



**Market Failure
Approach**

**CORPORATE RESPONSIBILITY
IN THE
TELECOM SECTOR**

Stakeholders at Stake

A Market Failures Approach for the Telecommunications Industry

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Keywords

CSR, Market Failure Model, Pareto Criterion, Justifiability-to-Each Criterion

In business ethics, corporate social responsibility implicitly goes hand in hand with stakeholder theory. The normative stakeholder approach states that an organisation has a set of moral obligations not only towards its shareholders but towards stakeholder groups as well. Apart from the theory's omnipresence and its assumed simplicity, companies struggle to establish or to comply with these moral obligations. In this paper, we question if the stakeholder framework is most suitable to model an organisation's social responsibility. As a promising alternative, we introduce the market failures approach by Joseph Heath. It states that an organisation's moral obligation is to maximise profit under the condition that it refrains from taking advantage of market failures. We choose the telecommunications industry as a sample to apply the market failure framework. Our application shows that in a non-ideal market, the market failures framework is difficult to apply due to its demanding Pareto criterion. We propose a modified criterion – 'justifiability to each'. It aims to render the market failures approach useful in non-ideal markets and open it up for managerial recognition in putting an organisation's social responsibility into practice.

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1. Introduction

“The thicker a company’s CSR-Report the more skeletons you find in their cupboard” (Bator 2013).

The first emergence of Corporate Social Responsibility (CSR) may be ascribed to J. D. Rockefeller and A. Carnegie’s philanthropic investments (cf. Gond/Moon 2012: 3) in the middle of the 19th century. The birth of the ‘modern period’ of CSR literature can be dated about a century later and is often marked with the publication of R. Bowen’s *Social Responsibilities of the Businessman* in 1953 (cf. Carroll 2008; Bowen 1953). A decade later, Milton Friedman presented his vision of a shareholder theory to describe the responsibilities of an organisation, to which R. Edward Freeman responded another two decades later with his stakeholder approach. Freeman’s idea of a more ambitious responsibility of organisations was rapidly growing in popularity so that already in the 1990s, CSR started to go hand in hand with his stakeholder theory. The interconnectedness of the stakeholder approach with CSR has gained ever more acceptance, inducing that nowadays, scholars even conclude that the first of “three fundamental lines of CSR enquiry in the academic literature” is that CSR is “stakeholder-driven” (Basu/Palazzo 2008: 125). In this paper, we want to offer an alternative to the orthodoxy of the stakeholder approach: Joseph Heath’s market failures approach with the amended justifiability-to-each criterion.

In the paper at hand, we refer to diverse accounts of business ethics and moral theories. These accounts seem to be confusing in the first place unless they are linked by the use of common terminology. All approaches we are using in this article conceive of business ethics as a species of professional ethics. Professional ethics has a longstanding tradition that can be dated back to the ancient Greek philosopher Hippocrates and the eponymous oath to which today’s physicians still adhere (Veatch 1981). Similar to questions of medical ethics that arise from the professional role of physicians, business ethics deals with the questions that arise from the professional role as managers (cf. Heath 2004). Therefore, in this paper, management is dealt with as a profession or, “a common denominator across several sub-professions” (Brinkmann 2002: 160). The assumption is that being a manager (or having any other professional role) imposes its own specific set of obligations upon a person which are not necessarily part of general morality. This means that being the corporate executive of an organisation places special obligations which arise out of his professional role upon

the manager. This particular set of obligations is imposed upon the manager not qua individual, but qua manager (cf. Heath 2006: 534). This account does not rule out that these obligations are derived or even sanctioned by morality in general, but it has the advantage that professional and individual obligations are not intermingled. When we speak about an organisation's social responsibilities in this paper, we always refer to the special obligations of the manager acting as an official representative of this organisation. As Howard R. Bowen and Milton Friedman suggested, we assume that the responsible individuals in an organisation are businessmen, i.e. individual proprietors or corporate executives (1953 ;1970). An organisation is "an artificial person and in this sense may have artificial responsibilities, but 'organisations' as a whole cannot be said to have responsibilities" (Friedman 1970:123). Only people can have responsibilities, both as individuals and as professionals (cf. Sandbu 2011: 74).¹

2. What is the Role of Organisations in Society?

2.1 The Two Predominant Approaches

The following section prepares the stage for our main argument. We provide a short and comprehensive overview of the two main theories that are prominent in the field of business ethics. In the first part of this section, we take a look at the heavily criticised shareholder view by Milton Friedman. We will discuss why the premise "the social responsibility of a firm is to increase its profits" (Friedman 1970: 122) is indeed problematic but often criticised for the wrong reason. In the second part of the section, we will immerse ourselves in the rather more prominent stakeholder views, which are part of the curriculum in business schools all over the world. The widespread perception is that for organisations to act in a genuinely ethical manner, they have to extend their responsibilities to groups other than shareholders. Instead of discussing where these obligations stem from, we focus on two objections of the stakeholder framework: the objections of moral laxity

¹ For a more thorough discussion of the question whether organisations can have responsibilities, consider Patricia H. Werhane's *Persons, Rights, and Corporations*, especially chapter 3 on "Rights, Responsibilities, and Corporate Accountability", 1985 Upper Saddle River, Prentice Hall, or Peter A. French's *Collective and Corporate Responsibility*, 1984, New York, Columbia University Press.

and moral arbitrariness. They provide us enough reason to question if the stakeholder view is the right framework to think about a manager's moral obligations.

2.2 The Social Responsibility of an Organisation is to Increase its Profits

After the first waves of CSR, critique started to erode the incumbent business ethics practice, and Milton Friedman published his renowned contribution to the debate in the New York Times Magazine (1970). He repeated famously what he already argued for in *Capitalism and Freedom*: “[T] here is [...] only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game” (Friedman 1962: 112).

As already brought forward in our introduction, it was Friedman who interpreted the term ‘responsibility of business’ as the responsibility of corporate executives. He substantiated his claim even further by stating that corporate executives or managers have a direct moral responsibility to their employers or shareholders. In detail, the managers are responsible to run the organisation in accordance with the desires of the shareholders. Casually, he suggested that the basic desire of a shareholder is for profit maximisation under the condition of compliance with the basic rules of law and those of ethical custom (cf. Friedman 1970). Still, he did not exclude the possibility that the shareholder's desire might also be of another nature than pecuniary, e.g. welfare. In this case, the executive's responsibility would consist in maximising welfare. In either case, Friedman emphasised that the manager is responsible to the shareholder. It needs to be said that Friedman did not negate other responsibilities the executive might have as an individual to other individuals or organisations, such as to her family or her cricket club. However, if the manager suddenly started to assume social responsibility as a manager (e.g. make expenditures in order to reduce pollution), she would be “spending someone else's money for a general social interest” (Friedman 1970). She would leave her assigned role in the game and interfere with the market mechanism, which could be interpreted as trying to be executive, legislator and jurist at the same time, according to Friedman. Her role, however, as a corporate executive, consists in serving the interest of the shareholders.

2.4 Moral Laxity vs. Moral Arbitrariness

All things considered, how should we behave when doing business? This is the question professional ethics seeks to answer. In other fields of management, research progress is made in a descriptive

or predictive manner, telling us how to act to pursue a particular goal, e.g. increasing turnover, reducing costs etc. The difference between business ethics and management studies in general is that the former is dominated by “normative concerns” while the latter provides strategic or “instrumental justifications” (Donaldson/Preston 1995: 71 and 77). Business ethics tells us how we should act, full stop (cf. Sandbu 2011: 14).

The pressing question in relation to the two approaches to business ethics described above is whether they are successful in answering ‘how we ought to act when doing business’. To come to the point: Neither one is successful in achieving this goal. According to the shareholder view, the only social responsibility of business is to increase its profits. However, this does not suggest that managers have no moral obligations. It is not an amoralist or subjectivist position. Friedman’s claim is beyond all doubt a moral one. Managers are under a real moral obligation, which is to manage their organisation exclusively in their shareholders’ interests, which is in most cases to maximise profits (cf. Sandbu 2011: 17). This is often the reason for considerable misunderstanding. Profit maximisation should be viewed as a managerial obligation and not as an expression of self-interest. A tendency in business ethics literature is to dismiss the profit motive out of hand. It is “more often treated as a piece of apologetic than as a serious piece of moral reasoning” (Heath 2004: 70). Getting back to the justification of the profit motive later on in the article, the shareholder perspective is problematic, not because it is morally lax but because profits are not intrinsically good. In the case of a doctor, the doctor’s obligations flow naturally from the objective (or at least should), which is to restore the patient’s health. Health is widely regarded as a desired end, and thus the doctor’s actions serve to promote a state of affairs that is morally desirable. In an organisational context, things are more complicated. Imagine that a manager makes a decision that disadvantages workers in order to benefit shareholders: the profit maximisation generates a distributive transfer that is by no means sanctioned. In fact, under special circumstances, the transfer will be regressive and thus problematic from a moral point of view. This problem arises from the institutional setup of free markets. Profits in themselves are only indirectly justifiable with some appreciation of what justifies the system of private enterprises (cf. Heath 2004: 72–74). In summary, the problem with the shareholder view is not that it is amoral but that it fails to integrate other motives into its moral scope besides the profit motive. A manager not only has permission to manage an organisation solely to maximise profits, but he is morally required to do so. It is certainly a mistake to think that a manager ought to do whatever the shareholders desire.

The stakeholder framework, on the other hand, can be accused of being morally arbitrary instead of morally lax. But why is this the case? Under the hood of the stakeholder framework, a certain set of morally relevant agents X entering the moral scope are put under the umbrella of the stakeholders of the organisation. As Freeman claims, managers must exercise moral restraint when dealing with stakeholder groups, and shareholders are just one group among many stakeholder groups. Managers have fiduciary duties toward all stakeholders (Freeman 1984; Boatright 1994). It is within the set X of moral relevant agents (stakeholders) where the hustle and bustle takes place and renders the framework difficult from different angles. One problematic perspective is the identification of relevant stakeholders in the set X in the first place. Depending on how narrowly or widely the set of morally relevant agents is defined, the set X consists of very different agents and hence very different objectives. This so-called identification problem can be illustrated as follows.

Freeman himself distinguishes between a wide and narrow group of stakeholders, whereas other scholars, such as Clarkson, name them primary and secondary stakeholders (cf. Freeman 1984: 46; Clarkson 1995: 105). The latter refers to the set of groups that are vital to the success of the firm. It includes employees, customers, suppliers and often the local community. The former tends to be so widely defined as to include all of society. But a manager's sanity would be threatened strongly if he were to argue why the firm should watch out for the inflation rate because "every pricing decision of the company contributes to the national inflation rate" (Heath 2006: 544). According to this view, every decision of the firm affects every member of society. In the wide definition, everybody who is affected by the organisation is a stakeholder. As a consequence, everyone is a stakeholder in everything. This view "collapses [...] into general ethics" in the sense that managers have fiduciary duties for an entire society (Heath 2006: 544). It is too far-fetched and too strong a requirement that managers should be motivated by considerations of social justice, for example, as general ethics would require from them. Thus, while the wide group of stakeholders is unsuitable for an account of professional ethics, the narrow definition leaves too much room for interpretation as to which employees, customers and suppliers are vital for an organisation's existence. This dichotomy of a wide and a narrow group of stakeholders can be objected to as arbitrary because it is hardly morally justifiable where the line of division needs to be drawn (cf. Heath 2006: 544).

Even if this dispute could be settled, stakeholder frameworks would still suffer from the so-called squeaky wheel bias: Not all of the stakeholders of the narrow group are necessarily affected to a larger extent by an organisation's particular action than those stakeholders in the wide group that do not have any voice. In terms of potential welfare loss, groups other than the narrow

stakeholders might suffer even more. Independent of whether stakeholders belong to the narrow or the wide group, those who are best organised tend to make their voices heard (cf. Heath 2006: 544). The smaller the groups, the better organised they are due to their ability to avoid shirking among members (cf. Olson 2009). This translates into smaller groups making their voices heard best. Let us take an example to buttress the squeaky wheel bias: in 2008, Nokia decided to close down a production plant in Bochum and to move it to Romania. A standard multi-fiduciary stakeholder approach requires managers to take into account the impact such a decision has on both employees and the local community whose livelihood depends upon their wages. Additionally, Nokia's suppliers' and their employees' interests should be considered when facing such a decision from a managerial perspective. In this case and in other similar organisational decisions, the local community, living where the new factory would be placed, is often neglected. Presumably they have a lot at stake, not only in terms of potential welfare gain or loss. Stating this, does not make any judgement on whether Nokia's closing of the German-based factory was good or bad, but it is questionable whether the relationship which was built over time with the local community in Bochum can justify ignoring the interest of the Romanian community. From a moral point of view, there is no apriori reason why the potential employees' interests should weigh less than the actual employees' interests (cf. Mitchell et al. 1997: 858). The difference lies in the possibility for either community to be regarded as a relevant stakeholder group. A set of not yet known workers in Romania cannot form any sort of community and make their voices heard. Stakeholder theory focuses on the relationship between the management body and different 'groups', and it seems to be obvious that those groups who can form a coherent body of interests are privileged (cf. Heath 2006: 545).

It can be said that as a result of the narrow vs. wide distinction of stakeholder groups, the theory introduces an unacceptable element of arbitrariness into business ethics. In addition, the relationship between the management of an organisation and its stakeholder groups can be biased in terms of the representation of interests by the relevant stakeholder groups. Those groups that are better organised might be granted more attention even if they are not affected to a large extent in terms of e.g. welfare.

3. Introducing the Market Failure Approach

3.1 Heath's Idea of a Market Failure Model

As discussed in section two, the approach to describe the moral responsibilities of managers in terms of fiduciary obligations towards several stakeholder groups is problematic. The approach is intuitively appealing because of the incorporation of managerial responsibilities besides the maximisation of profit. However, it turns out to be vague with respect to the selection of adequate stakeholder groups, or it could even collapse should social justice be considered. From this point on, this paper concentrates on a different perspective of business ethics. In particular, this perspective is that firms are obliged to maximise profit subject to the condition that they should not benefit from situations of market failure (cf. Heath 2004; Heath 2006). The section starts with a discussion of how the maximisation of profits can be justified from the background of mainstream economic theory. Having elaborated on this issue, the section then concentrates on market failures in the telecommunications industry. It will be shown that the telecommunications industry is especially prone to market failures and that the framework suggested by Heath appears to be a promising fix (2004; 2006). Heath's idea of the market failures model stems from the fact that "growth of regulation over the course of the twentieth century goes hand-in-hand with the increased positive economic role of the state in supplying public goods. Both represent strategies aimed at correcting market failure" (Heath 2006: 548). Instead of governmental efforts to increase socially responsible corporate behaviour through extended legal regulations, CSR efforts in the market failures approach are triggered by the market itself. Subsequently, the market is able, at least in theory, to increase socially responsible behaviour by organisations through its own mechanisms. Whenever a Pareto-efficient state is achieved, no one can be made worse off. Hence, an acceptable outcome for all market participants is reached. "Put more simply, the ethical form does not seek to profit from market failure" (Heath 2006: 550). However, our discussion results in altering the criterion of Pareto-optimality because it is inapplicable in real-world markets.

3.2 Preliminaries, Justification of Profit, and the Perfect Competitive Market

Markets in general are characterised by three characteristics: they direct the action of its participants; membership is involuntary; and participants are system takers (cf. Wollner 2013: 6).² It can be said that as an individual alone, it is not possible to leave or change the system as a whole. In fact, even states are directed by the market system, and when they decide not to take part in the system, their economy is severely harmed, e.g. North Korea. Theoretically, states are not directed by the market system because all transactions are voluntary. Yet, this assumption is questionable because the size and the impact of large multinational organisations let you assume the opposite. Leaving such issues aside, how can the market system (maximisation of profits) be justified to all its participants?

Economic theory teaches us that the market system is a place of exchange. This exchange system results in a Pareto-efficient outcome whenever three conditions for a so-called perfect or competitive market are satisfied. These conditions are the following: firms seek to maximise profit (1), consumers seek to maximise utility (2) and the market clears (3) (cf. Mas-Colell/Green 1995: 313–315). In a competitive market economy, there is a supply side and a demand side. Firms seek to maximise profits on the supply side, because this leads to competition and contributes to an efficient outcome. A competitive market will lead to a price which equals the lowest costs of production (cf. Mas-Colell/Green 1995).³ The profit motive of the firm, therefore, contributes to the efficient use of the resources given the available resources and technology, because it drives out firms producing inefficiently, i.e. using more resources (causing higher costs) than necessary, given the available technological possibilities (1). On the demand side of the market, the consumers are required to maximise their utility (mirroring the profit maximisation criterion on the supply side). The consumer maximises her or his utility subject to his/her preferences and the respective prices. The condition of utility maximisation requires the consumer to buy preferred goods at the lowest price possible. This will contribute to the maximisation of his/her utility because the consumer can spend the remaining money on other goods and thereby increase their utility (2). If there is lower demand as compared to the supply of the good, the price goes down and vice versa. The market clears if both conditions are satisfied (3). In such a state, the market is in a competitive equilibrium

2 Wollner is, in particular, describing features of the international financial system. It is assumed here that similar conditions hold as the financial system is part of the market system in general.

3 Chapter 10 in Mas-Colell provides an analytical solution.

because conditions (1), (2) and (3) are satisfied and a Pareto-efficient state can be achieved. The described mechanism is often referred to as the ‘price mechanism’, whereby the importance of a working price mechanism is the resulting price itself. The price coordinates the behaviour, i.e. the use of the available technology and resources of market participants. Such a situation would be Pareto-efficient. This is exactly why the price mechanism is valued for its efficiency effects: it allows us to minimise waste. The formal proof is known as the “first fundamental theorem of welfare economics (FFT)” (Mas-Colell/Green 1995: 326). The FFT is well known as the ‘invisible hand theorem’. What this theorem tells us is that the outcome of a perfect competitive market economy will be Pareto-optimal. Hence, it will not be possible to improve any one’s condition without negatively affecting someone else’s, and this is why the maximisation of profits should be valued. It secures a working price mechanism which in turn secures a perfect competitive equilibrium which is Pareto-optimal. “An allocation that is Pareto optimal uses society’s initial resources and technological possibilities efficiently in the sense that there is no alternative way to organise the production and distribution of goods that makes some consumer better off without making some other consumer worse off” (Mas-Colell/Green 1995: 313). We now turn to the discussion of what happens whenever such a Pareto-optimal state cannot be achieved. These situations are often referred to as market failures.

3.3 What is a Market Failure?

Francis M. Bator was the first scholar to describe a market failure in 1958: “Typically, at least in allocation theory, we mean the failure of a more or less idealized system of price-market institutions to sustain ‘desirable’ activities or to stop ‘undesirable’ activities” (Bator 1958: 351). Even though that is only half of the definition he provides, we would rather try to derive its meaning ourselves. As the word ‘market failure’ already suggests, the market fails to do its job. Its job consists of inducing an efficient allocation of resources to the market participants. Hence, in a market failure, there is an inefficient allocation of resources. The main problem with inefficient markets is that they are not Pareto-optimal, i.e. there would be another possible outcome where at least one participant could be made better off without worsening another participant’s situation. Consequently, the first question that might arise is: Why do markets fail? There are, in fact, seven basic causes for market failure: non-excludable goods and services, inefficient exclusion, missing markets, information asymmetry,

limited common property resources, externalities and monopolistic supply. One or a combination of these factors lead to inefficient markets (cf. Lipsey/Chrystal 1999: 274; Buckley 2003: 28).

3.4 Market Failures and Pareto-Optimality?

Pareto-Optimality and Ideal Markets

How can market participants avoid market failure? Posed differently, what can be done to achieve the Pareto-superior outcome? The answer to that question is simple: Market failure can be avoided by satisfying the Pareto-optimality conditions. In ideal markets, the Pareto-optimality conditions that are said to characterise economic efficiency are:

1. “The Marginal Rates of Substitution between any two goods are the same for all people”
2. “The Rate of Technical Substitution between any two inputs are the same in the production of all goods”
3. “The common Marginal Rates of Substitution between any two goods equal the Marginal Rate of Product Transformation between those goods” (University of Colorado 2000:1).

These three conditions are often called ‘conditions of perfect competition’ and are often reproduced less mathematically as: “rational conduct on the part of buyers and sellers, full knowledge, absence of frictions, perfect mobility [...] perfect divisibility of factors of production, and completely static conditions” (Robinson 1934: 104) or as Stigler suggests, “indefinitely many traders [...] acting independently [...] [and] full knowledge” (Stigler 1957: 14). If these conditions were satisfied, markets would be efficient, and the resulting allocation of resources would therefore be Pareto-optimal, i.e. a situation in which no person’s situation could be improved without leaving another person worse off. Despite the fact that markets have to fulfil ‘only’ these three requirements in order to avoid the above-mentioned causes of market failure and to produce Pareto-optimal outcomes, they are never fulfilled in real life. Why?

Pareto-Optimality and Ideal Markets

In real world markets, i.e. non-ideal markets, not even the first Pareto-optimality condition can be satisfied. This is no surprise as the Pareto-optimality conditions only apply in ideal markets. Let us consider the first condition (1): It states that your marginal rate of substitution (MRS) between

any two goods is the same as your mother's MRS. The MRS describes how much of a good G a consumer is willing to give up if she is offered in return an additional (marginal) unit of good W. Let us suppose, for example, that your MRS of a gin tonic and a whisky coke equals 3. That means, you are indifferent in choosing between three gin tonic and one whisky coke, i.e. you are willing to pay three times more for a whisky coke than for a gin tonic. The first condition (1) of Pareto-optimality not only states that people's MRS are all the same, but even that people's MRS are all the same for any two goods. Just consider the differences of taste between you and your mother, and you will – most probably – doubt that even the first condition can hold in real world markets.

Apart from conditions (1) – (3), which are problematic, it is not enough to know that one state is Pareto-inefficient while the other is Pareto-efficient to conclude that the second is Pareto-superior – and therefore morally better if the Pareto criterion is adapted to the first state. These cases are Pareto-incomparable situations. Situations of Pareto-incomparability always occur whenever some individuals are better off in the first than in the second state, but others are better off in the second than in the first state (cf. Sandbu 2011: 72).⁴ In such situations, the Pareto criterion cannot be action guiding.⁵ Linking this to a manager's situation, it would not be possible to assess the rightness or wrongness of a particular decision. Managers are stuck in the status quo and left with no practical advice.

3.5 The Market Failure Model

At the end of the previous section, we suggested that market failures could be avoided by satisfying the Pareto-optimality conditions. However, we just provided examples which show they cannot be fulfilled in real world markets. Nevertheless, market failures do not simply have to be accepted as a negative side effect. There is a possible way out: the institutional solution to market failure is governmental intervention and regulation. The classic economics textbook example suggests that governments levy taxes in order to e.g. reduce negative externalities or provide public goods. However, governmental intervention also has its weakness: it might result in government failure

4 Imagine a case where different levels of well-being are assigned to individuals. When person A is equipped with 60 and person B with 40 in situation X, and A is equipped with 50 and B with 60 in situation Y, the principle cannot be action guiding.

5 In economic theory, comparisons like this actually can be made applying the so-called Kaldor-Hicks-Criterion (cf. Stringham 2001). Due to the fact that there is no direct link to the argument presented in the paper at hand, it is not discussed here further.

which is basically the public sector analogy to market failure (cf. McKean 1965; Wolf 1979). To be fair, one would probably have to distinguish between market and non-market failure and consider government failure a sub-species of non-market failure (cf. Wolf 1979). Wolf describes the challenges of intervention as a means of remedying market failure which might bear the risk of inducing a non-market failure as follows: “Where the market’s ‘hidden hand’ does not turn ‘private vices into public virtues,’ it may be hard to construct visible hands that effectively turn nonmarket vices into public virtues” (Wolf 1979: 113). Subsequently, we will present Joseph Heath’s approach to how to deal with market failures from a managerial perspective, taking into account the danger of provoking a non-market failure.

Based on the condition of perfect competition, i.e. in an ideal market, the only way in which organisations can compete with each other is through prices, quality and innovation. Heath refers to these variables as the set of “preferred competitive strategies” (Heath 2006: 549). All the other strategies (e.g. advertising) are ineffective in an ideal market due to the draconic Pareto-optimality conditions. However, in non-ideal markets, other competitive strategies than those preferred competitive strategies are thoroughly effective (and probably even necessary for an organisation to survive). Heath refers to these kinds of profit-seeking strategies as non-preferred (cf. Heath 2006: 550; Jaworski 2013: 3). As examples of non-preferred competitive strategies, he mentions the production of pollution or the selling of products of a quality inferior than promised. The first example is an instance of negative externalities and the second an instance of information asymmetry. Externalities and information asymmetry are two of the seven causes for market failure mentioned earlier in this paper. Non-preferred competitive strategies consequently lead to market failure. In other words, organisations that implement non-preferred competitive strategies contribute to a suboptimal resource allocation.

On these grounds (recalling that profit maximisation is indirectly justifiable due to the invisible hand theorem, the FFT) and according to the market failure model, an organisation’s social responsibility consists of deploying only preferred competitive strategies. In order to approach the ideal of perfect competition, an organisation should pursue profit maximisation under the constraint of refraining from benefitting from market failure. In Heath’s words: “the ethical firm does not seek to profit from market failure” (Heath 2006: 550). Eventually, an organisation’s social responsibility involves pursuing the goal of profit maximisation without availing itself of market failure because this is how social welfare is maximised.

3.6 Market Failures in the Telecommunications Industry

In the telecommunications industry, you can encounter all of the seven aforementioned causes of market failure. Monopolistic supply is predominant in the telecommunications industry (cf. Buckley 2003: 27). In this section, we will expand on each of the seven causes for market failure that might occur in the telecommunications industry. We start the analysis with the least relevant factor and continue then in an order of increasing relevance.

Non-excludable goods and services (i.e. goods and services where it is either impossible to exclude access to people who do not pay for it, or the cost of exclusion is prohibitively high) play an unimportant role in causing market failure in the telecommunications industry. Still, there are some well-known examples, such as radio broadcasts that fail to exclude listeners that do not pay. Buckley adds, however, that it is a minor problem due to the fact that the majority of broadcasters and network providers can nowadays encrypt their services and introduce pay models, which makes their services thereby excludable (Buckley 2003: 28).

Inefficient exclusion is the second type of market failure that might occur in the telecommunications industry. Let us take a mobile Internet provider as an example in order to better understand this concept. The service that the organisation offers is 4G mobile Internet technology for smartphones. The service is excludable (you need to be a subscriber) and non-rivalrous (our consumption does not decrease your possible consumption), at least up to a certain number of users. The marginal cost of adding another user to the service is close to zero until the network operates at its full capacity. Any amount of subscription fee that the organisation charges results in a non-optimal use of the network. It costs the organisation nothing to let another user access the service, but to cover its fixed expenses, the organisation must collect a contribution. The prices for the service will therefore exceed the marginal costs. Thus people who are willing to pay more than the marginal costs but less than the imposed fee will not use the network, i.e. the market fails to allocate the service optimally (cf. Lipsey/Chrystal 1999: 276).

Missing markets are a cause of market failure and are best known for things such as public goods, common property resources and common pool resources. This cause arises when goods or services should be traded in order to achieve an optimal allocation, but there are no corresponding markets. Sometimes missing markets persist despite a constant demand, e.g. there exist house insurance policies against fire caused by 'ordinary' incidents; however, there is no market for house insurance policies against fire caused by acts of war (cf. Lipsey/Chrystal 1999: 289). In

the telecommunications industry, there is (often) no market for preferred telephone or cell phone number combinations. Another currently still missing market which could soon emerge is the market for fast and slow Internet ‘lanes’ suggested by the Federal Communications Commission. Instead of an open, free Internet broadband with the same speed for every Internet user, a for-pay, high-bandwidth option and a slower for-free option have been suggested to create markets where they are missing (cf. Hahn/Wallsten 2006).

Information asymmetry is a key concept in principal-agent theory. It occurs if one party is better informed in a contract situation than the other party. Information asymmetry arises mainly due to hidden characteristics, hidden information, hidden action or hidden intention (cf. Erlei et al. 2007: 148). It can result in shirking, moral hazards, adverse selection and other Pareto-inferior allocations. In the telecommunications industry, it is mainly domestic customers who are at a disadvantage due to information asymmetry. Experts and shopkeepers can talk their customers into products, tariffs and services, which the latter do not or only partially understand. Economic inefficiencies are created every time that a consumer pays too much or buys products that do not suit her needs (cf. Buckley 2003: 28).

Limited common property resources are among the most famous causes of market failures in the scholarly world, not only due to Garrett Hardin’s Tragedy of the Commons and Elinor Ostrom’s publications on common pool resources (Hardin 1968; Ostrom 1990; Ostrom et al. 1999). However, one would hardly associate the problem of common property resources with the telecommunications industry. Yet, there are scarce common resources such as radio spectrum, numbering and addressing capacity as well as hardware which is based on finite resources.

Externalities are actions of consumption or production that benefit (positive externalities) or harm (negative externalities) some market participants while the originating source is not being compensated (positive externalities) or is not compensating (negative externalities) for causing them. Externalities take place outside of market schemes and are not counterbalanced due to a lack of property rights (cf. Erlei et al. 2007: 304–305). They are not taken into account by the aforementioned price mechanism and therefore result in inefficient allocations. Pollution is by far the best-known example of a negative externality. The air pollution generated along the supply chain of a telecommunication hardware provider is neither compensated for by the end customer, the manufacturing organisation nor by its suppliers. The costs of air pollution (global warming, health hazards) are externalised, i.e. instead of being built into the cost of the production and passed on to the customer, the costs are shifted on to third parties. Therefore, the product’s price

does not mirror the entire costs, which in turn impedes the price mechanism from 'doing its job'. Apart from pollution, other possible negative externalities in the telecommunications industry include radio interference and the disfigurement of sites. Yet, there is also a common positive externality characteristic of the telecommunications industry: network externality, probably better known under the name of network effect. Let us consider a paid-for instant messaging service as an example. If you are the only user, the service will not be of much use to you. However, having your best friend joining in, your utility increases. With every new user entering the network, yours and your friend's utility snowballs without any further expenses. The telecommunications industry, based on interconnected networks, contains many more positive and negative externalities. Unfortunately, we cannot expand on all of them, but we will not withhold Buckley's example of a negative externality: "The utility to its recipient of an incoming call paid for by the caller is strictly speaking an externality, although it is rarely treated as one" (Buckley 2003:29). It is actually true that (almost) every time you are called, you benefit without paying for it: this is the definition of a negative externality.

Monopolistic supply is predominant in the telecommunications industry (cf. Buckley 2003: 27). This is mainly due to the fact that the telecommunications industry is said to be a 'natural monopoly'. Posner defines a natural monopoly as follows: "If the entire demand within a relevant market can be satisfied at lowest cost by one firm rather than by two or more, the market is a natural monopoly" (Posner 1969: 548). The invisible hand is said to produce efficient allocations only in markets with perfect competition. However, the case of a natural monopoly is different. If there are several organisations competing in a naturally monopolistic market, the outcome will be inefficient. Therefore, competition in a natural monopoly leads either to a natural selection where only one enterprise will remain or the production of the competing organisations will be more costly than necessary (cf. Posner 1969). Due to the fact that competition can be discarded as a regulatory mechanism to mitigate market failure in natural monopolies, governments have turned to so-called 'common carrier regulation' (cf. Buckley 2003: 28.).

4. Application of the Market Failures Model with the Justifiability-to-Each Criterion

4.1 Justifying Market Activity to its Constituents

Under the condition of a perfect competitive market, the only way firms could compete was through prices, improved quality and product innovation. These are the set of preferred strategies, which are secured by the Pareto conditions that specify the terms of perfect competition. As Heath admits himself, the Pareto conditions are never met in the real world.

“In order for competition to generate an efficient allocation of goods and services, there must be an absence of externalities (e.g. a complete set of property rights), symmetric information between buyers and sellers, a complete set of insurance markets, and rational, utility-maximizing agents with dynamically consistent preferences. Because of the practical impossibility of satisfying these constraints, firms are often able to make profit using non-preferred competitive strategies, such as producing pollution, or selling products with hidden quality defects” (Heath 2006: 550).

Thus, what does the market failures approach counsel managers to do if it is neither possible to achieve a situation of perfect competition nor to rule out non-preferred strategies? There is very little that can be done. In any case, there are such things as externalities (which are referred to as non-preferred strategies). Freezing all economic activities in order to stop the production of pollution completely is not a recommendable solution. Heath, who admits this, suggests that the market failures approach allows us to pick the “right level of pollution” (Heath 2004: 83). This sounds nice in theory but is as problematic as the Pareto conditions in real world markets.

The Pareto principle is conceptually problematic and difficult to apply in real world markets as discussed extensively in the previous parts of the paper. For example, the Pareto principle admits to situations, where some get nothing from the participation in the system and others get it all if this was the initial situation. The concept of ‘justifiability-to-each’ solves this problem. It measures market activity differently than the Pareto criterion, namely in terms of the greatest individual complaint. The principle assumes that reasonable actors would choose an economic system which “minimizes the greatest individual complaint”, or put differently, which is most acceptable to those

it is least acceptable to (cf. Wollner 2013: 11). The economic system “[...] must be justifiable to each participant in terms of how it advances his or her interests, taking into account that the same justificatory requirement applies to everyone” (Wollner 2013: 10). Please note that this principle is much stronger than simply avoiding harm or negative externalities. A justification requirement, as proposed here, assures the parties involved that the interests of all are taken into account equally. It does not require that all interests are satisfied but that all voices of affected agents are heard in the decision-making process. Why does the justifiability-to-each principle work in spirit of the Pareto criterion? In brief, it is assumed that the principle implies a notion of efficiency in the sense that when reasonable actors choose a kind of market system that is justifiable to everybody in terms of minimizing the greatest complaint, it promotes increasing economic efficiency. The principle assures that when the greatest complaints are minimized, technologies and available resources are used in the best way possible. Hence, it will increase the overall market outcome because all interests are taken into account equally. The respective outcome might not satisfy the Pareto conditions but aims to be as close as possible under the given circumstances. Under the premise that ‘reasonable’, not ‘rational’ actors, choose an economic system, it might be the closest to the Pareto-optimal state to satisfy the justifiability to each principle instead of trying to satisfy the FFT by heart.

4.2 Application of the Principle ‘Justifiability-to-Each’

Imagine a telecommunication organisation that aspires to set up a new tin mining plant for their newest smartphone: How should managers act when deciding upon the location of the mining plant? What are their responsibilities in the decision?

Executives that follow Heath’s approach will spot (at least) two market failures in the above-mentioned decision: externalities and information asymmetry. Let us concentrate on one in order to not necessarily complicate the example. One of the information asymmetries exists between the end consumer and the producer. The smartphone consumer has a relatively low willingness to pay because she does not know enough about conflict minerals. The executives decide to maximize profit under the constraint of not benefitting from market failures. Competing only through preferred strategies (quality, price, innovation), the management is conscious about the difficulty of finding both cost-effective and conflict-free locations for their mining plant. Their decision might be a compromise between the two, but in contrast to the shareholder approach, the organisation will provide a transparent overview of its supply chain to the end customers in order to not profit from

the market failure of information asymmetry. However, the managers will not be able to know which of the various market failures constitutes the biggest welfare loss in terms of the Pareto criterion. Therefore, they might succeed in alleviating one market failure but will most probably fail in achieving a Pareto-optimal allocation.

Our mechanism replaces the Pareto criterion with the justifiability-to-each criterion. Consequently, our approach is somewhat different, but it works in spirit of the Pareto criterion. Instead of trying to diminish market failures and achieve a Pareto-optimal state, the manager would instead still try to maximise profits but subject to the condition that complaints by the worst off are minimised. The implemented organisational process of setting up a new tin mining plant is then justified if it is most acceptable to those reasonable agents it is least acceptable to. How might such a process look in practice? On the one hand, the firm wants to increase its profits by mining tin cheaper in country A, where acceptable working standards are non-existent. On the other hand, the worker in country A might receive a decent wage but is exposed to high risk due to the lack of security measures and a lack of employee standards. While workers probably could not complain about the nominal wages they receive from the firm, they could complain about the high risk and the low working standards they face in country A. Due to the difference in the price level in A compared to some other country B, it would be a permissible strategy to lower the mining costs because the wage level in A is lower, and the worker can still afford a life worth living in country A. However, the workers in country A could reasonably complain about the poor working conditions they face. It would not be a permissible strategy of the firm to lower the mining costs by putting workers at excessive risk at their working place. The manager in question now faces two options. One strategy would be to shift the tin mining plant to a different country where acceptable standards are prevalent viz. legal standards and better monitoring by the authorities. While this might not be possible because tin resources are scarce and are not movable like production plants, the organisation should aim at providing acceptable standards where the tin mining plant is located. In other words, it is in general acceptable for the organisation to profit from lower wage rates (preferred strategy), but it is not acceptable to justify profiting from a situation where the poor workers carry the higher risk (non-preferred strategy).

5. Discussion and Conclusion

Our paper contributes to CSR research by broadening the perspective of existing CSR paradigms. Our proposed scheme of managerial responsibilities sits at the confluence of profit-oriented market mechanisms and responsible business practice. Existing normative theories and concepts, such as stakeholder approaches (cf. Freeman 1984; Litz 1996), provide general managerial action guidance. But they often fail to reflect context-specific complexity of situations in organisations in the sense that predefined stakeholders are not necessarily those groups which are involved or affected by managerial decisions in organisations. In this paper, we questioned if stakeholder frameworks are able to give guidance in terms of how a manager should act, or what an organisation's social responsibilities truly are. First, the selection of relevant stakeholder groups can be arbitrary from a moral point of view because it is not clear how the selected groups of stakeholders enter the relevant set and are considered as stakeholders for the organisation. Second, we elaborated on the squeaky wheel bias, from which stakeholder frameworks suffer. Consequently, those stakeholder groups which are better organized and make their voices heard are not necessarily those groups that have most at stake, e.g. in terms of welfare.

What distinguishes our proposed scheme of business ethics from stakeholder frameworks is the manner of how its implied constraints on managerial actions are derived. Rather than trying to derive it from general morality, our modified version of the market failures approach takes its guidance from the FFT. It asks what conditions must be satisfied in order for the market economy as a whole to achieve efficiency in the production and allocation of goods and services (cf. Heath 2006: 551). The very basic idea is that in the same way the state has to justify its activities to its citizens, organisations have to justify its activities to whom its activities are least acceptable to, in terms of how the activities affect their interests. It is an adjusted version of the Pareto criterion which assumes that reasonable actors would choose an economic system that “minimizes the greatest individual complaint”, or, put differently, which is most acceptable to those it is least acceptable to (cf. Wollner 2013: 11). Our modified market failures approach works in spirit of the Pareto criterion because it minimises individual complaints, implying that preferences of different actors are equally taken into account equally but not satisfied equally. We assume in this paper that minimising the greatest individual complaint will contribute to deploying the available resources and technologies in such a way that the overall market output increases and economic activity is made more

acceptable to society. From a manager's perspective, this implies that he or she is morally required to maximise profits subject to the condition that the greatest individual complaint is minimised.

At the very beginning of the paper, we asked, "How should we act when doing business, and what are the responsibilities of a manager qua manager?" The term 'qua manager' is an essential component of the professional ethics account which states that business ethics is concerned with the special duties that arise out of the managerial role, and which are imposed upon the manager qua manager and not qua individual. At this point, our contribution to the debate is theoretical in nature. With the conceptual underpinnings set in this paper, it should be possible to develop a guideline to implement our proposed scheme in the real world. From our point of view, contractualism (cf. Donaldson/Dunfee 1994; Scanlon 1998) would be one promising candidate in which to embed our theoretical framework into a strong normative core. This is because the key idea of contractualism is that normative truths – normatively relevant propositions – are defined procedurally as the outcome of (in almost all cases) hypothetical contracts or agreements between the relevant agents. Hence, a normative proposition is true or justified just insofar as all relevant and reasonable agents agree or should agree with it (cf. Frederiksen/Nielsen 2013: 26). This fits very nicely with the framework developed here. The core of our hypothetical contract would be that the outcome is morally desirable if the greatest individual complaint is minimised. Whatever the outcome informed by the hypothetical contract, it will necessarily emphasise reciprocity and mutual acceptability, alongside the notion of reasonability.

Very roughly outlined, what might such a process look like from a managerial perspective? Imagine that a manager must decide between different ways of upgrading an organisation's means of production. She can either opt for a cheap solution (X) that pollutes on a high level or a more costly one that reduces pollution (Y). From a shareholder perspective, it should be clear that it would be morally required by the manager to choose X because it might maximise shareholder value. From a stakeholder perspective, it depends who the stakeholders are and how distant or close the stakeholders might be considered in options X and Y. From a contractualist position, the evaluation of the options would be completely different. The outcome would be different in the sense that our scheme would choose the option which minimises the greatest individual complaint and finds the 'right' level of pollution which would be justifiable to reasonable people on grounds of mutual acceptability and reciprocity. The outcome would be in spirit of the Pareto criterion in the sense that it maximises the utility for all of the society under the given circumstances.

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