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What is public relations to society? Toward an economically informed understanding
of public relations

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Highlights:

- An economic conceptualization of public relations is proposed using *information asymmetry*.
- Public relations is categorized as signaling/screening, which reduces externalities and adverse selection.
- Using this economic lens, public relations can be understood as a contribution to the efficient allocation of a society's resources.

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ABSTRACT

The notion of public relations contributing to the fabric of society is heavily contested in the public sphere and under-researched by the academy. The authors of this paper propose that the study of the relevance of public relations to society can be enlightened by turning to economics. Using *information asymmetry* as a framework, the argument is that public relations can be analyzed as a social institution that both helps to mitigate market imperfections and consequently increases the efficiency with which society's resources are allocated as well as the chances for more market participants to derive value out of economic transactions.

1. Public relations and society

The notion of public relations contributing to the fabric of society is heavily contested in the public sphere and under-researched by the academy. As long as this remains the case, public relations will not complete the “route to professionalism” (Meyer & Leonard, 2013). After all, the contemporary lists of requirements for achieving professional status of public relations all include some form of constitutive or sustaining role for society (Cameron, Sallot & Weaver-Lariscy, 1996; Cutlip, Center & Broom, 2006; Niemann-Struweg & Meintjes, 2008; Parsons, 2004).

Instead, public debate about public relations often focuses on the possible harm inflicted upon society, with, e.g. the *Economist* claiming that “PR man has conquered the world” (18 December, 2010: 128) and is, according to the *International Herald Tribune* (31 January, 2012: 16) ladling out “slop meant to obscure rather than reveal.”

The public relations academy has not provided a counter narrative of equal weight. This is, first, because the organization – not society – is its prevalent level of analysis, as inspired by the excellence study (Grunig, 2006; Grunig et al. 2002), which remains the dominant paradigm for the field (Botan & Hazleton, 2009; L’Etang & Pieczka, 2006). Consequently, the public relations academy mostly theorizes from the viewpoint of managerial rationality and simply implies - mostly without investigation - that public relations at least does no societal harm, because it enables dialog as an enactment of mutual balancing between organizations and their publics (Demetrious, 2006).

Second, postmodern and particularly critical scholars repudiate the notion of public relations contributing to society. They contend that dialogic public relations perpetuates the hegemony of corporations over their environment and of “western” forms of corporate capitalism over marginalized communities and societies in general (Dutta, 2012; Leitch & Neilson, 1996, 2001; L’Etang & Pieczka, 2006; Munshi & Kurian, 2005). Society will be harmed, they contend, by public relations because it serves to maintain managerial hegemony “through the making of concessions at key areas of contestation” (Roper, 2005, p. 70; Demetrious, 2013).

Third, the academy has failed to connect public relations with society because the few scholars who use a macroscopic perspective have remained over-shadowed by the organizational paradigm. Investigations of public relations as a macro-social phenomenon are typically made by the academy in Europe, but with little impact beyond the continent. The seminal work by Ihlen et al. (2009) and the special issue of *Public Relations Review* (33/2007) started the application of grand social theory to public relations. The more specific question of how public relations and society

interlink has been tackled by scholars (Ronneberger & Ruehl, 1992; Burkart & Probst, 1991) using, for example, Luhmann's (1989, 1990, 1995) social systems theory as well as Habermas' (1981) communicative action theory. Heath (2006, 2013) has developed the notion of public relations assisting in the workings of a "fully functioning society" and democracy, building on the arguments of other rhetorical scholars such as Pearson (1989) and Toth and Heath (1992). However, all of these approaches have had limited impact on the debate about what public relations contributes or is to society.

A gap remains in public relations scholarship that brings organization and society together (Gregory, 2012). Organizations are actors beyond their managerial utility and they contribute to, shape and help define society. Indeed the language of business in particular, increasingly permeates public discourse. Hence, discussing the organizational level of analysis without including the societal perspective is partial.

2. An economic turn

The authors of this paper propose that the study of the relevance of public relations to society can be enlightened by turning to economics, which does not have the same bifurcation between organization and society and is "widely seen as the most advanced of the social sciences with its mathematical formalization, public prestige and Nobel prize awards" (Ioannides & Nielson, 2007: 1). This requires accepting the economic axiom that society as a whole can and should benefit from economy as long as markets – provided they function – allow a society to distribute its scarce resources.

Wildman (2008), Podnar (2009) and a special issue of *Public Relations*

Review (35/2009) have reminded the communication academy more generally of the potential of economic theory and of traditional schools of economic thought. McKie & Lawniczak (2009: 337) lament the lack of attention to economics and call for macro-economic input into public relations theory (Lawniczak, 2009). However, turning to economic theory for insights by public relations scholars has been limited (e.g. Willis, 2012). The authors suspect that this has to do with the educational background of practitioners and academics and their lack of familiarity with economic theory, and also with the “autistic condition” (Ioannides & Nielson, 2007: 1) of (neo)classical economics that traditionally uses idealized mathematical models and is not open to contingent social factors.

It is now appropriate to apply economic theory more specifically to public relations because economic theory has changed. The recent economic crises have fundamentally called into question the value of (neo)classic economic thought. In response, economic theories that veer away from the classic *homo economicus* are gaining traction since they offer richer explanations of “how the economy really works” (Akerlof & Shiller, 2009: 5) by incorporating the human condition. Two of these richer models have been awarded Nobel Prizes and are at the core of current economic debate: *information asymmetry*, as advanced by Akerlof (2000), Spence (1973, 1974, 1980) and Stiglitz (1975, 2001a,b), and “common-pool resources,” as described by Ostrom (1990, 2009). This paper focuses on the first of these two.

3. The market context of public relations

The authors’ argument is that public relations can be analyzed as a social institution that helps to mitigate market imperfections and consequently both increases the efficiency with which society’s resources are allocated and increases the

chances for more market participants to derive value out of economic transactions.

Akerlof, Spence and Stiglitz' starting point is the refutation of the assumption that markets are moved toward perfect efficiency by the "invisible hand". They challenge the (neo)classical economic axiom that market participants decide rationally, ultimately allowing every market to reach an equilibrium, of which a good's price is the most important reflection (also called the "optimal efficiency" by Adam Smith). In work spanning over four decades, the three Nobel laureates - Akerlof, Spence and Stiglitz - describe how markets in reality diverge fundamentally from that assumption, thereby inhibiting the ability and propensity of rational decision-making and ultimately damaging the capacity of markets to allocate society's scarce resources efficiently. Crucially for the argument about relevance to society, these imperfections also limit the equitable distribution of economic participation and welfare (Stiglitz & Walsh, 2006: 239-246).

More specifically for public relations, Akerlof, Spence and Stiglitz reject the notion that any market participant has all the relevant information about the transactions in which he or she chooses to engage, whether that is about the quality of goods, the nature of the relationship with the other party, the prices of all goods or so-called externalities. Externalities are the positive or negative consequences that are produced by a specific transaction, a field of transactions or an entire market, but for which the costs are not borne by the participants of the transaction and are therefore not included in the pricing system. For example, when a company moves its operations offshore, the social and economic impact on local communities in the country it is leaving is not borne by the company. While (neo)classical economic theorists mostly exclude these externalities from their analyses and assume that they

will over time be included in the price system (particularly given the globalized, highly networked economy), theorists of imperfect markets posit not only that the price system is incapable of reflecting externalities, but also that market participants are constantly at risk of remaining unaware of these external costs, thus making it more unlikely for a market to produce outcomes to society's benefit.

According to Spence (2012), markets "are tools that, relative to the alternatives, happen to have great strengths with respect to incentives, efficiency, and innovation. But they are not perfect; they underperform in the presence of externalities [...] informational gaps and asymmetries, and coordination problems when there are multiple equilibriums, some superior to others". This means that buyers and sellers agree on prices that are too low if they don't incorporate negative externalities (like pollution) or too high if positive externalities (like public health care services for a firm's employees) are unknown or ignored.

When market participants are clueless about costly externalities, the said market will fail to efficiently price and allocate society's resources or will collapse altogether, as was famously first laid out by Akerlof (1970) for the sale of used cars. Buyers often only know the distribution of product quality, but not the quality of the specific item in a transaction, while sellers (like used car salesmen) know both. Akerlof called the damage done to markets by this imbalance "adverse selection": When buyers become wary of hidden shortcomings, they will commit fewer resources, for they always risk being sold "lemons" (to use Akerlof's term). This decreases the value of all commodities in that market, be they of low or high quality, thus making it inefficient for sellers of high quality to keep participating. As a result, that market's efficiency is compromised: The incentive for sellers of high-quality

goods to withdraw from the market is high and an equilibrium is reached where only the worst products are sold. Adverse selection therefore reduces both the volume of a market as well as the average quality of its products. Consequently, the said market would have a socially less efficient outcome because not all gains from trade could be realized. Adverse selection has since proven to be a universal idea and a powerful analytical tool in the study of a wide range of markets, e.g. insurance, credit, mergers, employment, gift exchanges, wages, the caste system, sharecropping, etc. (Akerlof, 1976, 1984).

The parallels with public relations are apposite. Here we take a forced example to make the point. Practitioners (sellers) could be said to trade in the market of trust where they know both the generalities of the levels of trust around an issue (for example, pollution by the oil industry) and the specifics of trust around a particular incident (for example, a coastal oil spill). If the general population (buyers) discover that they have been misled on both the generalities and specifics they will, over time, invest less trust (adverse selection) in the oil industry and that sphere of discourse becomes devalued for all industry participants: the market's efficiency (measured in levels of trust) becomes compromised. Furthermore, those communicators who sell honestly, for fear of becoming tarnished by the bad practices of those who sell dishonestly, could well decide to withdraw, leaving the market to the worst practices, devaluing the trust market even more.

In a next step, which could be seen as even more relevant for public relations, Stiglitz focused on the underlying information asymmetries behind adverse selection and so provided the unifying term for the work by the three Nobel laureates. Stiglitz analyzed how “some of the most important conclusions of economic theory are not

robust to considerations of imperfect information” (Rothschild & Stiglitz, 1976: 629). Information, he proposes, is a public good which can never be optimally distributed by a private market (mostly because some information is too costly to get, relative to its benefit). When a party to a transaction has more relevant information than others, information is asymmetric and competitive markets become inefficient. It is therefore the privatization of information by some – not all – market participants that can ultimately lead to adverse selection. That this is to society’s detriment becomes particularly obvious when a party feels insufficiently informed about a transaction’s externalities (pollution, conditions of outsourced labor, etc.), or when a party suspects “moral hazard” (Arrow, 1963; Shapiro & Stiglitz, 1984; Stiglitz & Weiss, 1981; Stiglitz & Weiss, 1983), i.e., detrimental actions taken by the other party after a transaction has been agreed upon.

4. The informational context of public relations

With the Nobel Prize in 2001 for information asymmetry came the global acknowledgement “that understanding how information is obtained and disseminated is critical for understanding how economies function” (Barkley Rosser, 2003). More information – about a commodity, about its sellers, about the nature of the transaction between seller and buyer, about externalities and about the propensity of both sides to abide by the mutually accepted nature of their relationship – would reduce the asymmetries and preserve the abilities of markets to efficiently create wealth for societies. Even small, specific changes in the organization of information were shown to have major impact on markets, economies and societies (Akerlof & Yellen, 1985a,b; Stiglitz, 2000). This “information economics revolution” was therefore also a call to the academy to provide specific insight into how markets can improve the

organization, creation and dissemination of information.

Consequently, information asymmetry has generated a wide range of economic explanations of how social institutions emerge that can counteract market inefficiencies and failures (Loefgren et al., 2002). The public relations academy could have joined that debate and analyzed its own social phenomena and institutions, but didn't (Wildmann, 2008). Instead, that analysis was also left to economists.

Reputation, for example, was conceptualized by economists as a remedy against market failure caused by adverse selection (Kim, 2009): If buyers knew that the risk of getting 'lemons' from sellers was low, average prices would not be depressed and high-quality sellers might not be driven out of the market. Reputation is therefore a promise of quality. When information is asymmetric, economic actors will build reputation to maximize their own utility and secure repeated transactions. This rational investment into their own reputation prepares the ground for stable markets with more efficient outcomes. Building reputation becomes "an asset which can generate future rents" (Weigelt & Camerer, 1988: 443). However, this would only happen if the cost for building reputation were not prohibitively higher than its reward, as is the case in markets with infrequent repeat sales (Riley, 2001). Also, when the reward is not immediate, but economic actors need to maintain reputation strategies for a long time, their propensity to do so becomes lower (Mayhew, 2001).

Possibly because its costs are easiest to specify, the economists' debate around information asymmetry next turned to advertising as the principal reputation-building activity (Spence, 1980). In economic modeling, advertising creates market equilibriums by being a rational investment for firms with high-quality goods (who set up market-entry barriers), but from which sellers of low-quality goods will refrain

with equal rationality (Milgrom & Roberts, 1986; Nelson, 1974).

5. An economic conceptualization of public relations

However, the economic academy's advances into reputation and communication do not yet suffice for an economic reconceptualization of public relations. Economists have not advanced into the – certainly relative to advertising – more dialogic nature of public relations. More importantly, public relations as a social institution comprises far more than market transactions and involves multiple stakeholders in a dialog about the very externalities identified by economic theory, like a firm's carbon footprint, its workers' conditions, its diversity policy, etc.

The authors propose an economic conceptualization of public relations by understanding its role in the context of information asymmetry, which in turn enables the identification of its relevance to markets and society.

5.1 public relations as signaling and screening

As described above, economic actors benefit from investing in the reduction of information asymmetry, as it establishes their reputation and thus sustains the long-term efficiency of the market in which they operate. In addition, if not for economic actors' own investments, governments or other external bodies would regulate the market to reduce information asymmetry (e.g. compare the markets for hotels with those highly regulated markets for private education), thereby quite possibly creating even higher costs of compliance.

Organizations and other economic actors resort to signaling (revealing discretionary information) and screening (giving information when forced to choose from a limited number of options given by the other party), e.g. when a corporation responds to activist investors or to a public agenda built by its critics (Spence, 1973,

2002; Stiglitz, 1975; Zoch & Molleda, 2006). We propose that public relations can be understood as signaling and screening.

Signals are voluntary, observable and costly investments in information that will allow receivers to better discern qualities that they can otherwise not assess (e.g. rankings to indicate the quality of universities, environmental certifications of corporations) and allow them to discern the height of the investment needed by the organization to send the signal.

Screening is more closely related to risk than signaling. It is designed to avoid moral hazard by forcing senders to reveal information about their riskiness (Rothschild & Stiglitz, 1976). A recent example is the prominent blogger Vani Hari ('Foodbabe') who gathered 44,000 signatures and challenged the world's biggest brewers to list the potentially harmful ingredients in their beers for the first time. Two brewers quickly followed suit and revealed the information.

5.2. Public relations counteracts adverse selection

Spence (1973, 1974) proved the critical economic assumption that signaling only succeeds if the costs visibly vary between senders: the higher quality senders will find it less costly to do signaling and respond to screening than others, and this needs to be sufficiently apparent to recipients. For example, it is apparent to recipients that the costs to reputable organizations of living up to their signals is lower than to disreputable ones: Timberland, with its business model around reforestation in Brazil, risks much less when it comments on natural preservation than Nestle with its connection to palm-oil monocultures in Southeast Asia. The perceived cost (lost credibility and future market transactions) of misrepresentation is higher for the latter

(Spence, 1976) and “the signal will only signify something real if there is a negative correlation between signaling costs and [...] capability” (Barkley Rosser, 2003: 8). Public relations professionals might call this “the credibility gap,” where words (or other signals) and actions are seen to be out of kilter.

While the proposed conceptualization of public relations is therefore most obvious for firms, it ultimately comprises every organization in a market economy, because even not-for-profit organizations depend on negotiating their resources in a competitive process for which the costs are lower the better the organization manages its relations to allied and opposing stakeholders.

Also, signaling is the most effective in counteracting adverse selection when the quality that is being signaled is otherwise difficult to discern (Riley, 1975, 1979, 2001). This is poignantly true for externalities and moral hazards, e.g. environmental impact, labor conditions, diversity, compliance, innovation, etc., that make up the many themes in public relations today, as opposed to more product-related marketing communication. These externalities and an organization’s impact on them constitute, even if not discernable to parties, moral hazard.

The authors therefore propose that public relations can be understood to reduce externalities and moral hazard, counteracting adverse selection in the long run. Public relations does not contribute to the actual productivity or efficiency of the sender, but rather to its ability to avoid becoming the victim of adverse selection, where the perceived value of all senders gravitates toward the bottom because market participants are unable to discern their differences (Kumar & Park, 2011). This can even be said to be the case in the public relations consulting industry itself, where the low reputation of the overall industry and an inability for consultants and agencies to

sufficiently distinguish themselves from others depresses consulting fees.

5.3. Public relations contributes to the efficient allocation of a society's resources

Economists since Spence (1973) expect that signaling equilibriums are socially the most efficient in preserving markets: senders of high quality (for which the parameters vary, of course, and can be both strictly transactional as well as non-monetary) opt for investing in the minimal amount of signaling required to discernably distinguish themselves from others. The rise of the internet does not, according to Spence (2002: 454), make information asymmetries obsolete, even though the cost of getting and exchanging information has shrunk dramatically in today's networked societies, where information and power are diffusing (Naim, 2013).

Using an economic lens, public relations' contribution to society can therefore be understood as the reduction of the relative ignorance of market participants about the nature of the transactions and relationships in which they engage, thereby contributing to markets' efficiency in allocating society's resources. A current example is the move by some of the world's major corporations toward "integrated reporting" of their transactions' externalities, which is being driven by the accounting and public relations industries simultaneously (<http://www.theiirc.org/>). The ambition here is to give a true account of how the six types of capital upon which organizations draw from society (including financial, intellectual and relational) are enhanced so that a correct judgment can be made on whether the organization yields value to all the stakeholders that comprise that society.

6. Outlook

Two major caveats will need to be addressed on the way toward an economic conceptualization of public relations. Firstly, the analytical value of the economic approach is highly contextual: Not only does it depend on the society in question having a market economy, in which both profit and not-for-profit organizations are allocated resources in a competitive process, but also on having a pluralist nature and one in which the governance sphere does not dominate, via its own claims and access to information flow, public debate and market power. These conditions often form the context for public relations in the so-called West, but rarely, for example, in any part of Asia (Halff & Gregory, 2014). So while information asymmetry models and economics in general are universalist, the conceptualization proposed in this paper can never be. Instead, the exact conditions under which it can add analytical value to the study of public relations have yet to be identified and incorporated into future analysis.

Secondly, this economic conceptualization of public relations needs to face the charge of being more normative than analytical. After all, there are numerous examples in which public relations is detrimental to markets, and even to society (Demetrious, 2013): manipulative or propagandist public relations increases information asymmetry, prevents market efficiency from increasing and reduces net aggregate wealth because of the cost involved in a spiral of competitive signaling (Spence, 1980). The economic conceptualization proposed here shares this caveat of alleged normativism with all “information asymmetry” models, which – according to both their main proponent (Stiglitz, 2002, 2006) and ideological opponents - pave the way for government intervention and regulation in otherwise inefficient markets.

This caveat is connected, and can only be resolved together with the

contextualization mentioned above: Where the right conditions prevail, public relations can have the macro-social relevance as described in economic terms. However, in the absence of these conditions, such conceptualizations will remain as normative as any call for market efficiency. We propose that the insights provided by economic models of information asymmetry provide opportunities for the public relations academy to deepen its understanding of the relationship between public relations and society, once the conditions under which this is true are identified in future research. Once those conditions are explained, the authors hope that the academy can provide a new avenue for theoretical reflection and contribute to the aspiration for public relations to become socially relevant and fulfill its higher obligation, as a profession, to serve the public good.

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