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# Implementing stakeholder participation as “egalitarian bidding” –

The test of the Kantian pudding is in the institutionalized eating

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**Abstract:** Stakeholder conceptions of corporate governance tend to address managers and owners of companies as benevolent despots who follow ethical appeals to respect all stakeholders equally. Avoiding the benevolent despot assumption we axiomatically specify how “stakeholder participation as ‘egalitarian bidding’ ” could conceivably be used to implement the values underlying stakeholder conceptions as procedures of corporate governance. We do not claim that stakeholder theorists have to concur with our proposed operationalization of their ideals. Yet those who do not accept participatory ‘egalitarian bidding’ should come up with some alternative operationalization of “equal (Kantian) respect” or admit that their theories are non-operational.

**Keywords:** Stakeholder conceptions of management, interpersonal equal respect, corporate governance, intrinsic motivation, procedural fairness

**JEL Codes:** D44, D63, D82, G34, J50

## 1. Introduction and Overview

The conflict between so-called shareholder and stakeholder approaches forms one if not the defining controversy of business ethics. In this controversy classical liberal economists and ethicists tend to take sides with Milton Friedman's thesis that owners and managers should follow market signals in pursuit of shareholder value (the so-called shareholder value approach). Advocates of 'socially responsible management' lean towards Edward Freeman's view that stakeholders of a company have to be taken into account not only instrumentally in pursuit of shareholder value and according to prices but ethically deserve to be treated with (Kantian) *equal* respect as "ends in themselves" (the so-called stakeholder value approach).

To the best of our knowledge, stakeholder conceptions have not yet managed to show how their appeals can be translated into rules that can be implemented as corporate governance *procedures*. We subsequently exemplify in procedural terms how participatory corporate governance rules can *conceivably* guarantee that stakeholders of a company are not treated as "mere means" to others' ends in corporate decision-making. We regard this as a preliminary step towards an institutionally and practically grounded discussion of the relative merits of stakeholder value theories of corporate governance vis a vis shareholder value approaches.

In the next section we illustrate that both Freeman and Friedman subscribe to Kantian ideals of interpersonal respect albeit on different levels of governance. With this in hand, we introduce our procedural proposals for corporate governance as a specification of the normative theory of consensual, society-wide good governance developed in Buchanan's and Tullock's (1962) *Calculus of Consent*. Turning to stakeholder participation we axiomatically characterize a procedure expressive of Kantian equal respect for persons in a corporate governance context and illustrate its properties. Conceding the objection that "implementing stakeholder participation as egalitarian bidding" is not incentive compatible (not



underbidding proof) we draw attention to the role of intrinsic motivation. After discussing some further objections against our procedural proposal we conclude with a warning against relying too strongly on ideal theories of economics and ethics when it comes to practical business ethics and its relation to corporate governance.

## **2. Freeman's and Friedman's Appeals to "Kantianism"**

In opposition to prevailing shareholder value conceptions of good corporate governance Edward Freeman's declared aim is to "revitalize the concept of managerial capitalism:"

"My thesis is that we can revitalize the concept of managerial capitalism by replacing the notion that managers have a duty to stockholders with the concept that managers bear a fiduciary relationship to stakeholders. Stakeholders are those groups who have a stake in or claim on the firm. Specifically I include suppliers, customers, employees, stockholders, and the local community, as well as management in its role as agent for these groups. I argue that the legal, economic, political, and moral challenges to the currently received theory of the firm, as a nexus of contracts among the owners of the factors of production and customers, require us to revise this concept. That is, each of these stakeholder groups has a right not to be treated as a means to some end, and therefore must participate in determining the future direction of the firm in which they have a stake." (Freeman 1984, 184)

As upshot of this citation the last sentence emphasizes two crucial points: first, each stakeholder group has a "right not to be treated as mere means to some end" and, second, "therefore must participate in determining the future direction of the firm in which they have a stake."

The first point is a direct translation of the terms in which Kant himself presents his central ethical ideal of interpersonal respect. The second point that "each of these

stakeholder groups” ... “must participate in determining the future direction of the firm” indicates that for Freeman participation of all stakeholder groups is necessary to implement the “right not to be treated as mere means to some end.”<sup>1</sup>

Shareholder value theorists will be tempted to dismiss Freeman’s views as alien to the liberal type of market economics to which they typically subscribe. They should recall, though, that Kantian ideals have been and presumably are still shared by many of their fellow shareholder value theorists.<sup>2</sup> As a gentle reminder it suffices to cite Milton Friedman’s endorsement of values of Kantian inter-personal respect:<sup>3</sup>

“Desirable or not, any end that can be attained only by the use of bad means must give way to the more basic end of the use of acceptable means. To the liberal, the appropriate means are free discussion and voluntary co-operation, which implies that any form of coercion is

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<sup>1</sup> “Must therefore” is meaningful only if what “must” be done in fact “can” be done.

<sup>2</sup> It may be a contingent historical accident that the Darden School at which Freeman is located is part of the University of Virginia, Charlottesville. But it seems significant that in this environment some of the clearest statements of Kantian interpersonal respect norms in economics have traditionally been made. To give two examples from USA, in his 1956 UNESCO report “on the state of economics in the United States of America” Rutledge Vining says: “*To require of each individual that he takes no action which impairs the freedom of any other individual is to accept the moral principle that no individual should treat another simply as a means to an end*” (Vining 1956, 19), James M. Buchanan, who along with Ronald Coase had joined the faculty from the mid 1950’s has always worked in the equal mutual respect framework to which he himself refers as ‘politics as exchange.’ The voluntariness of exchange represents inter-personal respect and the inclusiveness of all affected is represented by the assumption that “‘political exchange’ necessarily involves *all* members of the relevant community rather than the two trading partners that characterize economic exchange” (Buchanan 1975, 50, emphasis original).

<sup>3</sup> At least in common perception Milton Friedman is the almost arche-typical “hard-nosed economist” and “witness of the crown” of a shareholder value approach in business ethics.

inappropriate. The ideal is unanimity among responsible individuals achieved on the basis of free and full discussion.” (Friedman 2002, 22-23)

Friedman’s statement is meant to apply on the constitutional political level of the “legal rules of market-interaction.”<sup>4</sup> Once the rules of the market are fixed then within market-rules, “*The Social Responsibility of Business Is to Increase Its Profits*” (Friedman 1970). According to the implicitly utilitarian (welfare economic) conception of Friedman business is obliged to allocate resources to their most valuable uses – i.e., the purposes most conducive (as indicated by price signals) to furthering general welfare.<sup>5</sup>

Contrary to Friedman, Freeman does not accept that the stakeholders’ “right not to be treated as mere means to some end” can be discharged by choosing on the polity-wide constitutional level rules of the ‘private law society.’<sup>6</sup> Freeman rejects the view that, once the rules of law have conferred well-defined (equal) legal rights and powers on all individuals, interpersonal respect will be sufficiently secured by the voluntariness of contractual agreement among individuals.<sup>7</sup>

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<sup>4</sup> The strategy of restricting unanimity to the constitutional level while assuming less than unanimous agreement on subconstitutional levels is developed in more detail in the *Calculus of Consent* of Buchanan and Tullock (1962, vol. 3) which we shall apply to corporate governance subsequently.

<sup>5</sup> Friedman assumes that the market signals tell – under appropriate conditions – fairly accurately what the value increasing allocations are.

<sup>6</sup> Böhm (1966), an influential German constitutional lawyer, uses this expression to characterize markets as a subsystem of the economic order of a free western society. Like other members of the so-called ordo liberal Freiburg School he strongly sympathized with the values of the Mont Pelerin society among whose “noble” members were besides its founder F.A. v. Hayek, scholars like G. Becker, J. M. Buchanan, M. Friedman, V. Smith.

<sup>7</sup> Private property as such confers the legal power to make decisions without any obligation to pursue the common weal. Within the powers so conferred the entrepreneur who owns a firm may legally do as seems fit

The second of Freeman's two central points indicates that letting groups of stakeholders participate in (co-)determining the future direction of the firm can prevent using them as mere instruments in pursuit of shareholder value. Though prima facie plausible, as a protection against using stakeholders as "mere means," relying on *group* participation in corporate decision making as an approximate expression of inter-individual respect needs to be qualified:<sup>8</sup> first, for individual group members who are able to personally exit from the corporate nexus at relatively low costs, "non-exit" is functionally equivalent and has the same "justificatory power" as expressing (tacit) assent by personal omission of a veto (on a higher level than implemented by group representation and group veto *within* the company). Second, complementary to omitting or taking the exit option the possibility of active participation (voice) yields a "graded" guarantee of Kantian respect to the extent that it amounts to "*some*" (group) veto power in matters that involve high exit costs for individual actors.<sup>9</sup>

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with her or his property. In particular, there is no legal obligation to follow market signals and to increase value. In this regard Milton Friedman, perhaps surprisingly, seems to endorse an ethical social responsibility conception as well since he seems to assume that there is an ethical obligation to use property in value increasing ways rather than being legally and ethically "free to choose."

<sup>8</sup> Though it seems plausible that the basic right of an individual to be treated as an end is respected if the individual herself participates in a decision that she could *individually* veto this seems quite precarious in cases in which the individual is merely a member of a *group* with veto power. To illustrate, consider the case of an individual taxicab driver who is instrumental to bringing her passenger to his destination. She is not used as a means *only* if she can reject the prospective passenger's contract offer (i.e. veto it). In case of a group of taxicab drivers who assign fares to individual drivers collectively, say by majority voting, it seems much more doubtful that participation in the voting process is sufficient to guarantee that the *individual* is not used as a mere means to ends that she does not own.

<sup>9</sup> Of course, in a fuller account costs of entry – including developing firm specific human capital as sunk costs – would have to be discussed, too. But for our present purposes it suffices to focus on exit as a protection.

In sum, Freeman substitutes the Kantian focus on individuals by a group related requirement. Subsequently we accept this deviation from Kantian individualism as a concession to practicability. Moreover, we restrict ourselves to a discussion of employee participation (leaving out, eg., customer participation). Our aim is, to transparently characterize a procedure of employee participation by an axiomatic representation of “values” that, as we shall indicate, jointly prevent instrumentalization of stakeholder groups. Our claim is, that implementing this procedure could amount to incorporating the “right not to be treated as mere means to some end” in corporate governance.

### **3. The *Calculus of Consent* Goes Business**

#### *3.1 Contractarianism and Economics*

Of the three so-called “new contractarians” (Gordon, 1976), Buchanan, Nozick and Rawls, the first is conventionally associated with Hobbes, the second with Locke and the third with Kant. In case of Nozick and Rawls this grouping of new and old contractarians seems basically correct. As far as Buchanan is concerned some additional comments and qualifications are, however, necessary. Though he certainly invited a broadly Hobbesian interpretation of his basic views in some of his work, the ethical ideals of inter-personal respect underlying his conception of “politics as exchange” are clearly Kantian in spirit (Kliemt 2011, Brennan and Kliemt 2019). We restrict ourselves to Buchanan’s and Tullock’s seminal *Calculus of Consent* and see Buchanan – as he did himself – as endorsing the same ethical outlook as Rawls who is a self-declared adherent of Kantian ideals (in particular in his

criticism of utilitarianism and welfarism as insufficiently respectful of “the separateness of persons”).<sup>10</sup>

Like Milton Friedman, Buchanan and Tullock’s *Calculus* invokes “unanimity” yet of an explicitly collective decision procedure. Buchanan, taking his inspiration from Knut Wicksell (1896), thinks that unanimity has to and can be brought about by side-payments. Collective projects are to be financed by positive or negative transfers that can induce each and every individual not to veto them.<sup>11</sup>

In slightly different terms: empowered to veto, the individual who omits using the veto, voluntarily ratifies the decision of the collective. The procedural presence of individual veto power guarantees – exactly as Freeman suggests for groups – that the veto-omitting (in this sense “ratifying”) individual is not used as a mere means.<sup>12</sup>

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<sup>10</sup> Like Rawls, and for that matter, John Harsanyi, Buchanan uses the figure of the decision-maker who, ignorant of how he would be personally affected by decisions, would in some way or other represent the common interest. This idea was articulated in full first by Vickrey (1945) in response to the then “new” preference-representational utility concept. The idea somehow must have transpired to others who all in the following years articulated their versions of a “veil of uncertainty,” “ignorance” or “ethical/impartial preferences” etc. But for our purposes these veils, though making voluntary agreement more plausible, are less important than the basic principle that agreement of each and every individual is – under certain conditions – taken to be necessary and sufficient for securing inter-personal respect: no individual who had a veto against a decision can afterwards complain that it was imposed on her or him, “volenti non fit iniuria.” Of course, that one cannot by voluntary agreement inflict an injustice on oneself can be criticized as well but the discussion of issues concerning obligations to oneself would lead too far here.

<sup>11</sup> Other than Kaldor-Hicks conceivable compensation, compensations have to be actually paid at least on the group level.

<sup>12</sup> The example of the taxicab driver invoked in footnote 8 can be adapted easily to show the analogy in case of voting under the unanimity requirement or collective decision-making in the shadow of individual veto power.

### 3.2 *Collective Action and Unanimity in Constitutional Economics*

If all have in fact unanimously agreed – in all likelihood induced by side payments and certain procedural guarantees of institutional “rights” –, the argument yields a convincing justification of the claim that due to prior assent nobody is used as a mere means.<sup>13</sup> However, the unanimity requirement may seem outrageously unrealistic in practical contexts. In view of this, an adherent of the ideal never to use other individuals as mere means must endeavor to find ways of approximating the ideal of unanimity where- and whenever possible. This is the line of argument that we shall explore via adapting the basic argument of the *Calculus of Consent* to corporate governance rules for stakeholder groups.

Note first, that in corporate as opposed to political governance free entry and exit can plausibly substitute veto power as bestowed on individuals by the unanimity rule.<sup>14</sup> *To the extent that it has been specified in advance what contractors agree to and to the extent that alternatives existed* those who contract with a firm have “veto power” and can plausibly be held responsible for joining the contract nexus of the firm.<sup>15</sup>

Adherents of free market organization often seem to think that the preceding line of argument is sufficient to secure that stakeholders of companies operating on such markets are not used as mere means. In particular the exit option secures against the more severe forms of abuse. However, like contract enforcement exit and entry may be very costly. Moreover, one

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<sup>13</sup> At least if certain conditions of “informed (cool-state) consent” are met.

<sup>14</sup> The emigration argument of Plato’s *Crito* –though often interpreted as justifying the moral obligation to submit to collective decisions because of choosing not to emigrate – is a forceful reduction to the absurd of the exit-argument in case of membership in political communities. Hume (1985, Essay XII) presents the classical criticisms against contractarianism in *politics*. Yet contractarianism remains alive and is certainly more plausible in case of firms or clubs than in case of political communities.

<sup>15</sup> To the extent that contractors know what they “buy into” the time honored maxims of “caveat emptor” and “volenti non fit iniuria” apply with full force.

central reason for having firms derives from the impossibility to fully specify contracts in view of an uncertain future. Where the use of contractually conferred powers remains substantively underspecified individuals may still be “abused as means” by those in command of discretionary powers. Therefore, for contingencies that cannot be sufficiently foreseen additional procedural safeguards *complementary* to those provided by “exit and entry” from the contract nexus with the firm may be required by the contractors.<sup>16</sup>

Safeguards of inter-personal respect in decision-making have typically be seen as embodied in the participatory nature of decision-making procedures. To the extent that procedural specifications are credible and transparent commitments of corporate governance, stakeholders can evaluate the participatory mechanisms on offer. Knowing the corporate governance structure of the company (due to procedural specification) *before* entering into a relationship with it the firm’s stakeholders (including shareholders) can “ratify” its governance procedures (or not).<sup>17</sup> This way, inter-firm competition for stakeholder patronage can be extended to alternative bylaws of (participatory) corporate governance. This part of corporate governance can thereby become subject to market valuations and the control exerted by them (including the additional level of group participation as an approximation of individual “powers”).

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<sup>16</sup> Freeman rightly emphasizes the role of “entry and exit” yet, underemphasizes that the presence of these options reduces the role of group participation in governance to a complementary or subsidiary role in expressing Kantian values of inter-individual respect.

<sup>17</sup> Stakeholder conceptions that go to the extreme of including non-contractual relationships with the environment or future generations are neglected here. The values that they support may be plausible but not as values of a stakeholder conception.



#### 4. Procedural Stakeholder Participation

To “translate” the “Kantian” ideals expressed by stakeholder conceptions into concrete institutional governance rules the corporate governance structure should procedurally support the search for universal advantage and agreement under constraints of inter-individual respect. To this effect, basically Buchanan’s ideal of “politics as (multilateral) exchange” must be extended from political governance to non-political corporate actors.<sup>18</sup>

The mechanism we outline next incorporates both a common denominator (facilitating compromise and tradeoffs) and group-based veto power (making compromise and concessions a necessity). In this as in other forms of bargaining the measuring rod of money will do better as common denominator than any conceivable alternative. At least this is what we assume in our outline of a procedure of stakeholder participation as egalitarian bidding.

##### *4.1 An Outline of a Procedure of Stakeholder Participation*

Assume that the management considers plans of how to (re)structure the firm. Let  $M$  denote the set of mutually exclusive<sup>19</sup> plans and refer to  $m \in M$  as a typical element of that set.

Assume that for each plan  $m$  management states a “surplus claim”  $S_m$ .<sup>20</sup>

Being informed about  $M$  and  $S = \{S_m : m \in M\}$  by management which has the prerogative of an agenda setter, the stakeholders  $i = 1, \dots, n$  ( $n \geq 1$ ) can participate via bidding, i.e. via stating bids  $b_i(m) \in \mathbb{R}$  for all  $m \in M$  according to the following rules:

*Veto condition:* If  $b_1(m) + \dots + b_n(m) < S_m$ , for some  $m \in M$  then plan  $m$  is rejected.

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<sup>18</sup> See Buchanan (1999, vol. 1), passim and for further discussion Brennan and Kliemt (2018).

<sup>19</sup> This is obviously no restriction since one can consider bundles of such plans as mutually exclusive.

<sup>20</sup> When the surplus, generated by  $m \in M$ , is stochastic, the surplus claims of management may condition on random events.

Since stakeholder groups  $i = 1, \dots, n$  – respectively their representatives – are all “free to choose” their monetary bids  $b_i(m) \in \mathbb{R}$  (*including negative values*) they can obviously veto it by some appropriately low bid so that for any  $m \in M$  the veto condition is fulfilled. By their veto they incur the opportunity cost that  $m$  is not realized. Otherwise voicing an “appropriately low” figure as a bid is a purely expressive act that imposes no higher transaction costs on them than voicing a higher bid.

If  $b_1(m) + \dots + b_n(m) \geq S_m$  plan  $m \in M$  is not vetoed. A necessary condition for implementing  $m \in M$  is met and management is authorized by the rules to consider it an eligible option.

It may be worth noting that management can subsidize ( $S_m < 0$ ) certain plans from other resources of the company to win stakeholders over. Yet, there is no guarantee that any plan will meet the necessary condition for implementing it; that is, after stakeholders have been bidding on all  $m \in M$  the subset

$$M_a = \{m \in M: b_1(m) + \dots + b_n(m) \geq S_m\}$$

of acceptable plans  $m \in M$  may be empty.

*Status quo condition:* If  $M_a = \emptyset$  or if, in case of  $M_a \neq \emptyset$ , none of the plans in  $M_a$  is realized by management the status quo is maintained.

Stating all payoffs in relation to the status quo, we can assume that management and stakeholders  $i = 1, \dots, n$  all receive 0-payoffs if either  $M_a = \emptyset$  or management abstains from realizing any of the acceptable plans  $m \in M_a$  despite  $M_a \neq \emptyset$ .

*Equal split condition:* If  $M_a \neq \emptyset$  and plan  $m \in M_a$  is realized by management then management receives  $S_m$  and stakeholders  $i = 1, \dots, n$  earn

$$V_i(m) - b_i(m) + \frac{b_1(m) + \dots + b_n(m) - S_m}{n}$$

$V_i(m)$  is the true value of stakeholder  $i$  when  $m \in M_a$  is realized. Of course,  $V_i(m)$  usually is  $i$ 's private information while all the other factors determining stakeholder  $i$ 's information are commonly known from overt bidding.

Since the mechanism grants veto power at zero opportunity cost (except for the constraint that bidders must jointly meet the requirement of  $M_a \neq \emptyset$  if any positively valued change is to occur), whatever their  $V_i(m)$ , the stakeholders usually have an incentive to underbid.<sup>21</sup> Still, despite the underbidding incentive, egalitarian bidding of the kind we suggest is at least one *feasible* way of translating into procedural terms the ideal of Kantian equal respect for stakeholders along with an adequately privileged role of management as agenda setter. Moreover, as we endeavor to indicate next, the procedure seems normatively and empirically more reasonable than economic folk wisdom on mechanism design may initially suggest.

#### 4.2 *Properties of Participation as Egalitarian Bidding*

(V) The mechanism guarantees “*voluntariness*.”

It fulfills

$$V_i(m) - b_i(m) + \frac{b_1(m) + \dots + b_n(m) - S_m}{n} \geq 0 \text{ if } b_i(m) \leq V_i(m) \quad \text{for } i = 1, \dots, n,$$

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<sup>21</sup> Only in case of commonly known  $V_i(m) + \dots + V_n(m) = S_m$  underbidding incentives would not exist.

i.e. stakeholder groups  $i = 1, \dots, n$  can only lose, relative to the status quo, when overbidding; furthermore, by bidding low enough, possibly via  $b_i(m) < 0$  or  $b_i(m) < V_i(m)$ , each stakeholder group  $i$  can veto any plan  $m \in M$ .<sup>22</sup>

As has already been mentioned, the values  $V_i(m)$  for all  $m \in M$  can, and as a rule, will be private information of stakeholder  $i = 1, \dots, n$ . This obviously renders procedural guarantees of equal treatment with respect to *private values* impossible. However, this does not rule out guarantees of *equal* treatment with respect to *monetary bids*  $b_i(m)$ . The latter and the equal treatment with respect to them are overt acts that are observable.

(E) The mechanism guarantees “*equal respect according to (overt) bids.*”

Substituting  $V_i(m)$  by  $b_i(m)$  in the payoff specification for stakeholders yields *equal respect according to (overt) bids*

$$b_i(m) - b_i(m) + \frac{b_1(m) + \dots + b_n(m) - S_m}{n} = \frac{b_1(m) + \dots + b_n(m) - S_m}{n} \quad \text{for } i = 1, \dots, n$$

With respect to their interpersonally observable *bids*, all stakeholder groups  $i = 1, \dots, n$  are treated equally by receiving an equal share of  $b_1(m) + \dots + b_n(m) - S_m$ . That is, the procedure not only grants equal veto power but also *equal treatment as far as overt payoff consequences relative to the status quo* are concerned.

(O) The co-determination mechanism is *overbidding proof*.

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<sup>22</sup> The so-called “hold out problem,” that this gives rise to, probably motivates many scholars to reject the unanimity requirement. It should not be neglected, though, that some stakeholders  $i$  with  $V_i(m) < 0$  for some  $m \in M$  may get compensated when moderately underbidding in terms of  $b_i(m) < V_i(m)$ . In that case,  $m$  may still be acceptable and possibly implemented by management. In any event, the interest of guaranteeing that  $m \in M_a$  applies will recommend to exercise some moderation in strategic underbidding.

It does not pay for any stakeholder  $i = 1, \dots, n$  to overbid the value  $V_i(m)$  since, relative to truthful bidding  $b_i(m) = V_i(m)$ , overbidding would yield a disadvantage for stakeholder group  $i$  due to

$$V_i(m) - b_i(m) + \frac{b_1(m) + \dots + b_n(m) - S_m}{n} < \frac{b_1(m) + \dots + b_n(m) - S_m}{n} \text{ for } i = 1, \dots, n.$$

This reduction of payoff would apply if management implemented a plan  $m \in M$  for which even the truthful bid  $b_i(m) = V_i(m)$  would not guarantee acceptability, so that  $b_1(m) + \dots + b_n(m) \geq S_m$  for plan  $m \in M$  results exclusively from  $i$ 's overbidding. If for  $b_i(m) = V_i(m)$  plan  $m$  is unacceptable, i.e.  $b_1(m) + \dots + b_{i-1}(m) + V_i(m) + b_{i+1}(m) + \dots + b_n(m) < S_m$ , stakeholder  $i$  would suffer a loss when overbidding --  $b_i(m) > V_i(m)$  -- due to

$$V_i(m) - b_i(m) + \frac{b_1(m) + \dots + b_{i-1}(m) + V_i(m) + b_{i+1}(m) + \dots + b_n(m) - S_m}{n} + \frac{b_i(m) - V_i(m)}{n} = \frac{n-1}{n} [V_i(m) - b_i(m)] + \frac{b_1(m) + \dots + b_{i-1}(m) + V_i(m) + b_{i+1}(m) + \dots + b_n(m) - S_m}{n} < 0$$

by assumption.

The co-determination mechanism of “stakeholder participation as egalitarian bidding” shares the properties (V), (E) and (O) with familiar institutions like, in particular, first-price auctions.<sup>23</sup> Belonging to a class of familiar institutions is certainly desirable with respect to practical uses of a procedure. Yet, familiarity is not sufficient to vindicate a mechanism like the proposed one against objections.

## 5. Critical Assessment of Underbidding Incentives

As indicated, if ideals of Kantian equal respect are procedurally expressed in terms of “stakeholder participation as egalitarian bidding” the resulting mechanism is not

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<sup>23</sup> It can be shown that some such mechanisms can be fully characterized by requiring that they be “envy-free” and meeting requirement (E) with respect to (overt) bids; see Güth (2011).

underbidding proof. It invites bid-shading, i.e.  $b_i(m) < V_i(m)$  for  $m \in M$  and  $i = 1, \dots, n$ . Yet whether this forms a decisive argument against the mechanism depends.

First, there is no procedure fulfilling properties (V), (E) and (O) that is over- and underbidding-proof and generally implementable.<sup>24</sup> A trade-off between fulfilling desirable properties cannot be avoided in procedural implementations of the ideals of stakeholder theories.

Second, we cannot imagine a mechanism that confers discretionary power on collective bodies and at the same time grants procedural veto power to each and every member of the decision-making body unless property (V) – or some variant of it – is fulfilled at least for groups. Adherents of stakeholder conceptions who reject “stakeholder participation as egalitarian bidding” but accept that they need to go beyond mere appeals to Kantian ideals should – and presumably would have a hard time to – come up with constructive procedural counter proposals.

Third, requiring (E) along with (V) translates ideals of substantive equality into procedural specifications. To the extent that the effects of (E) and (V) are perceived as such by participating stakeholders this may psychologically (*causally*) reduce their proclivity to underbid by strengthening the *intrinsic motivation* to bid truthfully or even to overbid due to some crowding in of, say, *corporate identity or corporate social responsibility* concerns.

## 6. Critical Assessment of a Potential Role of Intrinsic Motivation

As stated in our subtitle the practical proof of Kantian appeals expressing the values of stakeholder participation is in the institutional eating. This is why we took much care to

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<sup>24</sup> Using, for instance, the Revelation Principle would require the highly restrictive common knowledge assumption of game theoretic equilibrium analysis.

specify rules that conceivably allow to test the implications of approximating Kantian normative ideals of stakeholder theories in practice. We are ourselves not naively assuming that the implementation of our (or any alternative) procedural translation of the ideals of stakeholder theories will lead to attractive results independent of context. Yet, there is quite some empirical and in particular experimental evidence showing that under favorable circumstances intrinsic motivation may exert much stronger influences on practical stakeholder behavior than typical conceptions of mechanism design and principal agent theory assume in their search for “knave proof” institutions.<sup>25</sup>

Experimental research on bidding mechanisms has provided ample evidence that rather subtle aspects of implementation may matter. Moreover, some first findings of bounded under- and even some overbidding in an explorative experiment on “egalitarian bidding” suggest seeking ways of strengthening such effects.<sup>26</sup> In particular, explicit framing, to enhance awareness of properties (V), (E) and (O) may be expected to strengthen intrinsic

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<sup>25</sup> This point has been rightly emphasized by adherents of stakeholder conceptions from the start. It can be supported by many findings of psychology and experimental economics. Starting from Hume’s well-known remark “that, in contriving any system of government, and fixing the several checks and controls of the constitution, every man ought to be supposed a knave and to have no other end, in all his actions, than private interest.” (Hume 1985, 42, Essay IV). Bowles (2016) provides an excellent overview over relevant experimental results concerning the validity of the behavioral assumptions underlying mechanism design.

<sup>26</sup> In an explorative experimental study by Alberti, Güth, and Tsutsui (2020), that implemented “stakeholder participation as egalitarian bidding”, bounded bid shading and even some systematic overbidding could in fact be observed. It seems that some stakeholders did not want to block a plan that might be “good for the firm” even though affecting themselves negatively. Obviously more research concerning effects of fairness perceptions and intrinsic motivation based on procedurally fair bidding is necessary before stronger claims can be based on evidence.

motivation of stakeholders to act “fairly” in what they regard as the common interest of all stakeholders.

Of course, ultimately any co-determination mechanism for corporate governance must live up to the test of competitive market evaluation: In countries in which the market for corporate control is working reasonably well instances of testing “the Kantian pudding in the institutional eating” would in fact arise after some companies implemented values of stakeholder theory in terms of procedurally fair bidding for at least some types of decisions.

As long as stakeholder theorists do not go beyond mere appeals to Kantian ideals the lack of operational realism prevents subjecting their theories to the test of competitive markets. If they cannot or do not want to discharge the burden of *procedural proof* of their “appealing values” this speaks against stakeholder conceptions in general. Sympathizing with their values our tentative proposal is meant to nudge stakeholder theorists towards a new kind of “mechanism design” that leaves some room for precisely the intrinsic motives that they invoke in their ideal theories.

## **7. Concluding Remarks**

The so-called “contractarianism” to which countless modern philosophers, philosopher economists and business ethicists subscribe remains in the realm of ideal theory unless translated into procedures. It is one of the great merits of Buchanan’s and Tullock’s approach in the *Calculus of Consent* that it translates contractarian ideals into *ideal procedural theory*. Yet even this is merely a first step towards implementation since advocating an ideal procedure conferring veto power on each and everybody in ideal theory must consider how



ideal procedures for an ideal world can in fact be approximated by specific implementations in the real world.<sup>27</sup>

Following up on this, stakeholder theories should make an extended effort to demonstrate, first, that the values they propagate can be spelled out by operational rules, second, how the rules can be implemented institutionally in corporate governance and, third, that corporations that implemented corresponding mechanisms as part of their corporate governance structures can survive and thrive in inter-firm competition.<sup>28</sup>

If these three conditions could in fact be met this would have interesting implications for the somewhat overblown controversy between stakeholder and shareholder conceptions in business ethics. For, then, letting stakeholders participate in corporate governance could become instrumental to creating “sufficient” shareholder value in competition with other value creating firms.<sup>29</sup> Adherents of shareholder value conceptions could reasonably suggest that shareholders endorse corporate governance rules whose implementation can induce the corporation to behave “as if” led by Kantian ethical ideals. This would meet the shareholder theorists ultimate test of practical business ethics for competitive market societies in that such companies would be “doing well by doing good.” At the same time the search for procedures that implement the ideals of stakeholder theories would revitalize managerial capitalism as Freeman intends.

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<sup>27</sup> On ideal theory see Brennan and Pettit (2005), and Hamlin and Stemplowska (2012); for an extended recent account of the philosophical debate see Gaus (2016), while Geuss (2008) is a straightforward traditional defense of feasibility requirements in theories of political governance.

<sup>28</sup> In the spirit of Alchian (1950).

<sup>29</sup> Value measured as for instance in the McKinsey’s “valuation bible” (Koller, Goedhart, and Wessels 2015).

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