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A New Analysis of Corporate Social Responsibility

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Introduction

In his classical paper, M. Friedman (1970) suggests an overwhelming critique of the corporate social responsibility (CSR). According to the famous liberal economist, the corporations' sole business is business, and thus corporate social obligations should be restricted to those before the shareholders, and to the compliance with laws and government regulations. This view doesn't leave room for corporate contributions to charitable causes.

To better appreciate the economic underpinnings of Friedman's critique, one should invoke rationales for philanthropy. The latter usually fall into two main categories. First, donors could directly benefit, alongside the rest of society, from the supported public goods. The power of this incentive for private provision of public goods is however limited due to free riding; besides, this rationale cannot explain often observed contributions to "remote" causes which have no immediate bearings upon the benefactor. The second explanation is an *altruistic* one, when donors find satisfaction from the very act of giving and their involvement in furthering a worthy cause. Put differently, donors experience "*warm-glow*" feeling from their dealing in charity (Andreoni, 1990).

Turning back to companies, they are spiritless and thus cannot experience warm-glow.At the same time, warm-glow surely can be felt by corporate owners and managers who authorize contributions to charities. If the sole owner of a company makes such contributions, she spends her own money and this is essentially a case of individual giving, even if under a different guise. However, if a decision to donate to charity is made by a manager of a shareholder-owned company, this could constitute a conflict of interest and a possible breach of agency relation, since the manager enjoys warm-glow at the expense of shareholders in whose interests he is supposed to act.

The analysis of Friedman is quite simplistic in its specification of the motivation of donors and the challenges they face. Concerning the shareholders' interests, the Friedman's theory essentially assumes the ability of individual donors to achieve their goals through their independent relations to third sector organizations and thus does not go deep both into the nature of such relations and the processes of individual decision-making about contributions to non-profit causes. From the point of view of the author's treatment of corporations, the model is too naïve in that it does not attempt to inquire into the advantages for the firms coming from their connection to non-profits.

Nevertheless, Friedman's model continues to be a powerful legitimation for the separation of the for-profit and non-profit worlds in contemporary economy. For that reason, this paper uses this Friedman's paradigm as a reference point for the analysis of the intricate implications of CSR and essentially starts from the core questions: why do we still have CSR and why to have it at all?

Below I am going to examine a few frames through which to analyze the CSR. One possibility to approach this subject is to look at it through the newer theoretical perspectives and in particular to study the advantages of corporate form in economizing on transaction costs and dealing with information asymmetries between their customers and the third sector organizations. Another opportunity is to approach corporations not as just anonymous production functions and pay more attention to the complex causations characterizing the internal social processes inside them. Finally, the special attention could be paid to the external embeddedness of firms in the wider market and social structures. So, my focus here will be broader than in standard Friedman's theorizing in the sense that I will attempt to reflect in my modeling of CSR not only on the narrow corporate-actors, but also on the larger context surrounding them.

The core argument of this paper is that CSR has much more complex implications for the corporations themselves, for the third sector, and for the social welfare than is currently assumed. The general scheme of analysis of the CSR followed below includes two important constituencies. First, the nature and structure of incentives for corporations to interfere into the third sector is examined for each of the considered mechanisms of CSR. Second, the model attempts to predict what direct results would the corporate actions have for the third sector and social welfare.

To summarize the substantive argument of the paper, corporations participate in the third sector because of the benefits they can reap. In particular, in many cases corporations are in a good position to (partially) correct the third sector's failure to bring in financial resources (coming from individuals caring about non-profit missions), increase the accountability and thus efficiency of the processes of production in the NPOs, and finally make them more effective. The key advantages of corporations here is their ability to introduce the elements of competition and control into the third sector, simultaneously not changing its voluntary and non-profit nature. The corporations can do all of that not for free (and I believe they do that not for free!). However, as oftentimes happens in the social sciences the mechanisms responsible for such positive outcomes work in the limited set of cases (which I attempt to specify below).

Intro of NPO

The multiple schemes have been suggested in the literature to explain the emergence and observable diversity of the third sector organizations. Economic theory in particular suggests two largely complementary frameworks highlighting demand and supply sides of the non-profit sector.

Demand base theorizing approaches the problem from the point of view of the issues of market and government failures. According to the former, in serving certain markets the NPOs could have comparative advantage with respect to for-profit organizations. For instance, one of the standard explanations here points to the inability of for-profit organizations to be trustworthy to their customers in the situation of the asymmetry of information between producers and customers about the quality of the product. The claim is made that on such markets various forms of opportunistic behavior of for-profit firm could lead to the inefficient levels of production. In this situation NPOs having less incentives to cheat is potentially a better organizational form to correct this inefficiency[1] (Hansmann 1980, Glaeser, Shleifer, 2001). This argument is not fully convincing though, as it does not specify clearly enough the motives for NPOs to be honest. Explanations provided in the literature (e.g., the selection mechanisms providing the third sector with more altruist workforce[2]; the non-distribution constraint) are not complete as they hardly correspond to the observable misbehavior of management of the NPOs (see also below). The government failure perspective provides an alternative explanation of the proliferation of the NPO form by pointing to the limitations of the

[1] At the same time, the decrease in the information asymmetry between the producers and their customers could lead to the blurring of the differences between the services provided by the for-profits and NPOs (Frank, Salkever, 1994).

[2] The NPOs can attract specific types of managers valuing the non-profit missions and working for smaller remuneration then they could get in the for-profit sector (Handy, Katz, 1988).

political processes working well to serve the needs of the median voter, but in the situation of taste heterogeneity leaving certain segments of demand for public good underserved (Weisbrod, 1988). At the same time, this theory helps to understand the mutualistic relationships between the government and non-profit sector (Hall, 2000), which could partly correct this government failure. Overall, the demand theorizing points to partly unobservable character of the NPO activities and presence of the elements of public good in its products.

Supply-based theories try to provide explanations for the third sector by analyzing the creation of missions and emphasizing the role of social entrepreneurs/stakeholders in that. According to such theories, the process of establishing non-profit concerns should not necessarily be approached from the point of view of serving well-specified demand in the society. Oppositely, the core role of such NPOs could be the reinforcement of certain social values or advocacy activities. Evidently, such "production" could hardly be organized as a for-profit enterprise and its products directly be subjected to market evaluation. The key take-away from this perspective for this paper is the inherent difficulty to apprise the missions of the NPOs in the absence of real competition among them.

Apart from the determination from what side – supply or demand – to investigate the NPOs, the continuing difficulties to understand them originate also from the diversity of their structures. The sector includes a large variety of organizational forms with highly different systems of governance, membership, etc. Moreover, the distinction between non-profit and for-profit organizations becomes blurred with time (Dees, Anderson, 2004). The for-profit and non-profit organizations could occupy neighboring positions on various markets and interact with each other in a quite complicated way, so that sometimes they could be understood either as parts of the same organizational population, or as various populations occupying the adjacent niches in the same markets. In the latter case, the market partitioning between different populations of organizations could be thought of as the result of environmental selection.

This paper in no way is an attempt to contribute to the theorizing of the forms of the third sector. The theory suggested below addresses more the typological *problems* of the NPOs, than particular *organizations* (or populations of organizations) and uses as a reference point a quite schematic/abstract formulation of the key general characteristics of the third sector introduced above. More specifically, I emphasize five key elements lying in the foundation of the NPO activity that attempts to meet *societal needs*, is framed and reinforced by *idealistic over-statements/missions*, uses the not-for-profit motivations of the people (*donors* and *volunteers*), and exists in the situation of *poor observability of outcomes*.

Challenges to NPOs

The key challenge for the NPOs is the lack of mechanisms to make these five core elements properly lined up. The blurred motivations of donors of time (volunteers) and money, weakness of connection of mission statements to social needs, in effectiveness of the organizational actions, and inefficient use of scarce resources together create serious threats for the non-profits – threats that they could hardly meet independently.

In fact, the decisions to volunteer in general do not emerge as an outcome of a careful cost-benefit analysis and usually reflect the complex mix of various motives of individuals. For instance, Frumkin introduces two general functions of volunteering -

"expressive" and instrumental (Frumkin, 2006). Although the latter represents the mechanism of tight coupling between the individual and organizational goals, the former makes it essentially quite loose. In his qualitative study of students' volunteering, Gauthier (2008) claims that the personal satisfaction from the very fact of doing unpaid work for the NPO without the necessary link to the effectiveness of this labor is the major mechanism responsible for the decision to volunteer. Sugden (1982, 1984) emphasizes that the motivations of the donors and volunteers depends on their environment: according to the principle of reciprocity that he introduces, the environment with dominating altruists produces much higher level of voluntary participation in the third sector activities, whereas the more "egoistic" leads to the opposite outcome.

So, as the core resource of labor comes to NPOs through the set of separate/random non-rational decisions, the question arises if the system works properly. And if it does not, one of the key problems of the third sector becomes the lack of mechanisms of efficient matching between non-profit causes and voluntary efforts. Such situation makes the labor distribution across the NPOs highly inefficient. The question thus is how to find the possibility to blur the differences between the expressive and instrumental motivations of volunteers making them largely complementary and to make use of the individual idiosyncratic inspirations so that they have a direct positive influence on the social welfare.

Assumingly, the process of making monetary donations is more rational than volunteering, and thus it is reasonable to expect that the missions of the non-profits getting such donations reflect better the individual preferences of their donors. What makes these individual motivations still quite indirectly related to the real outcomes of

NPOs' activities is the inherent looseness of coupling between missions and actual organizational processes in the third sector. The key distortions here come from the power relations inside the NPOs, the possibilities of opportunistic behavior of their management, and the lack of incentives to align missions and actions.

The major mechanism of this latter misalignment is the absence of competition between missions, particularly because of the absence of reliable means to make objective evaluations of comparative advantages of different idealist over-statements characterizing the non-profit organizations[3]. Another reason for such misalignment is the path-dependency in the organizational fields (DiMaggio, Anheier, 1990; DiMaggio, Powell, 1983). So, although the NPOs may do their job better than other existing organizational forms, they are still far from being perfect both in the sense of efficiency and effectiveness.

We can conclude that the obvious need exists *to overcome the inefficiency of the use of non-profit motivations in the society, i.e. channel the resources available for the non-profit undertakings or advocacy to good causes reflecting the societal values in the best possible way and properly align such missions to effective and efficient production processes*. The paper inquires into the possibilities to solve this problem and suggests the direction of search for the societal actors who could potentially be responsible for the correction of this voluntary sector failure.

[3] For instance, James and Rose-Ackerman (1986), talking about the utility functions that are effectively maximized by the NPOs, provide the following list of them: those emphasizing the quantity of the product or service, its quality, usage of particular technology in the process of production, etc. How aligned are these preferences with those maximizing social welfare is hard to predict.

Introducing relevant actors

In fact, there are a few such candidates. The corrections of the voluntary failures could potentially come from the actions of individuals/contributors to non-profits, governments, other non-profits, institutionalized donors/foundations, and corporations. Unorganized individuals could hardly play such a role both because of the ambiguity of their preferences discussed above and the obvious restrictions of collective action they face. The very fact of the observable failure of the third sector shows that to correct it the actions of individuals should be supplemented by the organizational activities.

The candidate of government does not look particularly appealing here. Although governments have both resources (power and financial) and willingness to contribute to the social welfare, the key restriction for its effective participation in the third sector is that governmental actions are heavily constraint by legal rules. So, although the state could potentially influence the third sector by financing the organizations those missions correspond better to the goals of the government or make the organizations of the third sector more accountable and tax responsible, in substantive terms, the foundational statements of the Constitution (e.g., the First amendment) substantially limit the ability of the state to interfere into the real activity of voluntary organizations. Overall, it is safe to conclude that the government and individuals are not in good positions to fully correct the fundamental failures of the third sector.

Other non-profits can potentially fill this niche of controlling and making effective the NPOs. In this case the third sector as a whole would be able to correct its own failures. However, such mechanism has also some important limitations, particularly because of the lack of the real incentives and resources inside the third sector to control particular organizations. For instance, one of the most promising of such attempts is the introduction of the information-systems (oftentimes in the form of online databases) supplying for free the financial information about various NPOs and thus assumingly making them more transparent. However, the value of such information to understanding the real effectiveness and even efficiency of the third sector organizations is quite restrictive. In fact, the idea of effectiveness is hard to quantify, whereas the fact of low overhead costs that is usually treated as pointing to higher efficiency of the NPOs could be quite a misleading indicator as current accounting practices in the NPOs leave much space for concealing operational expenses. So, increasing the transparency of the NPOs could make them more externally legitimate, but does not prevent the continuing decoupling of real practices of particular organizations from their stated missions.

Another candidate, the institutionalized foundations are in a stronger position to make the NPOs really accountable, as their incentives to align the substantive content of the activity of non-profit to their expectations are quite strong. The weakness of this form of intervention into the third sector comes from the non-random biases of the preferences of the stakeholders of the foundations who have their own agendas and values, promote causes that they themselves consider appropriate, and because of that essentially breaking the correspondence between social needs and third sector dominants.

This argumentation should not be considered as an attempt to show that all of these control/incentive systems are fully misplaced, but is more about the existence of other complementary possibilities to improve the sector. At the same time, the above discussion shows that the major factor of inability of different actors to correct the voluntary failure is either the lack of resources or, even more importantly, the lack of incentives to do so. This key remaining actors having both the resources and such incentives, but staying underrepresented in the sector are corporations.

Corporations

This paper inquires into the reasons why corporations would want to collaborate with the third sector organizations and what implications such collaboration could have for the NPOs. The contribution of corporations to the elimination of the third sector failures can be achieved through three mechanisms. First, corporations can help bring scarce resources to NPOs – that thus make the failure of their financing less acute. Second, corporations are in a better position and have incentives to invest time and energy in introduction of the state-of-the-art accounting and monitoring practices and procedures restricting in reality the possibilities for the NPOs' management to engage in inappropriate/fraudulent activities. In fact, the important thing about corporations is that they – mainly because their soulless profit orientation - are the most efficient and effective form of social organization to carry out the control over internal processes of production. Finally, the mutual dependence of corporations and NPOs in the long run could automatically bring elements of real competition into the third sector and thus help to select out the missions that are not aligned to the social expectations.

The model of corporate involvement in the third sector to be convincing should simultaneously be able to address two key issues. First, it is necessary to outline how the corporations can improve the functioning of the NPOs. Second, the bottom-line reasons for corporations to participating in such activity should be clearly specified. Below I will reverse this sequence and will first attempt to clarify the latter question and then will discuss the implications of such CSR for the third sector and society as a whole.

Reasons for corporations

The difference between non-profits and corporations will be treated here as the difference in missions – one is more purely profit-oriented the others are more cause-oriented – and the structures of ownership (there is no appropriation of profits of the NPOs). In lines with such definition, the engagement of the for-profit organizations in any and all activities should necessarily be specified in terms of costs and benefits they face. What are mechanisms that could produce such benefits in the case of the CSR?

It makes sense to consider separately the positive and negative incentives for corporations. Among the first ones we can distinguish direct and indirect oppression. The former typically comes from the side of government that could be interested in financing public goods using the private money (see, e.g., Polishchuk, 2006). The example of the indirect mechanisms is the isomorphic pressures on corporations coming from the institutionalized inter-organizational fields. For instance, the spread of the CSR practice could make firms not engaging in it less legitimate from the point of view of their counteragents (Meyer, Rowan, 1977).

Such negative pressures, though quite powerful, do not generate self-sustainable and predictable processes of collaboration of corporations and the third sector organizations. As mentioned above, the government coercion is substantially restricted by the legal considerations, whereas the forces of institutional dynamic could lead to the unpredictable evolution of the practices considered legitimate. For instance, the deeply institutionalized practices could quite drastically change to just the opposite ones (as, for instance, did the whole practice of CSR when it substantially declined in popularity in the decades following the Friedman's critique).

Below I will concentrate on positive stimuli - those less dependent on the institutional environments of corporations. I will continue to use the same logic as above and classify these incentives in terms of their sources and key counter-agents, the relationship to which induces corporation to finance the non-profit sector. These other economic actors are the customers, the corporate insiders/labor, and other market players. The first type of relationships will be considered in much more depth and will serve as a reference point for the analysis of the other two.

The bottom-line rationale of the cause-related marketing[4]

The *cause-related marketing* (CRM) is the commercial practice of tying the image of the company or its particular brand or product with a charitable cause. The purpose of this business strategy is to differentiate the company and its products from competitors, to win loyalty and goodwill of customers by supporting a worthy undertaking, and thereby to ultimately expand the company's market share and profits.

CRM can take various forms, the most straightforward one being a pledge of remittance to a designated charity of a certain amount per customer's purchase (see e.g. Vogel 2005). The donated amount could be either lump-sum, or a percentage of the paid price[5]. CRM was pioneered in 1983 by American Express which promised to donate one cent per transaction conducted with an American Express card to the restoration of the Statue of Liberty, and contribute to the same cause one dollar per every newly opened American Express account. In the course of three months of this promotion, $1.7 million was raised to give the Statue of Liberty a facelift, and American Express was rewarded

[4] This section of the paper closely follows the introductory parts of Polishchuk and Firsov (2008).

[5] Donations could also be indirect, in the form of forgone profit due to the company's refusal to deal with suppliers or use technologies that cause damage to environment, violate workers' rights, etc. A yet another version of this approach is a promise to fairly compensate company suppliers that would be otherwise victims of "unconscionable" exploitation.

by an almost 30% swell of the use of its credit card, and by a 45% increase of new credit card applications (Adkins, 1999a). Since then CRM has mushroomed.

Why companies can profit from CRM? Polishchuk and Firsov (2008) claim that CRM is analogous to the commercial practice known as bundling (Adams, Yellen, 1976), or "tie-in sales" (Tirole 1988), when a company sells packages consisting of its primary products in combination with accompanying ingredients that could be in principle obtained independently. For CRM, such add-ons are charitable donations. Why adding donations to charity to the main product (the basic good) makes economic sense for the company? Clearly such package is more appealing to a customer that values the chosen charitable cause, but it costs the company more, and the latter could still make a profit under at least one of the following conditions:

(i) the company has an advantage over its customers in conducting philanthropy, and could keep the at least some of the gains that such advantage creates, or

(ii) CRM opens additional opportunities for the company on the primary market that it serves.

Gains of the first kind are due to the different abilities of large corporations, on the one hand, and their customers, on the other, to handle *transaction costs* associated with charitable donations. Such costs have two main origins – they arise due to asymmetric information (Firsov, 2005), and in addition are incurred when donations are actually executed.

Asymmetric information transaction costs are borne to avoid adverse selection and moral hazard associated with philanthropy. Adverse selection is preventable by expending resources on search for an appropriate charity and checking and establishing the prospective grantee's credentials and track records. To avoid moral hazard, the performance of the chosen recipient of funds should be properly monitored.

Costs of both types could be significant, and private individuals, at least those who do not make massive donations, can rarely cover such costs on their own, and even if they could, such costs most likely exceed the donors' perceived satisfaction from charity. Indeed, as mentioned above, informational asymmetry is one of the rationales for the very existence of non-profits. When potential donors aren't sure whether the charities would indeed use the donated funds for mandated purposes, and if so, how effectively they would use the donations, this concern can be addressed by applying the "non-distribution" constraint that disallows paying profits to charity operators and thus weakens incentives for opportunistic behavior. However, this constraint which defines the non-profit, in and of itself does not solve the adverse selection and moral hazard problem inherent to philanthropy; in particular it does not rule out excessive compensations to employees and managers of non-profits, and cross-subsidization that diverts funds away the specific activities they were supposed to support.

The rest of transaction costs, that are required to execute a donation (write a check, make a payment), are much lower, but still nontrivial, especially if a donation is small. These costs thus stay in the way of making donations, which are negligible for an individual donor but could add up to large sums when collected from numerous givers.

The above transaction costs pose entry barriers to private philanthropy. Corporations practicing CRM are able to remove these barriers. Indeed, the costs of processing and remitting donations made as parts of purchasing prices are trifle, and in addition spread over a large number of transactions, thus creating a valuable economy of scale. Asymmetric information costs are less trivial even for a big company, but first, they are also mitigated by the above scale economy, and second, corporations have important comparative advantages over individuals in performing search and monitoring of non-profit counterparts. Companies are not only better able to handle moral hazard and adverse selection problems in the non-profit sector, but also have strong incentives to do so, as a lack of performance of their NGO partners would cast a negative light on the corporate sponsors as well.

The second possible source of CRM profitability discussed in Polishchuk and Firsov (2008) is that it could serve as a screening device revealing valuable information about company's customers. This device works as follows: a willingness to buy the basic good at a premium provided that a portion of the paid price will be contributed to charity sends the company two signals – first, that the customer values the supported cause, and second, that she is ceteris paribus not particularly sensitive to the price paid for the basic good. The second signal is particularly valuable for the company as it allows third-degree price discrimination that would not be possible without consumers signaling their types. In this case charitable donations serve as a benchmark against which consumers' preferences for the basic good are measured.

Workforce morale

The cause-related marketing can serve as a proxy for some other types of socially responsible corporate conduct. This point can be illustrated by showing that the same logic as in CRM works pretty well for the explanation of the CSR stemming from the relations of the corporations to its insiders/labor.

In fact, the incentives for corporations to become socially responsible could come not only from outward (i.e., competitors and customers), but also from inward (i.e., the employees). One of the reasons for the firms to engage in CSR is to decrease the turnover, economize on training costs, decrease control costs, etc. by improving the morale of the employees. This mechanism essentially reverses the Friedman's assertion that corporations are soulless entities and introduces the social factor of corporate functioning that cannot be reduced to just profit-generation. The corporations thus are also approached as social objects, i.e. the collections of individuals partly governed by monetary incentives, but partly managed through more social means like culture, bureaucracy, and technology.

The claim that such motivation for social responsibility is real is quite plausible. In fact, corporations attempt to donate to non-profits not only directly (under the control of management or share-holders), but also through the mediation of its employees by matching their donations (e.g., for each dollar sent by an employee to a non-profit cause of her choice the company sends another dollar of its own contribution to the same cause). The basic rationale for such practice is that it contributes to the improvement of the psychological climate inside the company (the personnel becomes more inspired) and through that decreases the labor costs.

Although this mechanism looks quite differently from that of CRM, typologically they are still quite similar. In fact, the company facing the high turnover costs would want to save on them by providing its employees with incentives to stay. It can do that either through increasing their wages or by saving at least a part of these new costs by engaging the insiders in social responsibility. Here again the company capitalizes on its economy of scale in making donations. Therefore, we could see that similar mechanism work both when companies interact with their customers and labor[6].

Limitations of the CRM

So, the key implications for the third sector of the above mechanism are two-fold. On the one hand, the mediation of corporations helps to bring financial resources from the individual donors into the NPOs. On the other hand, the increase of control over their internal processes helps to use these resources more efficiently.

However, there are two key reasons why this scheme depicts reality in the inherently incomplete way. First, the assumptions of the model about the customers are not fully convincing. In fact, customers could be different in terms of the importance of warm-glow in their utility functions. At the same time, they can value different causes and be relatively indifferent (if not wary) toward others.

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[6] The more complex point is that to achieve the goals of better morale and productivity, the companies should improve itself on a few dimensions simultaneously, i.e. to align their practices to each other (Collins, Porras, 1994). The basic prediction is that the CSR taken alone is not enough to assure the success of the organizations, and if the CSR aims to influence the intra-organizational life, it should be framed in a more multi-dimensional way. This proposition could be formulated as a testable hypothesis. For instance, as it takes time to align the different parts of the organization the results of the acquisition of the CSR practice are observable only in the long run. The CSR is expected to be quite weakly correlated to success immediately after commencement of the practice. Another possibility to account for the same issue is to claim that the CSR will have no effect (or even will have a negative effect) for the bottom line if it is not accompanied by other practices (e.g., changes in culture or mission of the firm).

Although the logic for the firm is not changing drastically with the introduction of such corrections, the implications of these changes for the performance of the third sector are not fully neutral. In fact, the diversity of "non-profit" preferences among customers will force firms practicing CRM to engage in niche competition bundling their products with typologically different non-profit undertakings. The outcomes for NPOs of such actions are two-fold. On the one hand, the corporate contribution to a larger variety of missions is going to be observed. On the other hand, the selection of these missions through such mechanism will be quite competitive and because of that better connected to societal preferences.

Second, the market structures in which a socially responsible firm operates could differ from the both cases of monopoly and perfect competition (and even from the monopolistic competition) analyzed in the model. Below I will study the case of the stratified market for basic good and examine what forms of the CSR it generates.

Market hierarchies and CSR

The idea to consider markets as social structures goes back to the works of White (1981). J. Podolny (1993) defines the status as the assumed quality of the traded goods and elaborates the model of market hierarchy for investment banking industry. The key point of the author is the loose coupling between the statuses and real quality of products. The coupling exists in the long run, but not in the short time perspective. Although the high-quality producers in general produce the goods of higher quality, on observable markets this relationship could be not that clear and is established more in the customers' perception of the product, than in the objective measures. The explanation for this given by Podolny is that the link between quality and its perception is essentially confused by uncertainty of quality evaluation.

Podolny claims that market status is parallel in meaning to the economic concept of signal. The producer exercise some control over customers' perceptions because of its previous actions (the quality of the previous products). However, to maintain this link is costly, with the costs being in reversely related to the underlying quality of the product. The author sees as one of the key signaling mechanisms used on such markets the network embeddedness of the relations between producers and customers.

In this section I will consider social responsibility of corporations as a signaling mechanism and try to specify what implications such role of the CSR has for the corporate donations. Why CSR would serve as such signal? What are the incentives for corporations here? My explanation is to some extent similar to the theory of conspicuous consumption (Veblen) with the important difference that the corporation pays-off for this expenses. In fact, sending money to charities and tying the brand to good causes could help a corporation to assure its customers that the quality of this brand is high and finally to be able to charge higher price for it.

The key issue in any signaling model is to show how the signals help to clarify the real underlying unobservable variables. The model outlined below illustrates how CSR could serve as a means of signaling the real quality in hierarchical markets.

Imagine the market with two firms producing high quality and low quality goods. Imagine two cases. In the case of certainty the customer observes the quality of both goods and makes fully knowledgeable decision about the purchase. The market works perfectly. Consider now the case when quality is only partially observed, i.e. each customer with a non-zero probability *p* observes the quality and with probability (*1-p*) does not. In the latter case the customer either attempts to evaluate the quality of good using all the information that is available to him, or in the case that it is impossible he could make his choice randomly or just not buy the good at all.

In the case of uncertainty the producer of the low quality good gets incentives to "cheat" the customer, i.e. charge higher price for her product, so that to capitalize on customer's ignorance. In one of the equilibria on such market, the profits of the high quality producer becomes essentially contaminated because of the cheating of its competitor. This situation provides the rationale for the high quality firm to attempt to distinguish somehow its product from that of the low quality one.

One possibility to do that is by signaling its status to customers by engaging in social responsibility. The simplest way here is to send to charities a donation that exceeds the profits that the low quality company gets from cheating. By this action, the high-quality firm assures that the customer will not be confused in the situation of uncertainty and choose the product of the higher quality whatever the low quality firm does. Thus, at a cost of donating to social cause the higher quality company will succeed in separating itself from the low quality firm and make the situation analogous to that of full certainty.

To emphasize, the signaling theory of social responsibility in the situation of market hierarchy implies different motivation to send money to social causes than in the case of CRM analyzed above. The key concern of the firm now is to differentiate its core product. The CSR is only the means for that, whereas in the case of CRM the corporation sends money to charity responding to the real demand of its customers.

What implication does this difference have for NPOs? First, the NPOs are still financed. Second, the control function essential for the case of CRM now is much less profound. The customers in this model care relatively little about the non-profit causes (or at least they are willing to free-ride on the donations of others), and thus what matters for the firm the most is the amount of donation (that plays a signaling function). I will discuss the implication of this practice for the third sector in the next/last section of this paper.

Discussion and conclusion

As was shown above, there are multiple reasons for corporation to engage in the third sector and through that contribute to their bottom line (or at least break even). All mechanisms studied above lead to the increase of financing for the third sector. At the same time, considering the larger questions asked early on in this paper about the role of corporations in solving the key substantive problems of the third sector, I would claim that the answers are quite disparate depending on the particular characteristics of the corporations and their environment.

Homogenous markets push the corporations to work as mediators between the customers and third sector. The firms respond by serving important roles of controlling and to a certain extent directing not-for-profit organizations. Heterogeneous, hierarchical markets do just the opposite, and the resources send to the NPOs start being used in a much less ordered way.

The latter practice could be neutral or even have a contaminating effect on the effectiveness and efficiency of the third sector. The uncommitted money increases the bargaining power of the NPOs in their future negotiations with other sponsors and donators and thus can have a negative long-run effect. Whereas in the case of the CRM there exist certain obvious rationales for the firm to control the organizations (as the fund mismanagement in the NPOs will harm primarily the reputation of the corporation), in the situation of the CSR generated by the market hierarchy the firm does have much less reasons to actually care about the substantive part of their benevolent activity.

The CRM has an evident positive effect on both efficiency and effectiveness of the NPOs. The basic prediction of the model is that corporations will compete on the market for correcting voluntary failure and through that will introduce the real competition among the non-profit missions into the third sector. The effectiveness will increase, because in reality it will be society that will select out the obsolete missions and ineffective NPOs through the tensionless mediation of the private for-profit firms. So, the model shows that linking competitive markets for homogenous product and the third sector will make a substantial contribution to the latter making the activities of its organizations better aligned to the social needs. Market hierarchy will have just an opposite effect.

Nothing is new in that the introduction of corporate actors into the third sector could not become an ideal tool correcting all the eternal flaws in such a complex social system. The corporate social responsibility should be better considered as only one among other paths that can be used for this purpose.

The relative strength of the corporate social responsibility reflects the ability of this mechanism to self-sustain and in certain situations can to work almost perfectly. The policy implication of this finding is that there exist the needs, first, to re-legitimate this practice for certain markets and, second, to constrain its use in the situation when it leads to wasteful results. The positive and normative analysis of these issues transcends the limits of this paper.

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