magazine: *Social Power and the Coming Corporate Revolution — Why Employees and Customers Will Be Calling the Shots*, Forbes, Sept. 26, 2011; *see also Social Power and the Coming Corporate Revolution*, Forbes, Sept. 7, 2011, http://www.forbes.com/sites/techonomy/2011/09/07/social-power-and-the-coming-corporate-revolution/.

7 Ronald H. Coase, *The Nature of the Firm*, 4 Economica, Nov. 1937, at 386.

simultaneous obligations to other sectors, and therefore does not necessarily supply conclusive evidence about their orientation toward politicians.

Mandating greater corporate social responsibility, for example towards workers and suppliers, is not unrelated to the age-old tension in company law with regard to the main purpose of a business company. That is, should it merely or principally be "economically based" and aimed exclusively or narrowly towards *stockholders*, or should the company's orientation be directed towards its *stakeholders*? This question is particularly compelling in the modern age, when in many instances states become weaker and corporations become more dominant, and especially in the transformative phase when the state privatizes its activities and utilities. These two directions are not mutually exclusive: It seems that today, more than ever, there is a greater consensus that even "regular" business corporations can extract value if they consider the interests of all of their constituencies, such as employees, suppliers, customers, creditors, and even the community at large. Accordingly, I believe that Gadinis can benefit from connecting his thesis to the corporate social responsibility challenges raised in the business literature,[8] as is the case with the legal literature discussing the optimum purpose and goals of a business company and its managers' orientation.[9]

The increasing importance of the issue of corporations' growing commitment to their employees, suppliers, clients, the environment, and the public at large is substantiated not only in the literature but also in many practical modern contexts

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8 *See, e.g.*, Michael E. Porter & Mark R. Kramer, *Shared Value — How to Reinvent Capitalism and Unleash a Wave of Innovation and Growth*, HARV. BUS. REV., Jan.-Feb. 2011, at 62 (formulating the concept of "shared value," and focusing on the beneficial connection between societal and economic growth).

9 Consider in this regard the well-known historical debate between Merrick E. Dodd (who argues for the social responsibility of the company) and Adolf A. Berle (who emphasizes the supremacy of shareholders). Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1404 (1931); Adolf A. Berle, Jr., Note, *For Whom Corporate Managers Are Trustees*, 45 HARV. L. REV. 1365, 1367-68 (1932); Merrick E. Dodd, Jr., *For Whom Are Corporate Managers Trustees*, 45 HARV. L. REV. 1145, 1148-50 (1932); *see also* Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964). This debate "ended" with Berle's agreement that managers are entitled to act for the society as well, Adolf A. Berle, Jr., *Corporate Decision Making and Social Control*, 24 BUS. LAWYER 149, 150 (1968). For some more recent articles on this issue, see William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 (1992); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

in areas such as: (i) fair trade and human rights in the private sector; (ii) the extensive introduction of formal ethical and corporate responsibility programs in corporations around the world;[10] (iii) the growth of "ethical funds" focusing on investments in companies with social and environmental commitments; (iv) the emergence of "social" securities indices;[11] (v) the development of a norm of social reporting in business companies; (vi) the expansion of the fiduciary duties of directors and managers; and (vii) the constant of proper and fair corporate governance, to name only some of these prominent trends. These developments, as well as many local and international initiatives in the business-social realm, represent a broader application of Adam Smith's invisible hand theorem, one where "market forces" themselves encourage taking into account not only egoistic and utilitarian considerations, but also social, ethical, and humanitarian ones which might help in creating shared value. This integration of many — and often complementary — considerations, illustrates the development of a holistic and creative approach to capitalistic endeavors. It collapses the distinction between public and private law and the need for developing new theory justifying and explaining the innovative and complex functioning of corporate law toward a diverse body of stakeholders.

In conclusion, Gadinis' innovative "stakeholders' method" is an important and intriguing analytical tool. In further reflecting on his article and its insightful conclusion, I would like to offer the possibility that there may be more than a single conclusion one could draw beyond the political orientation of partially privatized corporations. Even if considering the interests of suppliers and employees serves the politicians' interests as well, maybe it is the Greek way — especially in the transformative period of the privatization process — to carefully build the bridge between the corporation's economic and societal goals. Whereas in the context of American corporations this trend is substantiated by integrating public and social objectives into private and economic ones, in economies that undergo a transformative privatization, like Greece, it is the other way around — with integration of private objectives into public ones. Regardless of the direction in which these objectives are integrated, and regardless of whether the American or the Greek way is followed, this approach may be promoting a new win-win era, one in which corporations are managed in a more sustainable and holistic manner while weighing the concerns and objectives of their broader sets of stakeholders.

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10 *See, e.g.*, Guy Mundlak & Issi Rosen-Zvi, *Signaling Virtue? A Comparison of Corporate Codes in the Fields of Labor and Environment*, 12 THEORETICAL INQUIRIES L. 603 (2011).

11 *See, e.g.*, Oren Perez, *Private Environmental Governance as Ensemble Regulation: A Critical Exploration of Sustainability Indexes and the New Ensemble Politics*, 12 THEORETICAL INQUIRIES L. 543, 566-78 (2011).