Implementing Corporate Social Responsibility Policies in a Developing Country-A Study of Iran

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A Study of Iran

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Abstract

The scant literature on Corporate Social Responsibility (CSR) in developing countries where CSR is relatively underdeveloped, has recently suggested that CSR in developing countries is different and reflects specific social and political background. So far, empirical research on this topic has been scarce. The purpose of this thesis is to discover how CSR practices can be implemented in a developing country such as Iran by exploring the role of the economy, state and societal culture. Qualitative research and semi-structured interviews were conducted with managers of some of the largest publicly held companies listed on the Tehran Stock Exchange. The analysis of data established that in developing countries, such as Iran, markets are imperfect and incomplete with lack of competition and strong government interference. This thesis also revealed that good-law-on-the-books does not necessarily ensure economic development but rather economic development comes before the rule of law. Other mechanisms such as competition, trust, legal compliance level and government interference level are more influential. The results of these data also provided that stakeholders have very limited impact upon the decision-making process in Iranian companies and the attitude of the managing director is the most important driver of CSR policies. It was recognized that Western style of economic development may not happen in Iranian business environments. Business strategies that depend on influencing the strengths of the existing market environment outperform those that focus on overcoming its weaknesses. The interesting finding was that despite the strong agreement amongst the interviewees on weak performance of the government in all aspects and constant call for lowering its interference level, all of them believed that the government plays the most important roll in promoting CSR policies. Finally it was concluded that Iran is not still ready and does not have necessary economic and cultural level for promotion of CSR policies.

Acknowledgment

I dedicate this thesis to my family and friends who have supported and encouraged me throughout this experience. Their continued encouragement has made a significant contribution to my success in completing the doctoral program.

I especially dedicate this manuscript to my husband Antonin Weyeneth, my parents Zahra Sattari Faghighi and Mostafa Modabber and my sisters, Neda and Faeze and my parents in law, John and Ariane Weyeneth who have inspired me to excel educationally and professionally. I am especially thankful to my husband, Antonin, who has inspired and supported me throughout this journey. He lifted me up when I was down and his continued encouragement kept me going throughout this process. I am very grateful to my mother. I probably would not have been able to realize this educational goal and dream without her tuition and assistance.

Many thanks to my friends, Nicoletta, Lina, Elahe and Andrea for their patience, understanding, and support.

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Statement of Copyright

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Chapter 1: Introduction

Corporate Social Responsibility (CSR) is one of the most important issues and developments of the 21st century. The 21st century has put forward a series of issues and challenges that are global and outside the authority of one state. These involve a set of common governance and regulatory issues such as the global economic crisis, climate change, human rights and sustainable development. CSR can provide an important part of the answer to these problems.

CSR has generated widely divergent reactions since, as it has been argued, corporations can be "both good and evil, making them appear as both responsible and irresponsible actors".[1] Corporations have been called "the Frankenstein monster that the State has created by their corporation laws".[2] Similarly, "The Report of the Citizen Works Corporate Reform Commission" argued that large public corporations are dangerous to society "because as profit-making machines, they know no limits and boundaries".[3] On the contrary, Madsen argues that taking corporations as the main source of evil on the world is incomplete. He maintained that corporations are "the backbone of our current global web of institutions".[4] Micklethwait and Wooldridge argue that the corporation is "the most important organization of the world" and "the basis of the prosperity of the West".[5]

[1] Peter Madsen, 'Professionals, Business Practitioners, and Prudential Justice' 39 McGeorge Law Review 835842
[2] *Louis K. Liggett Co v Lee* US 564-565-567
[3] Lawrence E. Mitchell, *Corporate Irresponsibility: America's Newest Export* (Yale University Press 2001) 94
[4] Madsen841-842
[5] John Micklethwaite and Adrian Wooldridge, *The Company: A Short History of a Revolutionary Idea* (Modern Library 2003) xv

G8 leaders further highlighted the importance of CSR. They directly addressed the need for CSR and suitable related standards in a new way that went beyond simply emphasising the desirability of voluntary CSR initiatives. Speaking directly to companies and those responsible for them, G8 leaders targeted corporate CSR disclosure and corporate engagement with particular CSR standards: "(w)e call on private corporations and business organisations to adhere to the principles in the Organization for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises". [6]

While there seems to be an agreement on the need for CSR, there is a huge disagreement as to what constitutes responsible behaviour and what limitations are placed on such responsibility, but there seems to be a consensus on the value of a socially responsible corporation in society. Corporations operate within a societal context; therefore, inevitable interaction and intersection with legal, economic and moral domains will occur. Still, much disagreement remains about the range of limitation "on corporate profit-making beyond legal compliance, market forces and business ethics" and "the ultimate sources and justifications for any limitations".[7]

The volume of studies on CSR is extensive but, strangely, comparative studies on CSR are relatively rare and tend to mostly focus on bigger regions such as continents and focus less on individual countries. One reason for this is the fact that corporations are rapidly growing and going global. Studying individual countries might not give the researcher the comprehensive understanding of the challenges that CSR might face while being implemented.

[6] Marc Gunthe, 'The Mosquito in the Tent' 149 Fortune 68 91-92
[7] Bryan Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar Publishing Limited 2010) 7

In order to debate the implementation of CSR policies in a developing country, this thesis will start with a discussion about the relationship between politics and corporate governance in Chapter 2. In developing countries, in most cases, politics plays an important role in how corporations are run. In this section, efforts will be made to show the relationship between politics and corporate governance.

In order to demonstrate this, first "path dependence" theory will be discussed; this holds that a country's pattern of ownership structure at any point in time depends partly on the patterns it had earlier followed. Then "convergence theory" will be discussed. This theory argues that systems of corporate governance around the world are converging towards the Anglo-American model. Then the "globalization of capitalism" theories claiming that capitalism is the bedrock of most of the advanced economies will be examined. Moreover, the effects of politics on different systems of corporate governance will be debated. Politics generally determines conditions under which changes in different systems are likely to happen. That is why politics should be seriously taken into account by international institutions trying to bring about changes. Finally, the role of corporate law in the relationship between politics and corporate governance will be discussed.

In this section key proposition 3.2 will be debated. This proposition maintains that transitional economies, such as Iran, present major obstacles to the adoption of a dispersed ownership model (Anglo-American model).

Second, attempts will be made to demonstrate the difficulties of defining CSR and what constitutes socially responsible behaviour.

Third, dominant CSR theories will be demonstrated. In this section two of the most important CSR theories will be identified and discussed: first, Shareholder Value Theory will be examined. Milton Friedman's opinions, as the paramount representative of this view, and his opponent's views will be debated. Second, Stakeholder Theory will be discussed.

In this section, key proposition 2 will be examined. This proposition argues that the impact of CSR values upon corporations in transitional economies, such as Iran, is likely to be shaped by internal norms in these corporations.

Further on this chapter, the role of law in CSR debates will then be discussed. CSR has been considered as going beyond what is required by law. Attempts will be made to demonstrate the importance of the role of law in the CSR debate. This section is related to Key proposition 1.1 where this thesis try to identify whether the connection between legal rules and CSR principles is a reflexive one.

Additionally, globalization's role in CSR debates will be examined. McBarnet has argued that CSR is a rapidly "developing business strategy" and it is "a response to globalization and the extension of global multinational enterprises". The importance

of the discussion on globalization is the fact that State control over multinational companies has considerably decreased.[8]

In Chapter 3, comparative law as a tool of law reform will be debated. Comparative law is an important branch of law; both as a tool of research and as a tool of education, but using comparative law as a tool of law reform in developing countries gives rise to concerns about the effect of foreign legal models in the process of law-making.

The extent to which one legal system may develop its own principles and procedures or adopt those of foreign jurisdictions (legal transplantation) has been recently the subject of an abundant literature.[9]

Scholars in different fields agree that over a period of 200 years the development of complex legal systems and the amelioration of "rule of law" have played a crucial role in modernization and industrialization, and are key determinants of economic growth, while the corporate form has been regarded as a very important factor in the creation of viable market economies.[10]

In this section, key proposition 1.3 will be discussed. This proposition argues that the act of borrowing is usually simple; on the other hand, building up a theory of

[8] Doreen McBarnet, *Corporate Social Responsibility beyond Law, Through Law, for Law: the New Corporate Accountability* (Cambridge University Press 2007) 453

[9] Pierre Legrand, 'European Legal Systems Are Not Converging' 45 International and Comparative Law Quarterly 52 and Pierre Legrand, *Fragments on Law-as-Culture* (W. E. J. Tjeenk Willink, Schoordijk Institute 1999)

[10] Yoram Keinan Katharina Pistor, Jan Kleinheisterkamp and Mark D. West, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 18 The World Bank Research Observer 89 92

borrowing is more complex. Additionally, key proposition 1.2 will be examined. This holds that the so-called "law-matters" thesis needs to be assessed by reference to what has been referred to as "functional equivalents" to law in transitional economies such as Iran.

Contemporary comparative law scholars, however, take the view that law is culture-specific and cannot be transferred from one society to another and have exactly the same effect. The transplanted law will change as it interacts with local laws and conditions.[11] A series of studies by Katharina Pistor and others have shown the deficiencies of transplanted laws in their new legal environment. They have concluded that legal institutions in transplant countries were less developed when compared with those in the origin countries due to lack of complementarities, [12] and that transplant countries were less innovative than the origin countries. [13] Pistor has further argued that law should be developed by society and made "part of the institutional fabric of society".[14]

This chapter will also discuss the first Key proposition. This Key proposition examines whether the process of transplanting into another legal system is likely to be affected by local socio-economic-legal conditions, cultural values and institutional arrangements. This chapter will also discuss Key proposition 3.3. This involves determining whether the relationship between the legal rule to be transplanted and the

[11] Alan Watson, 'Comparative Law and Legal Change' 37 The Cambridge Law Journal 313 313
[12] Katharina Pistor Yoram Keinan Katharina Pistor, Jan Kleinheisterkamp and Mark D. West 'Innovation in Corporate Law ' 31 Journal of Comparative Economics 676 7
[13] Yoram Keinan Katharina Pistor, Jan Kleinheisterkamp and Mark D. West 'The Evolution of Corporate Law: A Cross-Country Comparison ' 23 University of Pennsylvania, Journal of International Economic Law 791 791
[14] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 90 and 93

socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.

In this chapter, attempts will be made to define legal transplants, their development and influence in the study of legal culture and legal systems, taking into account the variation of transplantation process based on social, legal, economic, fiscal, financial and technical circumstances prevailing in each country's legal culture and legal system.[15]

In order to do this, the definition of legal transplants will first be presented. Second, attempts will be made to show how legal transplants are applied. Third, different series of arguments will be presented to demonstrate the role of legal transplants. Fourth, the costs of legal change and its effect on legal transplantation will be discussed. Fifth, the influence of culture on legal transplants will be presented and finally the development of legal transplants in developing countries will be discussed.

Analysis of CSR policies has a particular nature. The normative analysis of corporate governance[16] falls into two categories: first, the analysis of corporate governance responsibilities within the context of a given system or model of corporate governance; and second, the comparative evaluation of different models of corporate

[15]Irma J. M Valderrama, 'Legal Transplants and Comparative Law' 002 International Law: Revista Colombiana de Derecho Internacional 276 274

[16] Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders, the board of directors, employees, customers, creditors, suppliers and the community at large.

governance. Analysing CSR[17] policies in developing countries will encompass both categories. While one needs to analyse the contingencies of corporate governance in a given country, comparison should be made with the more successful implementation in other countries.

In Chapter 4, globalization and its effect on the developing country will first be discussed. In the first section, the different nature of CSR policies in developing countries will be demonstrated and attempts will be made to define a conceptual framework for studying comparative CSR. Second, the Anglo-American nature of reforms and the two factors contributing to development of this model of corporate governance will be discussed. These will involve an examination of: the failure of Import Substitution Industrialization (ISI) and the influence of international financial bodies. Third, three main social reporting theories[18]: legitimacy theory, stakeholder theory and institutional theory will be presented. In stakeholder theory, team-production theory as a credible challenge to the principal–agent model of corporate law and the arguments for and against it will be discussed. Fourth, the relationship between social development and economic development will be demostrated while drawing attention to cultural dimensions influencing society's CSR agenda. Fifth, attempts will be made to see if corporations have the responsibility to promote

[17] "CSR" is a term that defies precise definition. But nearly everyone can agree that it is about the business contribution to sustainable development - how business can take into account the economic, social and environmental impact their operations will have on the society.
It is a form of corporate self-regulation integrated into a business model. Ideally, CSR policy would function as a built-in, self-regulating mechanism whereby business would monitor and ensure its support to law, ethical standards, and International norms. Consequently, business would embrace responsibility for the impact of its activities on the environment, consumers, employees, communities, stakeholders and all other members of the public sphere. Furthermore, CSR-focused businesses would proactively promote the public interest by encouraging community growth and development, and voluntarily eliminating practices that harm the public sphere, regardless of legality. Essentially, CSR is the deliberate inclusion of public interest into corporate decision-making, and the honouring of a triple bottom line: people, planet, profit.

[18]Muhammad Azizul Islam and Craig Deegan, 'Motivations for an organisation within a developing country to report social responsibility information: Evidence from Bangladesh' 21 Accounting, Auditing & Accountability Journal 850

development. In this section the "private government" characteristics of corporations will be discussed.

In this chapter key proposition 3.3 will be further discussed where it is argued that transitional economies, such as Iran, present a major obstacle to the adoption of the dispersed ownership model of the corporation. Additionally, key proposition 1.2 will be further examined. This holds that the so-called "law-matters" thesis needs to be assessed by reference to what has been referred to as "functional equivalents" to law in transitional economies such as Iran.

In this part of the thesis, key propositions which have evolved out of the theoretical literature review and discussion of relevant legal issues will be demonstrated.

The thesis will then continue with an analysis of Iran. Iran is located in a politically troubled and unstable region of the Middle East and has unique environmental characteristics. Moreover, Iran as a strict Islamic country, bases its social and commercial activities on fundamentalist religious regulations. The 1979 Iranian Revolution changed the Iranian people's social values and corporate culture. For example, being religiously faithful is one of the conditions to be selected as a high-ranking board member or director. In addition to religion and culture, the Civil Law of France and Belgium also influences corporate culture in Iran.

The corporate governance system in Iran is not similar to those in Western countries. Several obstacles are embedded in the Iranian corporate governance system that makes the development of western-style corporate social responsibility policies very

difficult, if not impossible. Two of the most significant obstacles are the lack of a proper private sector and the lack of a proper taxation system.

In order to see how CSR polices can be implemented in Iran, one needs to study how a new socio-legal system can be instituted in Iran.

In Chapter 5, Key proposition 3 will be debated. This key proposition argues that the political determinants of CSR are fundamental to explaining its impact. These will vary from developed to transitional economies.

In order to demonstrate this, the recent historical-political process in Iran, as well as aspects of Constitutionalism Revolution, in Iran will be discussed. Constitutionalism in Iran is a historically tested experience of introducing a new system in the legally under-developed Iran of that time. It brought many contradictory social and political issues to the surface. How Iran of that time responded to that introduction might tell a lot about how it might respond to the introduction of other new systems. Moreover, Constitutionalism was a quasi-successful movement in Iran. How it gained its success and where it made mistakes that led to not-very-successful results can be very helpful in identifying what obstacles CSR will encounter while being introduced in Iran and how it will be dealt with. Additionally, studying the Constitutionalism Revolution, as a way of limiting State power, will help us understand how the Iranian government can be influenced; for example, whether the pressure for change comes from inside or from external forces such as globalization.

In this section attempts will be made to discuss key proposition 2.1, arguing that the State has major influence in developing countries such as Iran upon the adoption of CSR in many companies.

Second, the socio-legal dimension of Iran will be examined. “Iranian characteristics”, what make them do what they do, why they do it and how they can be influenced the most will be discussed. It has been suggested that there is an Iranian way of doing everything. Criticisms of this Iranian way will be made.

Third, corporate law which is included in the Commercial Code and the corporate governance system will be examined. Attempts will also be made to assess whether Iran’s corporate law and corporate governance systems are an impediment to good governance and what changes should be made in order to encourage more socially responsible behaviour by corporations.

In recent years, because of the increase in general knowledge, education, exposure to international communities of national corporations and the presence of international corporations, Iran’s market should have started becoming more competitive and gradually CSR should have started finding its way into the decision-making process.

The nature of CSR in Iran is, however, different from its western conceptualization. It is mainly understood as a kind of philanthropy or sponsorship of different cultural/sports events and is characterized as such conduct as donating money in natural disasters. Few companies have a strategic approach to CSR and if they do it is

usually within the European Foundation for Quality Management (EFQM)[19] framework.

Voluntary CSR in Iran is deeply interwoven with a strong cultural tradition of donating money to charities, building schools, mosques and hospitals. It is also profoundly embedded within Islamic religious customs of helping the poor by donating money under the Islamic concepts of Khums[20], Zakat[21], Waqf[22]. These Islamic concepts have not been specifically called Corporate Social Responsibility but socially responsible behaviour exists in Iranian culture and religious customs. Some argue that if these socially responsible cultural concepts combine with the new commercial concept of CSR better results will be achieved[23], but this view is rather simplistic. The modern concept of CSR, like any other modern western concept, is likely to be affected by socio-economic-legal conditions. The socio-political structure of Iran will determine the rejection or acceptance of CSR concepts. This further proves that the act of borrowing from other legal systems is, however, a complex matter.

The literature on Corporate Social Responsibility in Iran is somewhat limited. Such writings that do exist are very shallow and in many cases contradictory. Iranian authors do not explore CSR as an Iranian concept but rather try to explain why Iran

[19] EFQM (formerly known as the European Foundation for Quality Management) is a non-profit membership foundation based in Brussels.
[20] Khums is the Arabic word for One Fifth (1/5). According to Shia Islamic legal terminology, it means one-fifth of certain items which a person acquires as wealth, and which must be paid as an Islamic tax.
[21] Zakāt or "alms giving", one of the Five Pillars of Islam, is the giving of 2.5% of one's possessions (surplus wealth) to charity, generally to the poor and needy. The Shia double this to 5% of one's possessions.
[22] A Waqf is an inalienable religious endowment in Islamic law, typically denoting a building or plot of land for Muslim religious or charitable purposes. The donated assets are held by a charitable trust
[23] An interview with Bagher Namazi, the head of the Iranian Institute of Non-governmental Co-operatives: http://csriran.com/?page_id=26

does not have CSR of a western style. They argue that Iran is not economically ripe for the western CSR concept. While this argument might be partially correct when it comes to securing investments for large corporations, not having a western style CSR is not in itself a bad thing. Implementing western concepts in Iran is a complex matter that requires considerable research on how foreign laws and regulations can be transplanted into Iran. Introducing CSR policies into Iran without taking into account the above-mentioned considerations might end in their rejection. At the same time, Iran has special characteristics, a very different culture and a very different socio-legal system. Digging deeply into these elements might show that there exists an Iranian style of CSR that just needs to be strengthened and encouraged rather than changed or renewed.

In Chapter 6, key players in CSR in Iran will first be identified. Second, the main CSR activities in Iran will be discussed. Third, examples of domestic and foreign company activities will be illustrated. Fourth, the State role in promoting CSR policies will be demonstrated. Fifth, the UN role in promoting CSR policies will be debated. Sixth, the Stock Exchange's role in this matter will be examined. In this section a summary of the Iranian Code of Corporate Governance, as ratified by the Tehran Stock Exchange, will be presented. This chapter will conclude by showing the difficulties of promoting CSR policies in Iran.

In Chapter 7, fieldwork data will be analysed in four parts: a) Key proposition 1, b) Key proposition 1.1, 1.2 and 1.3, c) key proposition 2, and d) key proposition 3. The methodology and the interview questions are attached to this chapter as an index.

In the analysis of Key proposition 1, attempts will be made to analyse the effect of local socio-economic-legal conditions, cultural values and institutional arrangements in the process of transplanting CSR into another legal system.

In order to assess this Key proposition, the interviewees were first asked if they believe there is a demand for CSR, where they think this demand comes from and what they believe would stand as the key feature of CSR in Iran. Then, the interviewees were asked about the extent to which they believe that successful CSR policies depend on the existence of elements of social structure (such as unions, professional associations, etc.) sometimes referred to as "civil society". Additionally, in order to further assess the social and cultural aspect of this Key proposition, the interviewees were asked how flexible they believe Iran's legal and cultural system is in response to changing economic and cultural conditions.

In the analysis of Key propositions 1.1, 1.2 and 1.3, the interviewees' opinion was initially sought on the impact of corporate law on economic growth in Iran and the extent to which economic growth is facilitated by adherence to the rule of law (Which comes first?). Secondly, the interviewees were asked for their opinion about the extent to which they believed that Iranian courts and regulators rely upon corporations to regulate their own affairs (e.g. self-regulation as opposed to government regulation), the extent to which they believed that corporate law principles are applied within courts and the effectiveness of Iran's corporate regulators in enforcing corporate law. Finally, the interviewees were asked how effective they believed Iran's corporate law was in dealing with self-dealing by corporate officials. The interviewees were also asked to describe the level of compliance upon the part of

Iranian companies with legal and regulatory rules (e.g. re disclosure). They were also asked what formal and informal institutions were available to make up for weak corporate law.

In order to analyse key proposition 2 and assess whether the impact of CSR values upon corporations in transitional economies, such as Iran, is likely to be shaped by the internal norms in these corporations. It was of critical importance to see how CSR policies are actually implemented at lower levels in Iranian companies.

In order to do this, the interviewee's opinion was first sought regarding the extent to which they believed that different stakeholder groups were likely to impact upon the decision-making process of Iranian companies. This was directed at ascertaining whether support from multiple stakeholders is important for the success of companies in Iran. Furthermore, the interviewee's opinion was sought as to who they believed were the most influential stakeholders in their company.

Second, interviewees were also asked if and in what way positive public perception is important for the success of their company in Iran.

Third, the interviewees were asked how they believe that CSR values within corporations are shaped by the internal norm in these corporations. The interviewee's opinion was also sought as to the extent to which managers and directors of large Iranian companies are accountable to different stakeholder groups (e.g. employees, shareholders, consumers, etc).

Fourth, the interviewees were asked if they think more employee participation would further promote CSR policies in Iranian companies.

Fifth, the interviewees were asked to explain if they see the company as an economic player or as a socio-political player.

Sixth, the interviewees were asked why they think companies decide to get involved with CSR and how, if at all, companies benefit from CSR.

Seventh, the interviewees were asked if they believe corporations have extra responsibility for social development beyond the development that arises incidentally from their responsibility to their shareholders to generate profit.

In order to analyse key proposition 3, the State influence in developing countries, such as Iran, upon the adoption of CSR in many companies, attempts were made to see if the political determinants of CSR are fundamental to explaining its impact; if transitional economies, such as Iran, present major obstacles to the adoption of a dispersed ownership model of the corporation; and if the relationship between the legal rule to be transplanted and the socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.

In order to assess this key proposition, the interviewee's opinion was sought to see if CSR policies contradict any social/political values in Iran in a way that they would induce a backlash. They were also asked what local conditions have caused difficulties in transplanting commercial laws in Iran.

The interviewees were also asked to give their opinion about the role of the State (the government), if any, in promoting CSR policies. They were also asked what source, if any, the government has used to promote CSR policies and what the State has done to encourage CSR policies. The interviewees' opinion was also sought as to how they believe the private sector/their company benefit from CSR partnerships with the government, and if they think that promoting CSR policies will increase the level of cooperation between the public and private sectors in Iran.

Finally, the interviewees were asked to give their opinion about the factors they believe promote the adoption of CSR values in Iran.

Chapter 2: Corporate Social Responsibility Literature Review

2.1 Introduction:

> "Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and societies".
> (Sir Adrian Cadbury in the foreword to "Global Corporate Governance Forum", World Bank, 2003)

The behaviour of corporations and their responsibilities towards the society they are operating in was one of the most contentious issues discussed during the last decade of the 20th century and had generated widely divergent reactions. It has been suggested that the reason for these opposing reactions lies in the duality of "corporations being both good and evil, making them appear as both responsible and irresponsible actors".[24]

Jones has argued that since the beginning of the 21st century, global debates about CSR have reached a new level, having moved from the question of "why corporations must be socially responsible" to the current question of "how they can become socially responsible". [25]

Gunthe reports that:

> "According to a recent Deloitte global business survey on non-financial business information, almost 90 percent of CEOs and senior executives globally believed that their capacity to track the financial performance of their

[24] Madsen842
[25] Thomas M. Jones, 'Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics' 20 Academy of Management Review 404 7

> company was good or excellent, although slightly less than 30 percent of them could say the same about their tracking of their company's non-financial performance, notwithstanding that more than half of them admitted that companies are under more pressure than ever before to measure their non-financial performance, with more than 80 percent of these senior corporate executives admitting that this kind of performance information is increasingly emphasized by financial markets, investment fund managers, and others".[26]

In the G8 Agenda for cross-border investment and global economic development in their 2007 Summit Declaration, the world's G8 leaders committed their countries to "promoting and strengthening corporate and other forms of social responsibility" through "internationally agreed corporate social responsibility and labour standards" as one of four priority areas for action.[27]

G8 leaders also directly addressed the need for CSR and suitable related standards in a new way that went beyond simply emphasising the desirability of voluntary CSR initiatives. Speaking directly to companies and those responsible for them, G8 leaders targeted corporate CSR disclosure and corporate engagement with particular CSR standards: "(w)e call on private corporations and business organisations to adhere to the principles in the OECD Guidelines for Multinational Enterprises". [28]

The leading questions have always been: what role corporations should play in society? Who should corporations be run for? And, consequently, to whom are corporations accountable? The different answers that have been given to these questions have been playing a leading role in the way corporations have been governed to meet their goal[29]. The aforementioned questions lead to deeper questions: "Is the company essentially a private association, subject to the laws of the State but

[26] Gunthe 90
[27] Jones 7
[28] Gunthe 91-92
[29] Horrigan 6

with no greater obligation than making money, or a public one which is supposed to act in the public interest?"[30] or "How do we design the parameters for a profitable internationally competitive corporation for the 21st century that remains accountable to its shareholders while acting responsibly towards citizens affected by its actions?"[31]

In recent years, the idea that corporations should also act for other stakeholders, rather than merely shareholders, has been growing rapidly. There seems to be a consensus that corporation need to take into account both shareholders and stakeholders' interests since their interests are interwoven. But there is also a widespread disagreement as to how corporations should involve stakeholders' interests in corporations' decision-making process and the interests of different stakeholder groups relate to one another.[32]

Similarly, there is a huge disagreement as to what comprises socially responsible behaviour and what the limitations of such responsibility may be, but there seems to be a consensus on the value of a socially responsible corporation in society. In other words, corporations operate within a societal context, therefore inevitable interaction and intersection with legal, economic and moral domains occur, but still much disagreement remains about "the range of limitation on corporate profit-making beyond legal compliance, market forces and business ethics, as well as the ultimate sources and justifications for any limitations".[33]

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[30] Wooldridge xv

[31] Canadian Democracy and Corporate Accountability Commission (CDCAC), *The New Balance Sheet: Corporate Profits and Responsibility in the 21st Century* (Final Report of the CDCAC, 2002) 3

[32] Bryan Horrigan, '21st Century Corporate Social Responsibility Trends - An Emerging Comparative Body of Law and Regulation on Corporate Responsibility, Governance, and Sustainability ' 4 Macquarie Journal of Business Law 85 7

[33] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 7

The volume of studies on CSR is extensive but, strangely, comparative studies on CSR are relatively rare and mostly focus on bigger regions such as continents, with less focus on individual countries. However this gap in CSR studies might be somewhat understandable since corporations are rapidly growing and going global; therefore, studying individual countries might not give the researcher the comprehensive understanding of the challenges CSR might face while being implemented.

In this chapter, first, the relationship between politics and corporate governance will be discussed. In developing countries, in most cases, politics plays an important role in how corporations are run. In this section, efforts will be made to show how politics affects corporate governance and vice-versa. In order to demonstrate this, first "path dependence" theory will be discussed, holding that a country's pattern of ownership structure at any point in time depends partly on the patterns it had earlier. Then "convergence theory", which maintains that systems of corporate governance in the world are converging towards Anglo-American corporate governance, will be discussed. We continue our analysis by "globalization of capitalism" theories claiming that capitalism is the bedrock of most of the advanced economies. to which convergence is happening towards their shareholding model. Moreover, we will try to present the effects of politics on different systems of corporate governance to determine conditions under which changes in these systems are likely to happen and therefore should be seriously taken into account by international institutions trying to bring about these changes. Finally, the role of corporate law in the relationship between politics and corporate governance will be discussed.

In this section Key proposition 3.2 will be debated. This proposition maintains that transitional economies, such as Iran's, present major obstacles to the adoption of a dispersed ownership model.

Second, attempts will be made to demonstrate the difficulties of defining CSR and what constitutes socially responsible behaviour. Despite the widespread discussion on CSR, one of the most controversial issues in CSR debates is its definition. For a concept that has been discussed for so long, it is strange that researchers still do not share a common definition or set of core principles.

Third, dominant CSR theories will be presented. Different scholars have categorized CSR in different ways. One of the most complete categorizations of contemporary mainstream theories is: first, Corporate Social Performance; second, Shareholder Value Theory and Milton Friedman's opinions as the paramount representative of this view; third, Stakeholder Theory; and Corporate Citizenship Theory.

In this section, key proposition 2 will be examined. This proposition argues that the impact of CSR values upon corporations in transitional economies, such as Iran's, is likely to be shaped by internal norms in these corporations.

Fourth, in an attempt to further explain the business case for CSR, the relationship between CSR and Corporate Financial Performance (CFP) will be discussed. The search for a positive link between CSR and related concepts such as social performance and financial performance has spawned an abundant literature, the

results of which remain somewhat inconclusive, with some authors discovering a positive relationship between social performance and financial performance, others encountering a negative relationship, and still others finding no relationship.

Fifth, the role of law in CSR debates will be presented. CSR is considered to do more than what is required by law. Moreover, attempts will be made to demonstrate the importance of discussing the role of law in CSR debates.

This section is related to Key proposition 1.1 where attempts will be made to see whether the connection between legal rules and CSR principles is a reflexive one.

Sixth, globalization's role in CSR debates will be discussed. It has been argued that "CSR as a rapidly developing business strategy is a response to: globalization and the extension of global multinational enterprises across countries: this implies that the State control over such enterprises has significantly decreased".[34]

2.2 Politics and Corporate Governance

2.2.1 Introduction

Politics generally plays an important role in transitional economies in regard to how corporations are run.

In this section, efforts will be made to show the relationship between politics and corporate governance. In order to demonstrate this, first "path dependence" theory

[34] McBarnet 453

will be discussed. This theory holds that a country's pattern of ownership structure at any point in time depends partly on the patterns it had earlier. Then we will look at "convergence theory" and the arguments for and against it. We continue our analysis by taking a look at the globalization of capitalism, with capitalism being arguably the bedrock of most of the advanced economies, to which convergence, it has been strongly claimed, is happening towards their shareholding model. Moreover, we will try to present the effects of politics on different systems of corporate governance and to determine the conditions under which changes in these systems are likely to happen and should therefore be seriously taken into account by international institutions trying to bring about these changes. In conclusion, the role of corporate law in the relationship between politics and corporate governance will be discussed.

2.2.2 Path Dependence Theory

"Path dependence" theory tries to show that history and politics matter, and simply matter more than the conventional wisdom of the legal and economic communities suggests.[35] Roe[36] and Bebchuck and Roe[37] wrote that the patterns of history deeply influence the current patterns of politics which, in its turn, affects the law and social organizations that determine which corporations, which ownership structure and which governance arrangements survive and prosper and which do not. Therefore, studying political determinants of corporate governance will provide a deep insight as to why things are the way they are, and in which direction they are heading.

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[35]Christopher D. Stone, *Where the Law Ends: The Social Control of Corporate Behavior* (Waveland Press 1991) 114

[36]Mark J. Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford University Press 2003) 7 and 13

[37]Lucian A. Bebchuk and Mark J. Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' in Jeffrey N. Gordon and Mark J. Roe (ed), *Convergence and Persistence in Corporate Governance* (Cambridge University Press 2004) 77

Two types of path dependence have been recognized: first "structure-driven" path dependence, which holds that the ways of initial ownership structures in an economy directly influence subsequent ownership structures through developing complementarities[38] and network externalities that make the economy more efficient.[39]

The other type of path dependence suggests that substantial differences in corporate rules among countries might be sufficient to produce substantial differences in ownership patterns.[40]

2.2.3 Convergence Theory

In the light of the post-Enron corporate governance crisis in the United States, the European Union's repeated efforts at corporate integration and the effects of global economic integration of different systems, some have argued in favour of "convergence theory", maintaining that corporate governance systems all over the world are reforming towards the Anglo-American model of shareholding. This theory accounts for a tendency towards the rules that are objectively best by some efficiency standard. It identifies the main purpose of corporate law as minimizing the costs of

[38] Complementarities are an attribute of elements of a given system such as a corporate governance system, a financial system, the organizational or production system of a firm, or the system that constitutes the strategy of the firm. By definition, complementarities imply that partial changes with respect to individual elements do not result in an improvement if the starting situation is a local optimum. In practice this could mean that the relevant legal and business communities do not accept a given new legal advice or a non-standard corporate governance practice. The innovation might be discontinued or abolished again or simply not adopted. Stone 123

[39] Oliver Hart, 'An Economist's View of the Firm' 89 Columbia Law Review 1757 77

[40] Ibid 78

raising capital and discovering "the optimal rules to achieve this purpose"[41] either through parallel national developments or through the opening up of global markets. Advocates of this theory claim that it is important for nations who wish to enter the international arena – as exporters of goods or importers of capital – to adopt commercial and corporate rules similar to those of the leading players[42]. While they admit the efficiency of a number of corporate governance systems, they assume that, when dealing with a single larger market or "global" economy, corporations and their economies derive efficiency advantages if they have the same system of corporate governance as other participants in the market.

Parker argues pressure for further convergence is rapidly growing. The dominant ideology of convergence theory considers corporate law's principal task as increasing long-term shareholder value, since the best way to achieve social welfare is making corporate managers strongly accountable to shareholders' interests.[43] This shareholder-oriented model of corporate governance maintains that other corporate constituencies, such as creditors, employees, suppliers and customers should have their interests guaranteed by contractual and regulatory means rather than through participation in the corporate governance decision-making process.[44]

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[41] Klaus J. Hopt and Gunther Teubner, 'Corporate Fiduciary Duties and Their Beneficiaries. A functional approach to the legal institutionalization of corporate responsibility' in Klaus G. Hopt and Gunther Teubner (ed), *Corporate Governance and Directors' Liabilities* (Walter de Gruyter & Co 1985) 293

[42] Karin Buhmann, 'Corporate Social Responsibility: What Role for Law? Some Aspects of Law and CSR' 6 Corporate Governance: An International Review 188 294

[43]Christine Parker, 'Meta-regulation: Legal Accountability for Corporate Social Responsibility' in Aurora Voiculescu and Tom Campbell Doreen McBarnet (ed), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge University Press 2009) 33

[44]Dodd and Berle conducted a classic debate on the subject in the 1930s, in which Dodd pressed the social responsibility of corporate managers while Berle championed shareholder interests. Madsen;(CDCAC); Wooldridge; by the 1950s, Berle seemed to have come around to Dodd's celebration of managerial discretion as a positive virtue that permits managers to act in the interests of society as a whole; See Peter Cane, *Responsibility in Law and Morality* (Hart Publishing 2003). John Kenneth Galbraith takes a similar position in Halina Wrad, 'Corporate Social Responsibility in Law

Various economists and legal academics argue that the tendency towards convergence if a good level of regulatory framework already exists. They hold that law "matters" because it allows the investors feel more comfortable about holding a small percentage of shares in a company. Cheffins argues that one should not exaggerate the importance of the role of the law in the US and the UK since widely held companies developed without a great help from the law.[45]

Hansmann and Kraakman emphasized the failure of alternative models of corporate governance as a reason for the superiority of the shareholder-oriented model. According to them, the manager-oriented model fails due to the conventional wisdom that establishes that when managers are given great discretion over corporate investment policies they mostly end up serving themselves, no matter how well-intentioned they may be.[46]

As for the stakeholder-oriented model, the advocates of this model argue that stakeholders will be subject to opportunistic exploitation by the corporation if their rights are not included in and supported by the law. Based on this argument, Hansmann and Kraakman argue that if stakeholders' rights are supported by the law, then it is a legal obligation for the corporation, not a model of governance.

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and Policy' in Rachel Murray and Charlotte Villiers (Eds.) Nina Boeger (ed), *Perspectives on Corporate Social Responsibility* (Edward Elgar Publishing Limited 2008); In Parker 35

[45] Brian R. Cheffins, 'Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies' 23 Oxford Journal of Legal Studies 1

[46] Parker 37

The labour-oriented model[47] also fails because of the diversity of the workforce that naturally leads to the diversity in their claims. In most cases, this wide diversity will end in either a long process of reaching consensus or no consensus at all. Due to this flaw, Hansmann and Kraakman conclude that the labour-oriented model is very unlikely to be able to make an effective governing body and impairs the corporate decision-making process.[48] According to these two authors, the State-oriented model has lost attraction due to the sudden collapse of the leading presenters of this model, for example communism and the poor performance of Asian economies.[49]

Hansmann and Kraakman account for the superiority of the shareholder-value model further by asserting that the best way to protect investors' interests is through having the right to control since, unlike other participants' interests, it cannot be protected through contracts and regulations. At the same time, this control power will make them more motivated to maximize the value of the corporation, leading to more competitive advantages for the corporation.[50] They supported their arguments by examples such as the success of corporations that have followed the shareholder-value model – mostly incorporated in Common Law jurisdictions – as compared with the failure of corporations incorporated in East Asian and Continental European countries and which followed their corporate governance model.[51]

[47] Jeremy Moon and Wayne Visser Andy Lockett, 'Corporate Social Responsibility in Management Research: Focus, Nature, Salience, and Sources of Influence ' 43 Journal of Management Studies 115
[48] Parker 38; Some commentators, of course, continue to see co-determination as a core element of a unique Northern European form of corporate governance; See Mark S. Schwartz and Archie B. Carroll, 'Corporate Social Responsibility: A Three-Domain Approach' 13 Business Ethics Quarterly 503
[49] Parker 40
[50] Ibid 45
[51] Ibid 47; See also Stone

On the contrary, others challenge this predominant view among economists as well as law and economics scholars and support a continued diversity in corporate governance.[52] They argue there are multiple sets of efficient corporate governance institutions and each set is supported by different sets of underlying rules, various legal and non-legal norms and sanctions. Given that there are multiple efficient systems, there is no *prima facie* functionalist reason for convergence to occur. [53]

Cheffins and Bank also added taxes as the potential determinant of the ownership structure in big companies in the UK. They argues that profit, investment and inheritance taxes explain the reason why many block holders sought to exit resulting in disperse ownership.[54]

Cheffins and Bank give a historical overview with clear analysis of the role of taxes in social corporate governance. The conclusions that taxes play an important role in the ownership structure are very convincing and merit policy considerations at ministries of finance around the world. Capital gains taxes as well as dividend taxes play a key role in explaining corporate ownership and control. The introduction or changes of the tax treatment of entrepreneurs and closely held companies may trigger a sell-off, provided there is a capital market facilitating the change of ownership.[55]

Additionally, Cheffins argues that merger activity matters with respect to the US style of capitalism leading to the evolution of systems of ownership and control. According to him mergers in the US in the twentieth century were an agent for change for two

[52] Stone 114-115
[53]Teubner 293
[54] Brian R. Cheffins Steven A. Bank, 'Corporate Ownership and Control in the UK: The Tax Dimension' 70 MLR 778 18
[55] Ibid 40

reasons. Firstly, investor sentiment meaning that mergers caused the demand for corporate equity to go higher since investors were optimistic about the future prospects of newly founded companies. Secondly, anti-trust laws meaning that because of many anti-trust laws, companies were advised against cartel like businesses and advised to move towards mergers. Also, there were efficiency considerations as a result of the mergers.[56]

The UK experience confirms the US experience suggesting that that mergers are important since they affect the evolution of systems of ownership and control and "the manner in which anti-competitive behaviour is regulated influences the extent to which "transformative" merger activity takes place. The competitive advantages associated with operating on a large scale and the buoyancy of the stock market can influence the pace of corporate amalgamation" but in the UK neither factor had a major influence on the evolution of share ownership structures.[57]

Moreover, the developments regarding the regulation of anti-competitive behavior in the UK also provide a strong support for the argument that these regulations influences changes in ownership structure through mergers. "During America's great merger wave of 1897 to 1903, a legal bias against collusive arrangements seemingly acted as a catalyst for the amalgamations which provided a platform for the subsequent switch to dispersed ownership". The pattern was repeated in the UK.[58]

[56] Brian R. Cheffins, 'Mergers and Corporate Ownership Structure: The United States and Germany at the Turn of the 20th Century' 51 The American Journal of Comparative Law 473 480-485
[57] Brian R. Cheffins, 'Mergers and the Evolution of Patterns of Corporate Ownership and Control: The British Experience' European Corporate Governance Institute (ECGI) University of Cambridge - Faculty of Law 11
[58] Ibid 51

In the UK CSR was regarded as marginal, eccentric and largely dismissed by both proponents and critics of corporate capitalism became respectable from the early 1980s and is now firmly mainstream. "The rise of CSR can only be explained in the context of other major changes in society, the economy and political ideology. Among those changes are the increased criticism of the corporation, of course, CSR is reflective of much more profound changes. Indeed, the CSR phenomenon illustrates, and provides evidence for corporate political power. Every mention of corporate social responsibility is simultaneously an affirmation of market power and hence a recognition that perfectly competitive markets are an illusion".[59] Unless it is recognised that corporations have economic power, which can be translated into social and political power, then CSR is, by definition, nonsense. In a world of perfect markets CSR is impossible.

2.2.4 Globalization of Capitalism

Capitalism has been considered the root of the western economy in which big multinational corporations have prospered. This analysis of the globalization of capitalism will bring business enterprise back into the centre of comparative political economy and provide a deeper insight into the bone of contention in convergence theory debate.

Political economy is "a terrain populated by multiple actors, each of whom seeks to advance its interests in rational ways in strategic interactions with others", and corporations are seen as "actors seeking to develop and exploit core competencies and

[59] Stephen Wilks, *The Political Power Of The Business Corporation* (Edward Elgar Publishing Ltd 2013) 197

dynamic capabilities understood as capacities for developing, producing and distributing goods and services profitably".[60]

The conventional view of globalization, which argues that globalization is forcing nations to converge towards the Anglo-American model of corporate governance, is built on three pillars: First, this view assumes that corporations are almost similar, in terms of basic structure and strategy, and almost similar across nations. Second, it links up corporations' competitiveness with their labour costs, contending that many will move production abroad if they can find cheaper labour there. And, third, these structural similarities and production movements form a particular model of political economy inspired by globalization[61] and predicting substantial deregulation.

On the contrary, some scholars argue against the notion of convergence due to differences in social and economic national policies. Buhmann holds that the internationalization of trade and finance has not been as extensive or unexampled as is often believed and that the national governments are not as defenceless when faced with these developments as it seems. Many developing countries' governments have simply used international institutions to enter the global market and used the excuse of global pressure to propel reforms that they desired.[62]

For political economy, the principal issue raised by globalization concerns the stability of regulatory regimes and national institutions in the face of heightened

[60] Peter A. Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press 2001) 6
[61] Buhmann 55
[62] Ibid 56

competitive pressure.[63] This seems to be an especially important problem in nations where the powers of the State are highly concentrated in the political executive or where the influence of producer groups inside political parties is very limited.[64]

At the same time, corporations are tied to national politics due to the need of political settlements in order to reach social peace. Social peace is considered as the preliminary condition for productivity. The desired result of social peace is to reach to a social level in which managers, even without direct shareholder control, would take care of distant and minority shareholders. The ways to achieve this political settlement vary in different nations and this explains the variety in corporate governance structures all over the world.[65]

One of the most significant differences in corporate governance systems arising from differences in political systems is the degree to which ownership separates from control. When the world's richest nations are lined up on a left-right political flow and then on a close-to-diffuse ownership structure, the two correlate powerfully.[66] In other words, the left political continuum has concentrated ownership structures featuring weakly competitive markets, social democratic politics and significantly less managerial agency costs that makes diffuse ownership more costly for shareholders; the right political continuum has diffuse ownership structures matching fiercely competitive markets, conservative, almost *laissez-faire*, politics and high managerial agency costs.[67]

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[63] Ibid 55
[64] Ibid 48
[65] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 2
[66] Ibid 2
[67] Ibid 6

Another significant effect of politics on ownership structures is the fact that "it can determine who owns corporations, how big it can grow, what it can produce profitably, how it raises capital, who has the capital to invest, how managers or employees sees themselves and one another, and how authority is distributed inside the firm".[68]

Additionally, many analysts argue corporations' various economic performances or policies derive more or less directly from differences in the formal organization of the political economy.[69] The organization of a nation's political economy is inextricably bound up with its history in two respects: on the one hand, it is created by statutory-legal implementation means and their operating procedures; on the other, repeated historical experiences build up a set of common expectations that leads actors in certain directions in order to co-ordinate effectively with each other.[70] An illustrating example is the fact that the relationship between profit and a company's success in liberal market economies[71] allows firms to access capital, resist takeovers and lay off labour steadily due to a flowing labour market. By contrast, in co-ordinated market economies'[72] firms have access to capital independent of their current profit while lay-offs are difficult.[73] A highly developed stock market indicates greater reliance on market models of co-ordination in the financial sphere, and high levels of employment protection tend to reflect higher levels of reliance on non-market co-ordination.[74]

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[68] Ibid 1
[69] Buhmann 12
[70] Ibid 13
[71] In *liberal market economies* (LMEs), co-ordination occurs primarily through market mechanisms, e.g. the US.
[72] In *co-ordinated market economies* (CMEs) formal institutions play a much more central role in governing the economy and regulating firm relations with stakeholders; e.g. Germany.
[73] Buhmann 16
[74] Ibid 18-19

2.2.5 The Role of International Agencies

International agencies are often considered as a way of placing mechanical rules and basic institutional infrastructure for promoting international corporations in a nation; but these initiatives might induce a strong political backlash if that nation's underlying politics is not in line with those of international agencies. These differences will eventually lead to political instability and, over time, less productivity and less efficiency; hence, in order to implement changes, international agencies should focus on what can be changed and not to examine the political bedrock if changing it, at least in the short term, is impossible.[75]

International agencies should focus on promoting effective co-ordination between corporations of a nation in five aspects:

1. Bargaining wages and working conditions with the work force.
2. Securing workforce should be co-ordinated with suitable skills.
3. Accessing finance and assuring investors of returns on their investments.
4. Methods of promoting effective co-ordination between firms and stakeholders especially suppliers and clients in order to secure economic stability through securing demand for companies' products.
5. Promoting effective co-ordination between actors within corporations in order to achieve the objectives of the firm. [76]

[75] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 1
[76] Buhmann 7

Moreover, bringing change often requires the co-operation of those parties who control the corporation. And the fact that a change would be efficient would not ensure that controlling parties would always want it to occur. The controlling parties might prevent an efficient change if it reduces their private benefits. In other words, while a change might be efficient, if the controller does not capture the efficient change gains, that is unless the potential efficiency gains are substantially large, structures in place might persist.[77]

Similarly, if the possible efficiency and welfare gain brought about by changing an institutional arrangement is not sufficient to compensate the costs of adjustment, "society" might rationally retain the seemingly inefficient institutions.[78] A firm that can produce competitive products that can be sold can go on even with an outdated governance structure.[79] At the same time, global capital markets cannot generally be relied on to put managers under pressure to move to the most efficient ownership structure. "Many established companies do not use capital markets for funds, but rather finance themselves from retained earnings. When firms do not rely on external finance, their managers and controllers will not be constrained by capital markets".[80]

Additionally, factors other than corporate law need to be taken into consideration since "corporate law is not just the 'the-law-on-the-book' alone, but is 'law-on-the-book' plus the quality of the regulators and judges, the efficiency, accuracy, and

[77] Hart 80
[78] Buhmann 116
[79] Hart 101
[80] Ibid 92

honesty of the regulators and the judiciary, the capacity of the stock exchanges to manage the most egregious diversions, and so on".[81]

Similarly, the 'rules-on-the-books' could be very much the same in two nations but the quality of enforcement (because of a corrupt, incompetent or inefficient judiciary or regulatory system) might make corporate governance systems differ greatly. A flawed corporate law might work well in a system where contractual understanding and business practices counteract.[82] In other words, low-quality law might in some nations be a symptom of weak preparation for big corporations but not its base-line cause.[83]

2.2.6 The Role of the Law

Law can create or destroy formal arrangements so law is not irrelevant, but it is a second-order phenomenon. Other institutions primarily control the economic conditions of a country, including business conditions, incentives, professionalism, capital structure, and product and managerial labour market competition.[84] These institutions are the primary control, with the law just assisting or impeding.

According to Cheffins, however, one should recognize that even if corporate law does not have an important influence a country's corporate governance arrangements, other aspects of law could be relevant. For example, in the US and the UK being listed in the stock market might have been one of the reasons that the widely held company

[81] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 167
[82] Ibid 164
[83] Ibid 164
[84] Ibid 163

became the dominant business form. Stock exchange listing rules work as a binding contractual arrangement between the stock exchange and the company whose securities are being listed with clear legal implications.[85]

The primary source of the standard for commercial conduct is not legal rules, but extant social norms enforced by various non-legal sanctions.[86] What counts are not just general principles, but also all the particular rules implementing them; not just substantive rules, but also procedural rules, judicial practices, institutional and procedural infrastructure and regulators' enforcement capabilities. The concern is the corporate rules system "in action" rather than "rules-on-the-books".[87] The relatively worse performance of "rules-on-the-books" and structures might lead to their replacement only if decision-makers recognized that the rules and structures were indeed inefficient. Identifying which rules and structures are inefficient might be difficult not only for researchers but also for actual decision-makers.[88]

Existing legal rules might also have an efficiency advantage because institutions and structures might have already developed certain solutions to address needs and problem arising under these rules. In such a case, replacing the existing rules might make the existing institutional and professional infrastructure obsolete or ill-fitting. Replacing these rules would require new investments and adaptation to the new rules by different actors.[89]

[85] Cheffins, 'Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies' 11
[86] Teubner 295
[87] Hart 95
[88] Ibid 110
[89] Ibid 96

Moreover, legal rules are often the product of political processes combining public features and the interests of powerful economic-political groups. To the extent that interest groups play a role, each interest group will push for rules that favour it.[90] Control over corporate resources provides political power; therefore, the set of rules that might be easier to pass are those that would not directly lower those groups' interests[91], but instead simply allow transactional changes.[92]

Kenneth Dam also explores what problems economic transactions had to overcome to become viable and whether legal rules developed from common law traditions are as good as or better than legal rules developed from civil law traditions. The empirical setting for this second issue is sometimes framed as a chicken or egg question – must you have the legal framework in order to consummate the transaction or must you develop the economic framework before the legal framework? The answer is often an iterative process in which some transactions require the pre-existence of a legal framework in order for those transactions to be possible. Hedge funds, mortgage-backed securities and many other staples of modern financial transactions rest on a foundation of legally created (usually by statute) intangible rights that are enforceable by a court system. Nevertheless, it is clear that, historically, economic transactions preceded laws defining economic rights. [93]

Dam further emphasizes that the fact that the businessmen entre into transaction without an enforceable legal system which allows easy cheating is because the

[90] Ibid 97
[91] Rent-seeking occurs when an individual, organization or firm seeks to earn income by capturing economic rent through manipulation or exploitation of the economic environment, rather than by earning profits through economic transactions and the production of added wealth.
[92] Hart 104
[93] Kenneth W. Dam, *The Law-Growth Nexus: The Rule of Law And Economic Development* (Brookings Inst Pr 2006) 67

businessmen trust each other enough to enter into these transactions relies on the game theory experiments that show that players in a repetitive game (or set of transactions) generally find that cooperation produces more reliable and higher rewards than cheating. As Dam pointed out trust is the key element that makes market transactions possible, "but [the trust elements of transactions] are not commodities for which trade on the open market is technically possible or even meaningful." He correctly argues, "If everything must be treated in a book, nothing can be." [94]

Dam also noted that social understandings could be a barrier to adoption of western legal systems by traditional societies. He maintains that the theme that adoption of modern legal rules may not only not work, but may create problems that make the population worse off. He suggested that legal reform, as practiced by industrial technical assistance programs, should be careful not to create harm by "modernization." He further emphasizes that the development of modern transaction relationships took a long3 time to form and we should not expect commercial development in transitional economies to be quick or easily achievable. [95]

From a legal perspective, the question of convergence becomes an interesting one. Debates about legal convergence are concerned with what mechanisms actually bring about convergence and the possibility that the content of legal rules adapt to changed economic circumstances.[96]

[94] Ibid 86
[95] Ibid 275
[96] Teubner 296

Soskice[97] argues that bad and inefficient corporate law indirectly brings about economic losses in several forms. First, the prospect that managers might misuse their power leads to investors demanding a higher return as a security to their investment. As a result, investors choose corporations that are potentially able to generate this additional return. This practically means an increase in agency costs, which in turn increases capital cost. This situation might lead to the loss of some investment opportunities.

Another effect of bad corporate law, according to Soskice, is the fact that managerial efforts that should be spent on the business and socially productive purposes are instead diverted towards giving extra security to investors. This is because managers have problems raising capital since investors consider investing as high risk due to the fear of managerial expropriations.

Moreover, the fear of the need for careful, constant monitoring of managers and problems in raising capital prevents corporations from achieving optimal size. Corporations remain rather small. Only with small corporations can shareholders get enough information to make sure that they are not the victim of managerial expropriation.[98]

2.3 What is CSR?

Finding a definition for CSR is not just a matter of researchers trying to add conceptual precision. Defining CSR and its material scope is of utmost importance

[97] Soskice 301
[98] Buhmann 301

because different definitions represent different interests with different substantive concerns.

Horrigan has argued that CSR definition is "standpoint-dependent, context-sensitive and multi-textured".[99] It differs from one jurisdiction to another, from developed economies to developing economies and from the government's point of view to society's point of view.[100]

CSR began to take form in the 1950s. Murphy[101] has recognized four periods in which CSR evolved. First (up to the 1950s) was the "philanthropic" period in which CSR meant occasional charity work by corporations. Second (1953-67) was an "awareness" period in which social obligations of corporations were specifically recognized as CSR. Third (1968-73) was the "issue" period in which corporations focused more on specific issues, such as the environment and discrimination. And fourth (1974- till now) has been a "responsive" period in which corporations have taken serious management and organizational action to fulfil their social obligations and address CSR issues.

Despite the widespread discussion of CSR, one of the most controversial issues in CSR debates is its definition. For a concept that has been discussed for so long, it is strange that researchers still do not share a common definition or set of core principles. It has become increasingly difficult to determine what the definition of CSR is and what constitutes socially responsible behaviour. Some still even doubt

[99] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 37
[100] Wrad 12
[101] Patrick E. Murphy, 'An Evolution: Corporate Social Responsiveness' 6 University of Michigan Business Review 19

corporations should have social responsibilities in the first place. Similarly, empirical researchers have been unable to agree on the answer to the one question that has dominated CSR research probably more than any other over the past 30 years: whether CSR is good for business or not.

The problem with this lack of agreement and consistency in defining CSR and its material scope makes evaluating and comparing the findings from different studies very difficult.[102] Moreover, not having a particular definition for CSR has a rather significant effect in practice. In practice, managers need to have a proper definition to know what is expected from them and what the limits of CSR are otherwise they will not be able to answer to the calls for socially responsible behaviour. However, some have argued that the lack of a universal definition of CSR in itself should not necessarily be seen as a weakness for a field that is still in a state of emergence.[103] This situation allows managers to use different strategies to cover different aspects of CSR.

Lockett et al from their study of CSR literature over a ten-year period concluded that:

> "CSR knowledge could best be described as in a continuing state of emergence. While the field appears well-established … it is not characterized by the domination of particular theoretical approach, assumption and method."

[102]Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siege, 'The Corporate Social Responsibility Agenda' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siege (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 4
[103]Ibid 4

They suggested CSR is "a field without a paradigm".[104] It has been similarly argued that CSR would be better defined if it were seen as a process rather than as a set of outcomes.[105]

The main issue about defining CSR seems to be: "what responsibilities to society may businessmen reasonably be expected to assume?"[106] There seems to be agreement on considering CSR as voluntary actions that businesses can take above compliance with minimum legal requirements to address both its own competitive interests and the wider interests of society.

McWilliams and Siegel have argued that the most important feature of CSR is going beyond what law requires. They defined CSR as "actions that appear to further some social good, beyond the interests of the corporation and that which is required by law. CSR means going beyond obeying the law".[107]

CSR is a sensitive concept; a term that draws attention to a complex range of issues and elements that are all related to the position and function of the business enterprise in contemporary society. On the one hand, it focuses on how issues are internally and externally organized; on the other hand, it addresses the growing importance and influence of social issues.

[104]Ibid 6
[105] Thomas M. Jones, 'Corporate Social Responsibility Revisited, Redefined' 22 California Management Review 59 65
[106]Howard R. Bowen, *Social Responsibilities of the Businessman* (Harper & Row 1953) 11
[107] Abagail McWilliams and Donald Siegel, 'Corporate Social Responsibility: A Theory of the Firm Perspective' 26 The Academy of Management Review 117

Hayek sees the term "social" as unacceptably open-ended to be considered a responsibility. He argues that there is a wide range of issues which might be considered as socially responsible behaviour, involving political, charitable and educational issues.[108]

In response, McBarnet argued that "CSR is not philanthropy, contributing gifts from profits, but involves the exercise of social responsibility in how profits are made".[109] Corporations engage in CSR initiatives in order to be trusted within a society. Howard Bowen, often regarded as the father of CSR, defined the social responsibilities of "businessmen" as their obligations to "pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society".[110]

Some authors contend that CSR is not about how corporations spend their money and the pursuit of profitable business is not a non-socially-responsible thing in its own right. CSR sometimes even means making more profit; it is just a matter of long-term profit versus short-term profit. The emphasis of CSR is on how this money is made. Hu Li sees the beauty of CSR "in that it recognizes that changes in corporate governance and behaviour must be driven by re-conceptualizing self-interest in the marketplace in the light of the many social and environmental risks threatening sustainable profitability".[111]

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[108] Paul G. Mahoney, 'The Common Law and Economic Growth: Hayek Might be Right ' 30 Journal of Legal Studies 503 105-106
[109] McBarnet 2
[110] Bowen 6
[111] Hanson Hu Li, 'Finding Sustainable Profitability: the U.S. Financial Services Industry's Pursuit of Corporate Social Responsibility' 2 Corporate Governance Law Review 3

The challenge is to incorporate social expectations into internal actions while at the same time using the capabilities and capacities of the organisation to contribute to the traditional business role that is profit maximisation. Jonker suggests calling CSR the "interface management". He argues that "in pursuing such interface management an organisation not only produces private goods but also public goods. Public goods can be defined as the development of social, natural or intellectual capital which results in, for instance, a healthier, safer and more prosperous environment".[112]

McBarnet sees CSR as a change in corporation policies. Before, the focus was on profit maximization for shareholders but now it involves some responsibilities toward a broader range of stakeholders, such as protection of the environment, and accountability on ethical obligations. It is a shift from "a bottom line" to "triple bottom lines", in other words, a change from "profits" to "people, planet and profits", or indeed to "profits and principles".

Some authors have brought up the issue of "motive" in defining what constitutes socially responsible behaviour and whether it is necessary to have a genuine social motive, or whether a disguised business strategy designed to increase underlying profit would suffice. Dunfee argued that the answer to the issue of "motive" depends on the normative definition used. A duty-based approach holds that the intention underlying a particular action will be worthwhile if the motive behind it is that

[112] Jan Jonker, 'CSR Wonderland: Navigating Between Movement, Community and Organization'' 20 The Journal of Corporate Citizenship 19 2

intention. By contrast, a utilitarian approach holds that if the outcomes are the same, the acts count equally.[113]

In some contexts, "corporate social responsibility" is sometimes used interchangeably with terms such as "corporate citizenship", "responsible business", "corporate sustainability", and "triple bottom line" responsibility. Sustainability expert John Elkington famously described a "triple bottom line" as combining "economic prosperity", "environmental quality" and "social justice" in corporate strategies. Horrigan defined a sustainable corporation as "one that creates profit for its shareholders while protecting the environment and improving the lives of those with whom it interacts [and] operates so that its business interests and the interests of the environment and society intersect."[114]

While emphasizing the importance of sustainable corporations in today's world's intense global competition, Carroll argues that the business case for CSR will always be at the centre of attention since "CSR can be sustainable only so long as it continues to add value to corporate success". [115]

Carroll offers that "the social responsibility of business encompasses the economic, legal, ethical and discretionary expectations that society has of organizations at a given point in time". He categorized CSR into four layers in his famous "Pyramid of

[113]Thomas W. Dunfee, 'Stakeholder Theory: Managing Corporate Social Responsibility in a Multiple Actor Context' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 347-8
[114]Horrigan, '21st Century Corporate Social Responsibility Trends - An Emerging Comparative Body of Law and Regulation on Corporate Responsibility, Governance, and Sustainability ' 88
[115]Archie B. Carroll, 'A History of Corporate Social Responsibility: Concepts and Practices' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 42

Corporate Social Responsibility": first, the required economic function of making profit; second, the legal requirement of obeying the law; third, the expected ethical behaviour and fourth, desired philanthropic actions.[116] Jones recognizes three aspects for implementing CSR policies according to Carroll's "Pyramid of Corporate Social Responsibility": first, the "principles" aspect of recognizing social responsibilities; second, the "processes" aspect of responding to social issues; and third, the "policies" aspect of addressing those social issues. [117]

Johnson has argued that a socially responsible corporation is one whose managers balance a variety of interests, that is, "instead of striving only for larger profits for its shareholders, a responsible enterprise also takes into account employees, suppliers, dealers, local communities and the nation".[118]

Perhaps one of the best definitions of CSR that includes what is expected from corporations in terms of policies is the one by Hu Li. He argued that:

> "CSR refers to a way of doing business whereby enterprises try to find a state of equilibrium between the need to achieve financial and developmental objectives and the social and environmental impact of their activities. It is a mode corporations use to achieve commercial success in ways that also honour the ethical, legal, as well as environmental and other societal expectations. It considers a corporation not just a self-centered profit-making entity, but also an integral part of the economy, society and environment in which corporations exist".[119]

[116]Archie B. Carroll, 'The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders'' 34 Business Horizons 39
[117]Jones, 'Corporate Social Responsibility Revisited, Redefined' 34-35
[118]Carroll, 'A History of Corporate Social Responsibility: Concepts and Practices' 28
[119]Li 3

2.4 CSR Theories

Scholars have categorized CSR theories in different ways:

Klonoski[120] distinguishes three different types of CSR theories. The first is "fundamentalism", arguing that the only social responsibility of business is increasing profit; the second type of theories are those that defend the corporation's moral identity; a third group consists of theories that consider the social dimension of corporations as a particularly relevant matter.

Windsor[121] identifies three key approaches to CSR. First is the "ethical approach". According to this approach, corporations should exert strong self-restraint. Second is the "economic approach", which maintains that the main objective of corporations is wealth maximization and it is only subject to minimalist public policy and customary business ethic. Third is the "political approach", which considers corporations as citizens that have exactly the same rights and responsibilities as the latter.

Mele[122] suggests that the most complete of the contemporary mainstream theories of CSR are: A) Corporate Social Performance. This theory is grounded in sociology. B) Shareholder Value Theory or Fiduciary Capitalism. This theory is grounded in economic theories. C) Stakeholder Value Theory. This theory has an ethical approach. D) Corporate Citizenship. This theory is rooted in political theories.

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[120]Richard J. Klonoski, 'Foundational Considerations in the Corporate Social Responsibility Debate' 34 Business Horizons 9

[121]Duane Windsor, 'Corporate Social Responsibility: Three key approaches' 43 Journal of Managment Studies 93

[122] Domence Mele, 'Corporate Social Responsibility Theories' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 48-49

The answer as to what is the best theory is not easy. As some strengths and weaknesses of each theory will be enumerated, and arguments in favour of and against each one will be demonstrated, one should bear in mind that: "A good normative theory needs a good philosophical foundation, which has to include a correct view of human nature, business and society, and the relationship between business and society. In future one may hope for further philosophical developments in order to reach a more convincing normative theory of business and society relations".[123]

2.4.1 Corporate Social Performance

This theory maintains that corporations have responsibilities for helping to solve social problems created by corporations in general or by other causes, apart from wealth creation and beyond its legal responsibilities.

The advocates of this theory stress that corporations have power and with power comes responsibility. They also emphasize that society gives permission to corporations to operate. Consequently, corporations must serve society by creating wealth, contributing to social values and satisfying social expectations. In other words, improving corporate social performance "means altering corporate behaviour to produce less harm and more beneficial outcomes for society and their people".[124]

[123] Ibid76
[124] Donna J. Wood, 'Toward improving corporate social performance' 34 Business Horizons 66 68

Davis further explains "the power-responsibility equation". He states that "social responsibility of businessmen arises from the amount of social power they have", an "equation" which goes along with the "iron law of responsibility". This law emphasizes that "those who do not take responsibility for their power shall ultimately lose".[125]

At the core of this approach lies the idea that business and society are two interwoven systems; therefore, since corporations exist and operate in a shared environment, they should be socially responsible like any other member of that environment. A corporation would risk its reputation if its performance were contrary to the expectations of those people who constitute the corporation's social environment.[126]

2.4.2 Shareholder Value Theory

Shareholder Value Theory or Fiduciary Capitalism strongly argues that the only social responsibility of business is making profits and its supreme goal is to increase the economic value of the corporation for its shareholders. Other social activities that companies could engage in would only be acceptable if they are prescribed by law or if they contribute to the maximization of shareholder value.[127]

Milton Friedman is the paramount representative of this view. He wrote: "there is one and only one social responsibility of business – to use resources and engage in activities designed to increase its profits so long as it stays within the rules of the

[125] Mele 52
[126] Ibid 52
[127] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 93

game, which is to say, engages in open and free competitions, without deception or fraud".[128] He also considered the businessmen who are promoting "social conscience" for business as "preaching pure and unadulterated socialism" and accused them of undermining the basis of a free society.[129]

In order to support his claim, Friedman questioned the conceptual basis of CSR and maintained that taking CSR initiatives equals imposing extra tax on shareholders since they have already paid tax as citizens under the tax regulations of the government; therefore, CSR initiatives are a sort of double taxation. Moreover, a manager who is either directly or indirectly chosen by shareholders is imposing this CSR tax and decides how this money should be spent. In other words, this private employee is functioning as a public employee, legislator and an executive who should be chosen through a democratic political process. He wrote: "this process raises political questions on two levels: principle and consequences. On the level of political principle, the imposition of taxes and the expenditure of tax proceeds are governmental functions. We have established elaborate constitutional, parliamentary and judicial provisions to control these functions, to assure that taxes are imposed so far as possible in accordance with the preferences and desires of the public"[130], concluding that doctrine of social responsibility is preaching the socialist view that "political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses".[131]

[128] Milton Friedman, *The Social Responsibility of Business is to Increase its Profits* (1962) 6
[129] Ibid 1
[130] Ibid 2
[131] Ibid 3

Friedman drew a line between business as a whole and corporations, believing that it makes no sense to say business as a whole has any responsibility but since corporations are artificial persons, they can have artificial responsibility within the scope of law, ethical custom and the will of its shareholders. He wrote: "in a free-enterprise and private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires".[132]

On the contrary, Stout claimed that academics created the shareholder value theory based on a mistaken belief that shareholders are the firm's owners. Stout argued that corporations own themselves because corporations, through their managers, decide how to allocate profits. She rejected the notion that shareholders are a corporation's residual claimants. Because, according to Stout, shareholders have no more of a readily exercisable claim to the firm's assets than any other corporate constituent, their interests should not be pursued above all others when determining what is best for the corporation. The corporation's interests may include a broader range of outcomes than simply shareholder wealth maximization.[133]

Stout further argues that there is nothing in the law that supports the idea that shareholders should be the only constituency that matters. She stated that "the reason [for corporate underperformance] can be traced not to flawed individuals (greedy CEOs, out-of-touch directors) but to a flawed idea — the idea that corporations are

[132]Ibid 1

[133] Lynn Stout, *he Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Berrett-Koehler Publishers 2012) 49

run well when they are run to maximize 'shareholder value' as measured by stock price."[134]

Many sceptics of CSR and some economists[135] share Friedman's perspective. They argue that the market, not the managers, should allocate resources and returns. They are also concerned that acceptance of CSR by corporations may put market-effective functioning at risk of losing its effectiveness. They consider the market superior to corporations in the efficient allocation of resources, whereas if allocation of resources is left to managers, they may lead companies in favour of their own interests instead of shareholder interests.

Friedman's perspective was shaped on utilitarian and accountability approaches. His utilitarian approach is that political representatives and public officials are trained for and experienced in addressing public policy issues, whereas business managers are trained for and experienced in managing business organizations. His accountability approach is grounded is his presumption that business managers' prime responsibility should be to company shareholders, who generally expect profits, while "in democratic systems the accountability of the government officials to the electorate is secured through elected political representatives".[136]

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[134] Ibid 87

[135] Friedrich A. Hayek, 'The Corporation in a Democratic Society: ln Whose lnterest Ought lt and Will lt Be Run' in Melvin Anshen and George Leland Bach (ed), *Management and Corporations 1985* (McGraw-Hill 1960) 100

[136] Jeremy Moon and David Vogel, 'Corporate Social Responsibility, Government, and Civil Society' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 304

Husted and Salazar take Friedman's argument to another level by arguing that CSR should be seen as a wealth transfer from the shareholders to society.[137] Further, as they and McWilliams and Siegel view it, corporations that provide CSR will likely have higher costs, putting them at competitive disadvantage vis-à-vis corporations that eschew such expenditure.[138] Both pairs of authors come up with similar solutions. McWilliams and Siegel advocate that "(t)o maximize profit, the firm should offer precisely that level of CSR for which the increased revenue (from increased demand) equals the higher cost (of using resources to provide CSR)". Husted and Salazar advocate that "firms provide CSR resources up to the point that the social curve intersects the social benefit curve".[139]

Dunfee believes that Friedman's argument against social responsibility is strange. He argues: "if this is all illegal or inappropriate activity, then the relevant authorities must be asleep at the switch. So a better way to view the Friedman argument is that they are just that, arguments about a way they would prefer to see the world structured. But that is not the world that we live in. Nor is it likely a world that most citizens would prefer to live in. True, there are some agency abuses by executives, and yes, much philanthropy is incoherent and unfocused. But that does not mean that society would prefer that all firms cancel their programs of social investment".[140] But what Dunfee fails to explain is that Friedman gave his view of the world we live in, but Dunfee only refuses Friedman's outlook without suggesting any other views. At the same time, Friedman accounted for "justifying" CSR initiatives by profit-making goals or

[137] Bryan W. Husted and José de Jesus Salazar, 'Taking Friedman Seriously: Maximizing Profits and Social Performance' 43 Journal of Management Studies 75 142
[138] Siegel 310
[139] Dunfee 351
[140] Ibid 351

the law. He did not call for "cancellation" of all CSR programmes as Dunfee presumed.[141]

Theodor Levitt, who was the editor of the *Harvard Business Review*, considered corporate social responsibilities a danger. He argued that "corporate welfare makes good sense if it makes good economic sense – and not infrequently it does. But if something does not make economic sense, sentiment or idealism ought not to let it in the door".[142] He quoted Frank O. Prior, the then Chairman of Standard Oil Company (Indiana), who said that "Good human relations makes sense only when it rests on a foundation of economic good sense and not just on sentiment. Sentiment has a tendency to evaporate whenever the heat is on. Economic good sense is durable".[143] Levitt continued by arguing that the reason behind this style of corporate governance and even capitalism is the separation of power. He goes to the extreme by arguing:

> "Welfare and society are not the corporation's business. It is business making money, not sweet music. The same goes for unions. Their business is "bread and butter" and job rights. In a free enterprise system, welfare is supposed to be automatic; and where it is not, it becomes the government's job. This is the concept of pluralism. The government's job is not business and business's job is not government. And unless these functions are resolutely separated in all respects, they are eventually combined in every aspect. In the end the danger is not that the government will run business, or business will run the government, but rather that the two of them will coalesce, as we saw, into a single power, unopposed and unopposable".[144]

He further holds that social responsibility means having sentiments as a motive in business and will mislead the role of business while profit-maximization will mislead the role of the government. In the end, he recognizes two responsibilities for business:

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[141] Ibid 355
[142] Theodore Levitt, 'The Dangers of Social Responsibility' 36 Harvard Business Review 41 42
[143] Ibid 42
[144] Ibid 49

first, to obey the elementary canons of everyday face-to-face civility (honesty, good faith, and so on) and second, to seek profit. [145]

Advocates of shareholder value theory further supported their point of view by the following arguments:

1. Business is considered as a private and autonomous activity only restricted by the regulations of the government. Private property is crucial, since it is considered the best guarantee of individual rights and owners are legally entitled to the (residual) fruits of their financial investment and any other use is unjust. "One could argue that shareholders achieve primacy through the moral force of their property rights, the contribution of their equity capital, and the risks that investment can mean for their personal wealth".[146] Furthermore, stakeholders often purchase shares of a corporation's stock to enjoy the same rights and ownership privileges. This point of view has been challenged by some scholars who have argued against the notion of applying private property rule to corporations. Deakins argued that "if we take the company to be the fictive legal entity which is brought into being through the act of incorporation, it is not clear in what sense such a thing could be 'owned' by anyone. Nor does the ownership of a share entitle its holder to a particular segment or portion of the company's assets, at least while it is a going concern".[147]

[145] Ibid 49
[146] Jill A. Brown and Kareen M. Shabana Ann K. Buchholtz, 'Corporate Governance and corporate Social Responsibility' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 328
[147] Simon Deakin, 'The Coming Transformation of Shareholder Value' 13 Corporate Governance: An International Review 11 11-12

2. Some of the proponents of shareholder value theory base their arguments on efficiency grounds, suggesting that shareholder value theory creates the best environment for the creation of wealth and is the basis for economic growth. Profit maximization as the primary objective of the corporation acts as an incentive for businesses to create the goods and services demanded by consumers. Asking managers to deal with social concerns will either distract them from their main task or requires them to take decisions on an issue about which they do not have any knowledge or experience. Directors as entrepreneurs are experienced in business matters, not in balancing social interests.[148] The negative social impacts of business can be avoided through appropriate laws and government actions, along with private charity.

3. Shareholder value theory allows corporations to be accountable to their owners. It has been argued that according to other theories managers are not ultimately answerable to any particular group of persons, while in shareholder value theory they are accountable to shareholders since this clear accountability also provides for an efficient monitoring system.[149]

4. By creating wealth, businesses meet other social objectives, for example: providing employment and producing goods, enhancing competition and therefore bringing higher quality goods and lower prices.[150]

[148] Ibid
[149] Ibid 15-17
[150] Sarah Kiarie, 'At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?' 17 Internationa Company and Commercial Law Review 329 3

In sum, it has been argued that social concerns affect the business decision-making process in three ways: first, managers might decide to get involved in social values in hope of better economic gain; second, regulations and auditing, and third, consumer choices.[151] But the current findings[152] suggest that first, the bigger the corporation is and the more the executive pay is, the less attention their board of director pays to socially responsible activities. Second, in a capitalist system while regulations can affect the corporations' decisions, significant decisions are fully at the discretion of the corporation itself. This means that governments still lack the public legitimacy to more strictly influence the decision-making process within corporations. Moreover, corporate lobbying influences the government itself. Similarly, governments do not have enough information to act on time in order to hold corporations accountable. The regulation process is costly and time-consuming. Additionally, more regulation leads to the public sector trying to monitor, and the private sector trying to find loopholes to escape the regulations. Third, the motivation of consumer choice is not convincing[153] since it is not clear enough why one would prefer more socially responsible products, taking into account the fact that they are usually more expensive than the normal products. Even with similar pricing, the question remains the same. If consumers are not well informed and sufficient advertising has not been done, it is highly improbable that a consumer would even notice this difference. "As many have shown, free-market capitalism was never intended to represent the public will; it was intended to describe how to make a return on financial investment".[154]

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[151] Timothy Kuhn and Sranley Deetz, 'Critical Theory and Corporate Social Responsibility: Can/Should We Get Beyond Cynical Reasoning?' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008)178

[152] Ibid 178

[153] Ibid 176

[154] Ibid 177

Some scholars went so far as arguing there is no longer any serious competitor to the view that corporate law should principally try to increase shareholder value.[155]

Hansmann and Kraakman contended that the five basic characteristics[156] of corporations strongly feature shareholder value theory. These characteristics are not directly concerned with the interests of other participants in the firm, such as employees, creditors, other suppliers, customers or society at large. These stakeholders should have protected their interests by contractual and regulatory means rather than through participation in corporate governance.[157]

They further argue that:

> "The primacy of shareholder interests in corporate law does not imply that the interests of corporate stakeholders must or should go unprotected. It merely indicates that the most efficacious legal mechanism for protecting the interests of non-shareholder constituencies – or at least all constituencies other than creditors – lie outside of corporate law".[158]

On the contrary, Mele argued that the limitations imposed on business by the law have very limited and even sometimes-imperfect influences. It is neither possible nor convenient to regulate everything in business life. Furthermore, laws generally come after some undesirable impact occurs. Moreover, loopholes can easily be found in the law and many regulations strangle business creativity and entrepreneurial initiatives.

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[155] Henry B. Hansmann and Reinier H. Kraakman, 'The End of History for Corporate Law' in Jeffrey Gordon and Mark J. Roe (eds) (ed), *Convergence and Persistence in Corporate Governance* (Cambridge University Press 2004) 34

[156] Those features, which continue to characterize the corporate form today, are: (1) full legal personality, including well-defined authority to bind the firm to contracts and to bond those contracts with assets that are the property of the firm as distinct from the firm owners; (2) limited liability for owners and managers; (3) shared ownership by investors of capital; (4) delegated management under a board structure; and (5) transferable shares.

[157] Kraakman 35

[158] Ibid 43

In addition, a strong interventionism with laws, rules and other governmental actions is opposed to a minimalist regulation of markets, also required for strong free competition". [159]

Kuhn and Deetz argued that the current picture of corporations in the human mind is due to the "communicative picture of a particular vision of reality that dominant powers depict as legitimate and reproduce across space and time".[160] That is, as time goes by, the historical patterns that a social phenomena has gone through to take its current form and how a certain practice has been portrayed as a response to these social needs will be forgotten and the phenomena will be considered natural; therefore, one can argue that the problem truly lies within the assumed nature of the corporation. Clemens and Cook define institutions as "models, schemas, or scripts for behaviour. "Consequently, institutions endure because these models become "taken for granted" through repeated use and interaction or they become "legitimate" through the "endorsement of some authoritative or powerful individual or organization".[161]

For the purpose of this thesis, the corporate goal of profit maximization would make a good example. As it has been argued, this goal "was originally an assumption introduced by economic theories of the firm to explain the firm's behaviour, but – as an unintended consequence – it has gradually become a normative goal of corporate governance so firmly entrenched that we rarely think otherwise".[162] Indeed, this

[159] Mele 61-62
[160] Deetz 178, in Ibid.
[161]David. L Levy and Rami Kaplan, 'Corporate Social Responsibility and Theories of Global Governance: Strategic Contestation in Global Issue Arenas' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 437
[162] John R. Boatright, 'Business Ethics and the Theory of the Firm' 34 American Business Law Journal 217

process that the modern market has gone through "makes it difficult to see firms and their "imperatives" as anything but natural and normal elements of the social scene and, in turn, to see their social influence as legitimate".[163]

2.4.3 Stakeholder Theory

Stakeholder theory draws on the definition of "stakeholder". One might mistakenly assume that after all these years there is fundamental agreement regarding such a critical term and concept. In fact, it appears that there is more consensus on the definition of CSR compared with the one for stakeholders. All definitions explicitly or implicitly suggest that the stakeholder has some interest in the corporation's decisions in a way that the corporation can have an effect, positive or negative, on the stakeholder.

Stakeholder theory was first presented as a managerial theory. For the purpose of this thesis, a stakeholder is one who has an interest in the enterprise and who is at risk if it fails. It might consist of an employee, a creditor, suppliers and a community that are all in a position where they have a stake in the enterprise's sustainability.[164]

Stakeholders can be taken in two senses: in a narrow sense, the term stakeholder includes those groups who are vital to the survival and success of the corporation; in a wider sense this includes any group or individual who can affect or is affected by the corporation.[165]

[163] Deetz 178
[164] Deakin 12
[165] Mele 64

Stakeholder theory aims at broader accountability for corporations. It maintains that no group that has contributed to corporate success should remain unrecognized. The advocates of this theory argue that shareholders are but one of many stakeholders and contend that employees and other constituencies' interests should be considered in the corporate decision-making process.[166] The success of a corporation depends on stakeholders as much or even more than it does on shareholders.[167] Jensen doubts the practicality of stakeholder theory since the advocates of this theory do not specify how managers should handle the competing interests of different stakeholder groups. Managers are left with a theory "that makes it impossible to make purposeful decisions" and keep score of managers' decisions. This will make managers "unaccountable for their actions".[168]

Similarly, Jensen famously argued that it is impossible for managers to seek to maximize more than one meaningful objective. This objective is long-term value maximization or value-seeking. Jensen then connects this principle to stakeholder theory through what he calls Enlightened Stakeholder Theory. Jensen states: "(E)nlightened stakeholder theory adds the simple specification that the objective function of the firm is to maximize total long-term firm value".[169] While enlightened stakeholder theory appears to utilize the structure of stakeholder theory, it also "accepts the maximization of long-term value of the firm as a criterion for making the requisite trade-off among its stakeholders".[170]

[166] Janice Dean, 'Stakeholding and Company Law' 66 Company Lawyer 67 66
[167] Kiarie 5
[168] Michael C. Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function ' 14 Journal of Applied Corporate Finance 4 in Abstract
[169] Ibid
[170] Ibid in Abstract

When talking about stakeholders, the first thing that comes to the surface is the question of legitimacy; that is, why the managerial team in a corporation needs to include stakeholders in their decision-making. In answer to this question, it is argued that stakeholders, if not included, will be subject to opportunistic exploitation by the corporation and its shareholders. Moreover, running a successful corporation involves balancing the multiple claims among which conflicting stakeholders' interests is an important one. If stakeholders feel insecure, they will ask for more return as a guarantee for investments or services. This situation will lead to an increase in capital-raising costs which, since most corporations cannot ensure that they make this surplus profit, will lead to less investment and less opportunities for the corporation.[171]

Evan and Freeman base the legitimacy of the stakeholder theory on two ethical principles: "Principle of Corporate Rights" and "Principle of Corporate Effects". Both principles are based on Kant's motto of Respect for Persons[172]. The "Principle of Corporate Rights" holds that "the corporation and its managers may not violate the legitimate rights of others to determine their future". The "Principle of Corporate Effects" focuses on taking responsibility for the consequences of one's actions, holding that "the corporation and its managers are responsible for the effects of their actions on others". [173]

[171] Dunfee 350

[172] Kant thought that humans occupy a special place in creation. Animals have value in so far as they serve humans' purposes. Things only have the value that humans give them. Humans cannot be used as a means to an end but animals can. Humans have dignity because they are rational agents capable of making their own decisions and guiding their conduct by reason; therefore, we have the duty of beneficence, doing good, to all persons.

[173] William R. Evan and R. Edward Freeman, 'A stakeholder theory of the modern corporation: Kantian capitalist' in Norman Bowie and Denis Arnold Tom L. Beauchamp (ed), *Ethical Theory and Business* (Prentice Hall 1988) 140

Stakeholder theory seems ethically superior to maximizing shareholder value because it implies that managerial duties are wider than just their fiduciary duties to shareholders. It takes into consideration stakeholder rights and their legitimate interests beyond what is strictly required by law in manager-stakeholder relations. This theory, at least in its original formulation, is more respectful of human dignity and rights.[174]

Another positive point of stakeholder theory is that it fills in the conceptual gap and obscurity of current CSR theories by addressing concrete interests and practices and demonstrating specific responsibilities towards specific groups of people affected by business activity. Therefore, it is not a mere ethical theory disconnected from business management, but a managerial theory related to business success.[175]

In the same fashion the UK law in Hutton v West Cork Railway emphasize that the value of the judgment today lies in the general doctrine that during the life of the company, it may conduct itself in a way which benefits stakeholders other than shareholders, but only insofar as that will in the end, albeit indirectly, be in the shareholders' interest. [176]

The facts of the case were that a railway company which had no provision in its articles for paying remuneration to directors, and had never paid any, sold its undertaking to another company at a price to be determined by an arbitrator. By the Act authorizing the transfer it was provided that on the completion of the transfer the

[174] Ibid 140
[175] Mele 66
[176] Ben Pettet, 'From Cake and Ales to Corporate Social Responsibility' 20 Current Legal Problems 289

company should be dissolved except for the purpose of regulating their internal affairs and winding up the same and of dividing the purchase-money. The purchase-money was to be applied in paying the costs of the arbitration and in paying off any revenue debts or charges of the company, and the residue was to be divided among the debenture holders and shareholders. After the completion of the transfer a general meeting of the company was held at which a resolution was passed to apply £1050 of the purchase-money in compensating the paid officials of the company for their loss of employment, although they had no legal claim for any compensation, and £1500 in remuneration to the directors for their past services.[177]

Cotton LJ and Brown LJ held that the money payment was invalid. In the course of his dicta, Bowen LJ held that there is "…a kind of charitable dealing which is for the interest of those who practise it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose."

So according to Bowen LJ, directors can only spend, "money which is not theirs but the company's, if they are spending it for the purposes which are reasonably incidental to the carrying on of the business of the company. That is the general doctrine. Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational… It is for the directors to judge, provided it is a matter which is reasonably incidental to the carrying on of the business of the company… The law does not say that there are to be no cakes and ale,

[177] *Hutton v West Cork Railway Co 23 Ch D 654* LR 23

but there are to be no cakes and ale except such as are required for the benefit of the company."[178]

The upshot for a company in insolvency was that directors were not free to make payments to employees, because payments could only be made which were incidental to the business, and an insolvent business had no further business. In English law, the position has been altered by the Insolvency Act 1986, s.187 and the Companies Act 2006, s.247, which allow directors to consider employees directly when a company has gone insolvent.[179]

The case's practical significance was limited by cases and statute as in *Re Horsley & Weight Ltd* where the Court of Appeal held that a company's substantive object may include making gifts, and under CA 2006 section 172 which entitles and obliges directors to regard interests other than shareholders as a proper exercise of their power.[180]

Hansmann and Kraakman have criticized the practicality and proper functioning of stakeholder theory. They recognize two models of stakeholder participation: first, a "fiduciary" model where the board of directors functions as a neutral co-ordinator of the contributions and returns of all stakeholders in the corporation. They argue that this type is just a reformulation of the manager-oriented model, and suffers from the same weaknesses.

[178] Ibid LR 23 Ch D 654
[179] Pettet 297
[180] *Re Horsley & Weight Ltd 3 All ER 1045* CH 442 and Pettet 302

Second, a "representative" model of the corporation where two or more stakeholder constituencies appoint representatives to the board of directors.[181] According to Hansmann and Kraakman, this type also closely resembles labour-oriented model and is subject to the same weaknesses. "The mandatory inclusion of any set of stakeholder representatives on the board is likely to impair the corporate decision-making process with costly consequences that outweigh any gains to the groups that obtain representation".[182]

2.4.4 The Agency Theory

This theory assumes that the predominant underlying assumption for understanding the governance framework of publicly traded corporations is that managers will operate with self-serving motivations; this stems from agency theory, which is derived from economics.

Friedman, who originally framed the issue of socially responsible versus profit maximizing behaviour in terms of whether business managers should be what he called "civil servants" or alternatively agents of their shareholders, further developed this theory. Basically, Friedman argues that managers as agents owe the owners of the corporation, the shareholders, a duty to pursue their interests. In other words, managers should spend corporations' money in the way its owners would want. To the extent that CSR activities do not accord with the desires of shareholders, the agent violates that duty. His argument is a moral one, arguing that it is unethical for a

[181] Kraakman 42
[182] Ibid 42

corporate manager or an agent to engage in CSR activities because the agent violates his or her duty to act in the interests of the principals (the shareholders).

"An agency relationship may be defined as a contract in which a principal engages an agent to perform a service on their behalf; this necessitates the delegating of some level of decision-making authority to the agent".[183] Agency models have two actors: the principal and the agent. The principal delegates authority to the agent to act on his or her behalf. The principal's problem is to motivate the agent to do what he or she was asked to do. The costs associated with motivating the agent to act on behalf of the principal are referred to as agency costs. This issue arises due to the fact that the agent has more information than the principal. Agency theorists generally assume that managers will pursue their own interests whenever possible, rather than those of the principal.[184]

While agency theory focuses on the actions managers might take that are not in line with the shareholder's interests, "managerial hegemony theory", in line with agency theory, focuses upon the significant control managers can have over the board election because of the information they have about the corporation's business and how that can enable managers to maximize their own self-interest. When managers are able to control boards of directors, the opportunity for them to pursue their own self-interest is high.[185]

[183] Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' 3 Journal of Financial Economics 305
[184] Salazar 144
[185] Ann K. Buchholtz 333

By contrast, "stewardship theory" argues that the agency theory is incomplete and assumptions about the manager as self-interested will not always hold. It follows the pattern from psychology and sociology to adopt a different model of man, who can be collectivist, pro-organizational and trustworthy. [186]

Generally speaking, it is expected that the severity of agency costs will lessen in CSR activities compared to business activities for two reasons:

1. Due to limited knowledge and the lack of consensus about what constitutes best CSR practice and its impact on society and the corporation, one might argue initially that managers (agents) do not have a greater level of knowledge than shareholders (principals) in this area. If this statement is correct, the problem of asymmetric information would be less severe in CSR investments than in those associated with the traditional business activities of the corporation where the managers have a greater knowledge than the shareholders.

2. Moral hazard occurs when the objective function of the agent differs from that of the principal. If shareholders' (principal) values hold that the corporation should contribute to social causes due to altruism, then the agent may undertake actions even if they result in negative result for the corporation. In contrast, if the contract between the principal and agent includes an incentive mechanism that depends only on the financial returns obtained, then the objective functions of the principal and agent will differ and moral hazard will arise.[187]

[186] F. David Schoorman and Lex Donaldson ames H. Davis, 'Toward a Stewardship Theory of Management' 22 he Academy of Management Review 20
[187] Salazar 144-146

Agency costs appear to be lowest, it has been argued[188], in the case where the government makes CSR activity an obligation for the firm. This result might be used to support CSR legislation as it is being proposed in different countries. To the extent that legislation reflects societal needs, the conflict between what shareholders believe are social needs and what these needs actually are, can be reduced.

According to Stout, the common but misleading claim that directors and executives are shareholders' "agents" is a legal error underlying shareholder primacy. At law, a fundamental characteristic of any principal/agent relationship is the principal's right to control the agent's behaviour. But shareholders lack the legal authority to control directors or executives. Traditionally, shareholders' governance rights in public companies are limited and indirect, including primarily their right to vote on who sits on the board, and their right to bring lawsuits for breach of fiduciary duty. As a practical matter, neither gives shareholders much leverage. Even today it remains very difficult for dispersed shareholders in a public corporation to remove an incumbent board.[189] And shareholders are only likely to recover damages from directors in lawsuits involving breach of the duty of loyalty, meaning the directors were essentially stealing from the firm. Provided directors do not use their corporate powers to enrich themselves, a key legal doctrine called the "business judgment rule" otherwise protects them from liability.

2.5 CSR and Corporate Financial Performance (CFP)

[188] Ibid 149
[189] Stout 44-46

The search for a positive link between CSR or related concepts like social performance and financial performance has spawned an abundant literature, the results of which remain somewhat inconclusive, with some authors discovering a positive relationship between social performance and financial performance, others encountering a negative relationship, and still others finding no relationship. Still, there appears to be a growing consensus in the business community that CSR is good for business.[190] The business case has re-emerged more recently as a discussion of strategic CSR, a concept that Friedman himself would have called "hypocritical window-dressing; but consistent with profit-maximizing behaviour of the corporation".

The grounds for arguments in favour of a positive relationship between social performance and financial performance are:

1. It has been argued that CSR seems to reduce business risk[191] by having a positive effect on organizational reputation in the long run.

2. Some have argued that the empirical evidence shows CSR and Corporate Financial Performance are most likely correlated in a sense that CSR helps improve managerial knowledge and skills and therefore enhances corporate reputation. By balancing a large number of stakeholder interests, a corporation may increase various stakeholder groups' confidence that the corporation will be understanding and non-adversarial in resolving future stakeholder conflicts.[192] CSR and CFP may influence one another in

[190] Salazar 138
[191] Benjamin M. Orlitzky, 'Corporate Social Performance and Firm Risk: A Meta-analytic Review' 45 Business & Society 149
[192] Jones, 'Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics' 404

a way that good managers are capable of taking positive strategic action in both economic and social domains. Astute managers are able to identify and implement specific CSR activities through which their organization's reputation can be enhanced in social or environmental domains. They also ensure that slack resources are invested wisely to promote these opportunities.[193]

3. Stakeholders may favour socially responsible corporations in which they are constructively engaged.[194]

4. The more socially responsible are the corporations, the better and more committed employees they may attract.[195]

5. Other groups of stakeholders, such as customers, may become more willing to buy the corporation's products or pay a premium for the goods from socially responsible corporations.

6. Additionally, and in line with the above-mentioned literature, the meta-analytic findings suggest "a business can develop mutually beneficial relations with stakeholder groups, which might pay off surprisingly fast for the socially responsible firm. In turn, these positive economic effects of CSR might translate into more slack resources available for future investments in CSR. Over time, these dynamics might constitute a virtuous cycle for the socially responsible firm".[196]

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[193] Benjamin M. Orlitzky, 'Corporate Social Performance and Financial Performance: A research Synthesis' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 123
[194] Ibid
[195] Ibid
[196] Ibid 117

By contrast, some have argued against the over-emphasized positive relationship between CSR and CFP on the following grounds:

1. Evidence suggests that at present many consumers, especially US consumers, are not particularly concerned about a corporation's environmental track record.[197]

2. The integration of prior CSR-corporate financial performance research shows that, "although the internal skills perspective is substantiated empirically to some extent, the internal learning effects of CSR tend to be 33% smaller than the reputation affects emanating from high CSR".[198]

3. It is true that certain customer segments, such as members of socially responsible groups or older people, have been found to be willing to pay premium prices for products from high-CSR corporations, but these purchasing decisions cannot be generalized to the whole population of consumers.[199]

4. High levels of CSR may provide the slack resources necessary for a corporation to engage in corporate social responsibility; at the same time, CSR often represents an area of relatively high managerial discretion, so that the initiation and maintenance of voluntary social and environmental policies may depend on the availability of excess funds. In other words, no matter how much the executive leadership and organizational culture is supportive of CSR, the primary condition to use their discretion is profits and thus slack resources represent the necessary conditions for

[197] Gunthe 70
[198] Orlitzky, 'Corporate Social Performance and Financial Performance: A research Synthesis' 119
[199] Orlitzky, 'Corporate Social Performance and Firm Risk: A Meta-analytic Review' 149

high CSR. That is, a corporation's prior profit level, if it is low, may act as a factor inhibiting CSR activities and investments.[200]

In sum, these evidences and arguments reaffirm CSR as an important, but not essential, internal resource.

The concerns of CSR advocates start where there is a clash of interests. In these circumstances, it is highly probable that the CSR which are about the long-term profit and reputation of the corporation will not be chosen over short-term profit and eye-catching limited business opportunities.[201] "If efforts to do good become a distraction from the core business, corporations may actually be downright irresponsible".[202]

There has to be a moral element involved in the way business is done; so as long as the only justification for adhering to CSR is profit maximization, it cannot be assumed that in a conflict of demands CSR will win out. "People sometimes argue that if it makes good commercial sense to respect human rights, then market forces will secure compliance. It is not self-evident, however, those human rights norms are always good for businesses."[203] It has been argued that the current role of CSR in industry is the response of businesses to new opportunities and strategic use of an ideology which has made CSR policies as a "business case", not a responsibility. McBarnet argues that CSR is another level of social accountability for business that is inadequate without enacting new legal accountability.[204] If CSR were considered a legal responsibility, corporations would have to obey it without considering whether it

[200] Orlitzky, 'Corporate Social Performance and Financial Performance: A research Synthesis' 122
[201] McBarnet 11
[202] *Just Good Business. A Special Report on Corporate Social Responsibility* (January 19th 2008) 8
[203] McBarnet 25
[204] Ibid 26

is cost-effective or not. If the chance of getting caught and the penalty were less than the costs of complying, then CSR would be just thought of as a business decision.

2.6 The Role of the Law in CSR Debates

As discussed earlier in the chapter, although there is not a generally accepted definition, CSR is commonly considered to do more than what is required by law. Having said that, one might ask why law should be discussed at all? Does legal science have a role to play in the study of CSR?

Business corporations have to obey the law. This has always been a precondition and has been accepted as a minimum social responsibility of businesses, even by the harshest critics of CSR.[205] However, since the legal system and the State's capacity to enforce it are incomplete and insufficient to respond to the problems that are emerging fast, there are big regulation gaps and implementation deficits which, as it has been argued, have to be filled and balanced by diligent managers with pro-social behaviour and an aspiration to the common good[206]; therefore the more incomplete these regulations and implementation processes are, the more is the demand for corporations to be socially responsible and even to go beyond what is required by law. Horrigan[207] considers the emphasis on corporate responsibility being just the observance of the minimum legal requirements to be simplistic. Cane[208] argues that this emphasis fails to take into account all of the dimensions of corporate legal responsibility. Legal responsibility includes what is legally forbidden as well as what

[205] See, e.g., Friedman and Levitt
[206] Friedman 41-50.
[207] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 26
[208] Cane 30

is legally permissible. In other words, the "compliance-based and sanction-focused account of corporate responsibility overemphasizes law and its authoritative enforceability of norms as the dominant regulatory mechanism".[209] This approach does not take into account other forms of regulatory mechanisms that do not depend on official authority such as "best practice" standards, common business norms, self-regulation and community influences.[210]

Buhmann argues that there are two roles that law can play within the scope of CSR: first, that corporations need to abide by the law primarily to be able to go beyond the law, then, second, compliance with international law. Many CSR demands and corporate CSR actions appear to be based exactly on assessments of compliance with international law, especially human rights and labour law.[211] Buhmann sees the significance of international law in the role it plays "as guidance for CSR self-regulation and for reporting and benchmarking".[212]

Human rights might work as a common principle of law, and as a principle that can be used in many CSR initiatives for development in the third world. In most cases, human rights, labour rights and environmental protection are heavily regulated in developed countries, but less so in many developing countries.[213]

Moreover, another role of law is through the informal law. Informal law might appear in two forms: first, a set of normative ideas, patterns of behaviour and action that are

[209] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 26
[210] Ibid 26
[211] Buhmann 189
[212] Ibid 193
[213] Ibid 198

not based on a sharp distinction between law and morality. In other words, they are not enacted by the State and their validity does not rely on State sanctions but rather on moral or practical sanctions. Second, informal law is pre-formal law. This is the case where informal law may be a result of a societal development and later on, the normative ideas of informal law will be the subject of formal regulations.[214]

Legal rules can also act as a driver for CSR. It other words, they can encourage actors to act in line with a mix of economic and marketing considerations in order to gain legitimacy and to avoid negative sanctions by stakeholders. [215]

One of the most important elements in the discussion about the role of law in CSR debate is the debate about the theory behind the corporation's legal personality. There are two major opposing theories about the nature of the corporation: first, nexus of contract (shareholder value) and second, organic theory (stakeholder value). [216]

Nexus of contract theory rejects the legal personality of the corporation and the consequent imposition of a conscience and social responsibility. According to this theory, "the company is like a market; it is the product of a complex equilibrium process. In this theory, the company is viewed as a connection of contracts and all who deal with it are therefore expected to bargain for their respective positions via contract".[217] Since the corporation is created by shareholders and regulated by contract, shareholders as owners have the right to define the objective of the corporation. This theory explains why the only objective of the corporation and the

[214] Ibid 191
[215] Ibid 192
[216] The main stakeholders include employees, suppliers, creditors, customers and the environment.
[217] Hart 1757

sole purpose of the top managers have been considered to be profit maximization. Stakeholders, in this view, are supposed to secure their rights through contracts.

By contrast, the organic theory supports a stakeholder's view.[218] The advocates of this theory argue that the corporation is a separate legal entity different from its shareholders, a social being with a distinct will and conscience of its own. Owing its existence and capital to society, the corporation has an obligation to act responsibly and consider wider stakeholder interests.[219] Corporations have been treated as an individual within society, having the same rights and obligations as an individual, therefore it should act as one. It is an established principle that every individual is responsible for the society in which he or she operates.

Another leading question is to what degree the law acknowledges social obligations of the corporation? That is, in which specific way the law is in a position to control CSR? In this respect Berle[220] and Dodd[221] had different views: Berle took a minimalist view, believing in the role of law as the protector of only shareholders' benefit, while Dodd took a maximalist view, advocating protection of not only shareholders but also for other social groups.[222] If the minimalist view of Berle is accepted, the social responsibility of business would be, as Friedman[223] also argued, profit maximization, which would be better achieved through market mechanisms.

[218] Kiarie 2
[219] Dean 67
[220] Adolph A. Berle, 'Corporate Powers as Powers in Trust' 44 Harvard Law Review 1049
[221] E. Merrick Dodd, 'For Whom are Corporate Managers Trustees? ' 45 Harvard Law Review 1145
[222] Teubner 150
[223] Friedman 41-50.

It has also been argued that the idea that the law might make business responsible for CSR is not feasible in reality. Parker holds that "ideally CSR includes compliance with businesses' legal responsibilities to society, economic expectations (to produce goods and services that society wants and to sell them at a profit), society's ethical expectations (additional behaviour and activities that are not necessarily confined into law but nevertheless are expected of business by society's members) and even society's discretionary expectations (those about which society has no clear-cut message for business, but society does expect business to assume a discretionary role, for example making philanthropic contributions)".[224] If so, how is it possible for legislators to enact laws to encompass all the above-mentioned areas?

Another criticism is the question of legitimacy that can be applied to business going too far from its role towards making public-interest decisions; this is not corporations' expertise. It is not what their structure asks them to do, so it can be argued that they are going out of their range, and certainly it is not democratic. No one cares what a CEO of a corporation says and wants in this respect; no one elected them. They do not have any power to speak for people. These are the decisions that should be made by governments not by corporations. As *The Economist* put it in a critique of CSR: "the proper guardians of the public interest are governments, which are accountable to all citizens".[225]

Corporations react differently to their legal responsibilities. Schwartz and Carroll[226] have categorized these reactions into three major groups:

[224] Parker 207
[225] McBarnet 26
[226] Carroll, 'Corporate Social Responsibility: A Three-Domain Approach' 503

The first category is “compliance”. Compliance reaction can be demonstrated in three different ways. First, companies might comply passively to their legal responsibilities. This means that the corporation is doing what it does naturally and accidentally that action is in compliance with the law. Second, companies might comply restrictively with their legal responsibilities. This implies that the corporation does the compliance because it is required by the law; otherwise, it would not do it. Third, companies might comply with their legal responsibilities in an opportunistic manner. They might take advantage of loopholes in the law, leading them to comply with the text, not the spirit, of the law. Corporations might also change their operating jurisdiction in order to evade the law, for example incorporating in developing countries.

Schwartz and Carroll have categorized “avoidance of civil litigation” as the second reaction that companies might have to their legal responsibilities. They have also categorized “anticipation of the law” as the third way that companies might react to their legal responsibilities. This means that legal systems are usually slow and corporations have the time to effect the enactment procedure through lobbying.[227]

Comparative legal analysis still has much to offer in understanding CSR. The laws that governments pass to encourage CSR have significant influence in: first, the standards established by laws and mandatory regulation, while not immediately translated into action in any realistic portrait of global organizational practice, have a particularly strong influence on establishing social expectations about responsible corporate behaviour. Second, once the social expectation is created, a number of other forces, including consumer demands, institutional investor demands, community

[227] Ibid 503

demands and NGO demands press for the standards set out in the law. Third, the laws and policies that governments enact send a strong signal about the importance of a subject, possible future legislations and the individualistic versus collectivist nature of the country's underlying political and social philosophy.[228]

2.7 Globalization and CSR

Globalization is defined as two processes: first, the process of intensification of cross-border social relations between actors from very distant locations, and the process of growing transnational interdependence of economic activities, with the State losing most of its political and monetary power leading to economic integration and convergence.[229]

The advocates of globalism are convinced that an unlimited and borderless global economy will lead to better common good. They argue that the primacy of market imperatives over political regulation will leave everybody better off.[230] In other words, the "invisible hand"[231] of the market will direct private corporations to do less harm and move towards the common good. They assume that corporations can be considered as the solution to the global regulation gap and public wellbeing.[232]

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[228] Cynthia A. Williams and Ruth V. Aguilera, 'Corporate Social Responsibility in a Comparative Perspective' in Dirk Matten Andrew Crane AM, Jeremy Moon and Donald S. Siegel (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 454

[229] Andreas George Scherer and Guido Palazzo, 'Globalization and Corporate Social Responsibility'' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 415

[230] Such as: Irwin, 2002; Krauss, 1997; Norberg, 2003; in ibid 416

[231] This term is used to describe the self-regulating nature of the marketplace. It is a metaphor first coined by the economist Adam Smith in *The Theory of Moral Sentiments*. For Smith, the invisible hand was created by the conjunction of the forces of self-interest, competition, and supply and demand, which he noted as being capable of allocating resources in society. This is the founding justification for the laissez-faire economic philosophy.

[232] Palazzo 417

Additionally, the power of multinational corporations is not just based on their enormous expansion and the amount of resources they control. Their power is further enhanced by their mobility and their capacity to shift resources to locations and legal systems where they can generate more profits.[233] This profit-making goal is a constraint on their power as well; that is, less profit will lead to disinvestment and might put the corporation at risk of takeovers. This kind of market pressure puts socially responsible managers under pressure to seek for more profitable activities instead of CSR in order to satisfy the investors. [234]

At the same time, companies are scared that if they do not try to find solutions to community problems the government may increase its role, leading to new obligations and greater intervention in the labour market. Many companies prefer to "be one step ahead of government legislation or intervention, to anticipate social pressures themselves and hence be able to develop their own policies in response to them".[235]

Business engagement in social responsibility is either for financial reasons or political ones. As for the economic reasons, there is an enormous literature (as discussed in earlier sections) about the relationship between CSR and corporate financial performance (CFP), but empirical studies[236] have proven that there is a weak relationship between the two. This weakness in economic argument draws attention to the political reasons. It has been argued that CSR is a response to political pressure.

[233]Andreas Georg Scherer and Guido Palazzo, 'Toward a Political Conception of Corporate Responsibility - Business and Society Seen from a Habermasian Perspective ' 32 Academy of Management Review 1096
[234] Kaplan 434
[235] Vogel 308. In Ibid.
[236] Griffen and Mahon, 1997; Guerard, 1997; Waddock and Graves, 2000

Engaging in political process "allow[s] business to not only deflect or dilute certain pressures but also be in the driving seat to ensure that change took place on terms favourable to business".[237]

This assumption brings up an important question about government since it is generally presumed that the State is in charge of public wellbeing by setting out the rules and preconditions for proper business behaviour in the capitalist societies' market. But government performance is affected by the increasing reluctance or unwillingness of States to impose regulations on global corporations since they fear that such limitations will lead to disinvestment and make their economies less competitive.[238] Governments also informally use corporations' help for implementing public policies that, as it has been argued[239], will cause excessive dependence of States on big corporations. Additionally, the World Trade Organization (WTO) has prevented governments from restricting imports on the basis of environmental or labour standards that are practices in the exporting country even if they were willing to do so. More specifically, WTO rules generally restrict a country's ability to require product labelling that includes an explanation of how a product was produced outside of its borders.[240]

Moon presented two models for further exploration of the role of the State: first is the view that argues CSR comes to the surface when there are no formal regulations or public policies about that issue. This view holds that CSR, by definition, means going

[237] Kaplan 436
[238] Ronnie Lipschutz and James K. Rowe, *Globalization, Governmentality and Global Politics* (Routledge 2005)
[239] Kaplan 438
[240] Vogel 308. In Ibid.

beyond the law; therefore CSR and a government are mutually exclusive. The second view posits that CSR is an interaction between market actors and a government.[241]

A current discussion about the role of government in CSR is based on the assumption that socially responsible corporations operate in a more or less properly working political context with proper regulations. But, as has been shown before, with globalization this assumption is not entirely true anymore and, due to the huge gap in global regulations and framework and a reduction in State enforcement power, business corporations have an additional political responsibility to contribute to the development and proper working of global governance.[242] Due to the multi-nationality of corporations and the emergence of NGOs with political power, one State or one set of regulations cannot cover the newly emerging issues. This situation needs multilateral and beyond-national-border regulation and governance.

The problem of assuming a political responsibility for corporations in a liberal market is the fact that they are not considered democratic but rather private non-political actors, and if they enter politics it is due to strategic decisions to maximize profits; therefore, they are not accountable before the public.

Another issue is that when corporations go global, they do not face homogenous social values but rather different sets of social (sometimes contradictory) expectations while, at the same time, getting fuzzy and losing their respective power.[243]

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[241] Ibid 304
[242] Palazzo, 'Globalization and Corporate Social Responsibility'' 414
[243] Palazzo, 'Toward a Political Conception of Corporate Responsibility - Business and Society Seen from a Habermasian Perspective ' 1096

While current theorizing in CSR is still dominated by an economic view of the corporation and an instrumental view of CSR projects[244], it has been argued that, since political solutions have been decentralized in non-State actors, new forms of political regulation beyond nations are needed to find a new economic rationality. The challenge of CSR is, first, getting involved in the political process of setting global standards and regulations for multinational corporations. A second challenge is making corporations and governments believe that corporations are both economic and political actors rather than purely economic actors.[245]

2.8 Conclusion

In this chapter an attempt was made to show the importance of studying the political bedrock while studying corporations in developing countries. Efforts were made to show how politics affects corporate governance and vice-versa. In order to demonstrate this, first "path dependence" theory, which, maintains that patterns of history deeply influence current patterns of politics, was discussed. Then "convergence theory" was discussed. This theory claims that corporate governance is on a reform agenda all over the world, moving towards the Anglo-American model of shareholding of maximizing shareholder value. The advocates of this theory pointed out the success and prosperity of Common Law jurisdictions (which follow the shareholder value model) as compared to the failure of other jurisdictions. They also emphasized the failure of alternative models of running a corporation as justification for their argument.

[244] Jones, 'Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics' 404
[245] Palazzo, 'Globalization and Corporate Social Responsibility'' 427

The chapter continued by analysing the globalization of capitalism. It was argued that capitalism is the bedrock of most of the advanced economies to which convergence is happening towards their shareholding model. Further, the role of international institutions in bringing about these changes was presented. Finally, the role of corporate law was discussed, concluding that law can create or destroy anything so law is not irrelevant but it is a second-order phenomenon; other institutions primarily control managerial mistakes; they are business conditions, incentives, professionalism, capital structure, product and managerial labour market competition.[246] These institutions are the primary control, with the law just assisting or impeding.

Different definitions of CSR were presented and attempts were made to show the diversity and lack of consensus on this matter. The conclusion was drawn to the effect that a good definition is the one that encompasses what is expected from corporations in terms of CSR policies. They are expected to balance their desire to maximise profits with respecting other stakeholders' interests.

Different CSR theories were discussed. It was concluded that it is not easy to say which theory is the best and a good normative theory needs to include a correct view of human nature, business and society, and the relationship between business and society.

The shareholder-value theory seems to still have strong conceptual bases. Friedman's profit-maximization theory and the agency theory seem to have lost a bit of their

[246]Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 163

attraction due to the collapse of the market and a growing census on the need for more socially responsible corporations, but they still remain the most significant criticism of CSR initiatives.

Different studies that have been conducted to show the link between corporate social performance and corporate financial performance were demonstrated. It was concluded that, in line with Friedman's "Strategic CSR" and meta-analytic evidences, CSR might be considered as an important factor for better corporate financial performance, but not as an essential, internal resource.

The role of law in CSR debates was then discussed. CSR has always been considered to go beyond what is required by the law. Having said that, attempts were made to answer the question of why law should be considered in CSR debates at all? The role of legal science in the study of CSR was discussed.

Further, the role of globalization in CSR debates was demonstrated. "CSR as a rapidly developing business strategy is a response to globalization and the extension of global multinational enterprises across countries, with the implication that State control over such enterprises is rarely fragmenting".[247] It was argued that the primacy of market imperatives over political regulation would result in a better-off society. The "invisible hand" of the market will direct private corporations to do less harm and move towards the common good. The role of States as compared to corporations in regulating the market and the problems associated with assuming political responsibility for corporations were discussed.

[247]Aguilera 453

Chapter 3: Legal Transplants

3.1 Introduction

Comparative law is an important branch of law, both as a tool of research and as a tool of education, but considering comparative law as a tool of law reform gives rise to concerns about the uses and misuses of foreign legal models in the process of law making.

In this chapter, Key proposition 1.3 will be discussed. This proposition argues that the act of borrowing is usually simple, while on the other hand, building up a theory of borrowing is more complex. Additionally, Key proposition 1.2 will be examined. This holds that the so-called "law-matters" thesis needs to be assessed by reference to what has been referred to as "functional equivalents" to law in transitional economies such as Iran.

This chapter will also discuss the first Key proposition. This key proposition examines whether the process of transplanting into another legal system is likely to be affected by local socio-economic-legal conditions, cultural values and institutional arrangements. This chapter will also discuss Key proposition 3.3. This involves determining whether the relationship between the legal rule to be transplanted and the socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.

Max Weber considered a calculable legal system as a precondition of legal development in capitalist societies.[248] Looking from an idealist point of view, in order to ensure calculability of a legal system, laws should be fairly stable over time.[249] A stable legal system is a better platform for long-term planning. However, lawmakers cannot foresee the future; therefore, there is a critical need for ample legal change in the real world. Laws are written incomplete and once gaps in the laws become apparent, lawmakers need to fill them either by writing new law or by reallocating law-making and law enforcement powers to agents who are capable of responding more flexibly to such changes.[250]

The extent to which one legal system may develop its own principles and procedures or adopt those of foreign (legal transplantation) jurisdictions has recently been the subject of an abundant literature.[251] Legal transplants can range from the wholesale adoption of entire systems of law to the copying of a single rule. "Foreign legal systems may be considered first, with the object of preparing the international unification of the law; second, with the object of giving adequate legal effect to a social change shared by the foreign country with one's own country; and third, with the object of promoting at home a social change which foreign law is designed either to express or to produce".[252]

Scholars in different fields agree that over a period of 200 years, the development of complex legal systems and the amelioration of "rule of law" have played a crucial

[248] Max Weber, *General Economic History* (Dover Publications 2003)
[249] Ibid quoted in Katharina Pistor, 'Innovation in Corporate Law ' 22
[250] Katharina Pistor, 'Innovation in Corporate Law ' 22
[251] Legrand, 'European Legal Systems Are Not Converging'and Legrand, *Fragments on Law-as-Culture*
[252] O. Kahn-Freund, 'On Uses and Misuses of Comparative Law' 37 The Modern Law Review 1 3

role in modernization and industrialization, and is the key determinant of economic growth while the corporate form has been regarded as a very important factor in the creation of viable market economies.[253]

The problem is that there is no systematic data available on what are the legal rules related to corporate governance around the world, how well these rules are enforced in different countries, and what effect these rules have. There is no systematic knowledge of whether different countries actually do have substantially different rules that might explain differences in their financing patterns. Comparative statistical analysis of the legal foundation of corporate finance – and commerce more generally – remains unchartered territory.[254]

As Alan Watson, the most prominent contributor to the transplants literature, has noted, while "the act of borrowing is usually simple… building up a theory of borrowing on the other hand, seems to be an extremely complex matter."[255] For example, there is little agreement among scholars on the feasibility of legal transplant and the conditions for successful transplants, or even how to define "success". Moreover, there is little analysis of how the rejection or acceptance of legal transplants relates to economic development.[256]

[253] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 92
[254] Florencio Lopez-de-Silanes Rafael La Porta, Andrei Shleifer and Robert W. Vishny, 'Law and Finance' 106 Journal of Political Economy 1113 4
[255] Alan Watson, 'Aspects of Reception of Law' 44 The American Journal of Comparative Law 335335
[256] Hideki Kanda and Curtis J. Milhaupt, 'Re-Examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law' 51 The American Journal of Comparative Law 887

Watson has famously argued that legal transplants were one of the most important sources of legal development.[257] Movement of laws from one legal system to another have been both voluntary and involuntary. The European legal harmonisation project and the adoption of corporate governance codes are examples of voluntary transplants and the imposition of colonial laws is an example of involuntary transplants causing a multiplicity of legal systems in which the colonial system existed alongside the customary one. This imposition first served the needs of commerce and capitalism; and second, "the rule of law" was seen as a start of the civilizing process.[258]

Watson also controversially asserted that the autonomy of law means that it can be freely transplanted from one legal system to another. Contemporary comparative law scholars, however, take the view that law is culture-specific and cannot be transferred from one society to another and have exactly the same effect. The transplanted law will change as it interacts with local laws and conditions.[259] Otto Kahn-Freund maintained that it cannot be assumed that all laws are transplantable. For Kahn-Freund[260], laws that are deeply embedded in a society will not be suitable for legal transplants. It will be necessary to first determine the relationship between the legal rule to be transplanted (whether mechanical or organic) and the socio-political structure of the origin jurisdiction. It will also be necessary to compare the socio-political environment of both the origin and the receiving jurisdiction. This two-pronged process is necessary to determine the viability of the transplantation. Teubner claimed that the most important question is how closely a particular area of law is

[257] Alan Watson said that legal transplantation is 'extremely common' and forms 'the most fertile source of [legal] development': Alan Watson, *Legal Transplants: An Approach to Comparative Law* (2nd edn, The University of Georgia Press 1993) 95
[258] Mohammad Rizal Salim, 'Legal Transplantation and Local Knowledge: Corporate Governance in Malaysia ' 20 Australian Journal of Corporate Law 55 5
[259] Watson, 'Comparative Law and Legal Change' 313
[260] Kahn-Freund 14

"coupled" to one or more "social processes". He says that received ideas act as an "irritant", resulting in distortion of the ideas behind the law that is being transplanted.[261] However, even Alan Watson acknowledged that transplanted laws will inevitably develop. He compared it to a human body: it will grow in its new body according to him. The development of the law in the host country is a natural process which should not be seen as a rejection.[262] "These laws, at least in the early stages of transplantation, would not be as effective as laws which have been developed locally".[263]

A series of studies by Katharina Pistor and others showed the deficiencies of transplanted laws in their new legal environment. They concluded that legal institutions in transplant countries were less developed compared with those in the origin countries due to lack of complementarities, [264] and transplant countries were less innovative than the origin countries.[265] Pistor has further argued that law should be developed by the society and made "part of the institutional fabric of society".[266] Legal institutions here mean the institutions that create, support and enforce laws. It therefore covers a whole range of institutions – courts, legislative bodies, law-making and drafting agencies, enforcement agencies, law schools and bar associations. This does not mean that the legal transplants are impossible and will be rejected immediately. It means that they need to take into account the specific cultural values

[261] Gunther Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences ' 61 Modern Law Review 11 11
[262]Watson, *Legal Transplants: An Approach to Comparative Law* 27
[263] Salim 6
[264] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' Katharina Pistor, 'Innovation in Corporate Law ' 7
[265] Katharina Pistor, 'The Evolution of Corporate Law: A Cross-Country Comparison ' 791
[266] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 90 & 93

and needs of a particular society and evolve; therefore, they cannot function the same way and produce the same results.

There are other criteria which affect the efficiency of corporate governance regulation in developing countries including culture and value systems, the quality of legal institutions, access to courts, and the amount of the State intervention in businesses. These issues cannot be resolved merely by reforming the law-in-the-books or by importing laws from other legal systems. Reforms should pay attention to elements of uniqueness in the local setting. [267]

Another problem with most transplanted laws is that they are usually to serve the business interests of big corporations, despite being unsuitable for local conditions. For example, in many developing countries the law which focuses on the agency problem of director-shareholder conflict was not designed for the concentrated nature of the companies in these countries; therefore, the focus on the regulation of directors is unnecessary and only secondary to the controlling shareholder-minority shareholder conflict. The State also plays a significantly different role in developing countries. Not only is the State the majority or controlling shareholder of many of the largest listed companies, it also has direct influence on the management of many companies. To the extent that the State benefits as direct and indirect beneficiary of businesses, it cannot be considered as merely an impartial intermediary seeking to benefit the whole populace by implementing appropriate development strategies and ensuring free competition and fair-play to all.[268]

[267] Salim 1
[268] Ibid 11-12

In this section attempts will be made to present the definition of legal transplants, its development and its influence in the study of legal culture and legal systems, taking into account the variation of transplantation process based on social, legal economic, fiscal, financial and technical circumstances prevailing in each country's "legal culture" and legal system.[269]

In order to do this, first the definition of legal transplants will be presented. Second, attempts will be made to show how legal transplants are developed. Third, different series of arguments will be presented to demonstrate the role of legal transplants. Fourth, the costs of legal change and their effect on legal transplantation will be discussed. Fifth, the influence of culture on legal transplants will be presented and finally the development of legal transplants in developing countries will be discussed.

3.2 What Does 'Legal Transplants' Mean?

In Watson's words, legal transplants mean "the moving of a rule or a system of law from one country to another, of from one people to another."[270] He argues that it is now the most fertile source of legal development since "most changes in most systems are the result of borrowing".[271] He maintains that the object of legal transplants is the "rules not just statutory rules; [but also], legal concepts and structures that are borrowed, not the spirit of the legal system".[272]

[269]Valderrama 274
[270] Watson, *Legal Transplants: An Approach to Comparative Law* 94
[271]Ibid 21
[272] Alan Watson, 'Legal Transplants and European Private Law' 4.4 Electronic Journal of Comparative Law <http://wwwejclorg/ejcl/44/44-2html>

Pistor et al. defined a transplant country as "a country that imported its corporate law – typically wholesale with a set of other formal laws – from another country or other countries rather than developing it domestically."[273]

3.3 How Are Legal Transplants Developed?

Perhaps Valderrama has put forward the best classification of ways through which legal transplants take place.[274] He enumerated five drivers for legal transplantation:

1. Authority; a concept which he took from Alan Watson. Alan Watson stated:

> "In the absence of legislation, which typically has been scarce for private law, law making is left to subordinates – judges and jurists – who, however, are not given power to make law. They must justify their opinion. It will not do to say, "This is my decision because I like the result". They must seek authority".[275]

2. Prestige and imposition; it has been argued that every legal culture has faith in itself and tries to impose its legal culture on other countries if it has the power to do so. For example, many civil developing countries have the desire to import the French system because it is considered a good-quality work and prestigious.[276]

3. Chance and necessity

[273]Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 90
[274] Valderrama
[275] Alan Watson, 'Legal Culture v. Legal Tradition' paper presented at the conference of Epistemology and Methodology of Comparative Law in the Light of European Integration, Brussels 2
[276]Rodolfo Sacco, 'Legal Formants: A Dynamic Approach to Comparative Law (Installment II of II)' 39 The American Journal of Comparative Law 343 398

4. Expected efficacy of the law; this theory follows the research conducted by Daniel Berkowitz, Katharina Pistor and Jean Francois Richard on cross-national legal transplants.[277] They concluded that:

> "The way in which a formal legal order incubated in Europe was transplanted into other countries was a far more important predictor of the effectiveness of legal institutions than the association of that transplant with any particular legal family ... . The quality of transplantation process counted far more than the content of the transplant effect".[278]

5. Political, economic and reputational incentives; it has been argued that in developing countries the law cannot be considered the result of social rule-making. The mere fact that these imported laws actually do not work in the system shows that another interest other than that society's specific interest has been followed. In these countries, legal process is often determined by political relationships. Mattei argues "the very notion of limiting powers by formal law is completely inconsistent with the philosophy of rule-making in those countries".[279]

3.4 Why Do Legal Transplants Take Place? (The Role of Legal Transplantation)

In recent years legal transplantations have become more frequent, possibly due to greater domestic demand for regulating the market in another way as a result of economic change and development. This process has been referred to as globalization and has been usually considered the main reason for legal transplants. It increases

[277] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries'
[278]Katharina Pistor Daniel Berkowitz, Jean-Francois Richard, 'Economic Development, Legality, and the Transplant Effect' 308 William Davidson Institute at the University of Michigan in its series William Davidson Institute Working Papers Series 2 quoted in Valderrama 267
[279] Ugo Mattei, 'Three Patterns of Law: Taxonomy and Change in the World's Legal System' 45 The American Journal of Comparative Law 528

competitive pressures due to the integration of financial markets and "(...) brings laws and legal cultures into more direct, frequent, intimate, and often complicated and stressed contact".[280]

The role of legal transplantation was furthermore explained by Watson. He stated that:

> "As a practical subject Comparative law is a study of the legal borrowings or transplants that can and should be made; ...an investigation into the legal transplants that have occurred: how, when, why and from which systems have they been made, the new circumstances in which they have succeeded and failed and the impact on them of their new environment".[281]

The main question here is: "Why do legal transplants seem to exist everywhere?" First is the "practical utility motivation", which means legal transplants are a cheap, quick and potentially fruitful source of new law and may be the only feasible means of law reform in some instances. Second is the "political motivation", which often follows colonization or military occupation. The idea is that the transnational and cross-border spread of law and legal ideas is not, as it might appear, just for scientific, technical and economic ideas that have value by themselves but may instead be substantially dependent on the political factors that may have more power in determining how law migrates than do factors that relate to the intrinsic or instrumental value of the migrating law itself.[282] Third is "symbolic motivation", meaning that "all law-making, apart from legislating, desperately needs authority" [283]

[280]David J. Gerber, 'Globalization and Legal Knowledge: Implications for Comparative Law' 75 Tulane Law Review 949 950
[281] William Ewald, 'Comparative Jurisprudence (II): The Logic of Legal Transplants' 43 The American Journal of Comparative Law 489 309
[282]Frederick Schauer, 'The Politics and Incentives of Legal Transplantation' 44 Center for International Development at Harvard University in its series CID Working Papers 2
[283] Watson, 'Aspects of Reception of Law' 335 & 346

and law borrowed from a prestigious foreign source often fills that gap of authority among the legal profession.[284] Fourth is "blind copying", meaning some rules are transplanted quickly and without adequate preparation in the home country.[285]

Commentators are split between those who argue that legal transplants, as a mechanism for legal change, are possible, and those who claim that legal transplants are impossible. In fact, the whole debate is about the relationship between law and the society in which it operates. At one extreme is the optimism of Alan Watson, who views law as separated from political and social institutions. For Watson, "the transplanting of legal rules [by which he means both individual rules and large parts of a legal system] is socially easy."[286] At the other extreme are those who argue that "rules cannot travel [because their meaning is culture-specific]. Accordingly, "legal transplants" are impossible."[287]

However, each of these extreme theories put forward several questionable assumptions. Watson's optimism fails to take into account that "what matters most is the idea behind the law being transplanted, rather than the law itself".[288] Another questionable assumption by Watson is that he assumes "many legal rules make little impact on individuals".[289] At the same time, the view that legal transplants are impossible is contradicted by a variety of empirical evidence. However, the argument that the probability of survival of efficient transplanted legal rules in competition is

[284] Broadly defined to include lawyers, judges, and ministry of justice officials.
[285] Milhaupt 889
[286] Watson, *Legal Transplants: An Approach to Comparative Law* 95
[287] Milhaupt 890
[288] Watson, 'Comparative Law and Legal Change' 890
[289] Ibid 96

higher might be partially true, but it fails to address the conditions under which in a given country inefficient rules might continue their existence.

Between these two extremes, several more moderate positions are also present in the literature. Otto Kahn-Freund argues that distinctive "environmental" conditions in each country, particularly the political environment in the form of constitutional structure and interest group coalitions, make successful transplants rare.[290] "Anyone contemplating the use of foreign legislation for law-making in his country must ask himself: How far does this rule or institution owe its existence or its continued existence to a distribution of power in the foreign country which we do not share? How far would it be accepted and how far rejected by the organized groups[291] which, in the political sense, are part of our constitution?"[292] And consequently the strongest "organic" element in the law today is "its close link with the infinite variations of the organisation of power in culturally, socially, economically very similar countries".[293]

Ugo Mattei has taken an economic oriented analysis and suggested that legal borrowing can best be explained as a movement towards efficient rules. That is, competition in a "market for legal culture" determines which laws are transplanted from foreign legal systems, arguing that the most efficient legal rules survive around the world.[294]

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[290] Kahn-Freund 7: By politics, Kahn-Freund means constitutional structure of government as well as interest group pressures.
[291] By 'organized groups', he means not only groups representing economic interests: big business, agriculture, trade unions, consumer organisations, but equally of organized cultural interests, religious, charitable, etc. All these share in the political power, and the extent of their influence and the way it is exercised varies from country to country.
[292] Kahn-Freund 12
[293] Ibid 12
[294]Ugo Mattei, 'Efficiency and Equal Protection in The New European Contract Law: Mandatory, Default and Enforcement Rules' 14 International Review of Law and Economics 3 3

Some have considered "fitness" between the transplant law and the host environment crucial to the success of a transplant:

> "'Fit' might be thought of as having two components – micro and macro. Micro-fit is how well the imported rule complements the pre-existing legal infrastructure in the host country. Macro-fit is how well the imported rule complements the pre-existing institutions of the political economy in the host country. Central to analysis of both micro-fit and macro-fit is the availability of substitutes. The fewer the available substitutes for the transplanted rule, either within the legal system (in the form of other laws and legal procedures) or outside the legal system (in the form of norms, informal State interventions, or market constraints), the more likely it is that the transplanted legal rule or institution will be adapted to local conditions and thus used by relevant actors in the host country". [295]

Another important question in the discussion of the role of legal transplantation is: "What are the conditions of successful legal transplants?" In order to answer this question, one first needs to find out what baseline is being used to measure the "success", and this too is controversial.[296] It has been argued that "success" simply means "use of the imported legal rule in the same way that it is used in the home country, subject to adaptations to local conditions".[297] Therefore, failure is the case where the transplanted law is rejected, ignored by relevant actors or leads to unintended consequences.

Motivation is also highly relevant to this analysis. Motivation must be considered both from the law reformers initially responsible for the transplant, and the legal actors[298] with the potential to use and to implement it.

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[295] Milhaupt 891
[296] David Neklen, 'Towards a Sociology of Legal Adaptation' in David Neklen and Johannes Feest (ed), *Adapting Legal Cultures* (Hart Publishing 2001) 37-39
[297] Milhaupt 890
[298] Courts, attorneys, government officials.

3.4.1 Watson's Series of Studies

The legal historian Alan Watson provides rich historical evidence showing that legal transplantation has been happening frequently throughout history. He maintains that legal transplantation has been a huge success despite the socio-economic diversity in societies. He further argues that convergence of socio-economic structures, functional equivalence of legal institutions and the totality of society's culture does not matter for developing legal transplants. [299] In this way, he confronts functional comparative analysts and the culturalists.

This argument is based on three assumptions. In the first assumption, Watson emphasizes that comparative law should study the interrelation between different legal systems instead of studying the foreign law.[300] In line with Watson's argument and in order to explain it, Teubner[301] uses Montesquieu's "*esprit des lois*", stating that in Montesquieu's words laws are the expression of the spirit of nations, that they are deeply embedded in and inseparable from their geographical peculiarities, their customs and politics. Therefore, the transfer of culturally deeply embedded laws from one nation to another was a "*grand hazard*". But today, due to the process of globalization the situation is different. The primary unit is no longer the nation and national laws (following their economies) have been separated from their unique regional comprehensive spirit. The growing globalization process has created one worldwide network of economic culture and legal communication which places national legal orders in second place as merely regional parts of this network.[302][303]

[299] Watson, *Legal Transplants: An Approach to Comparative Law* 3
[300] Ibid1 21
[301] Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences ' 15
[302] Montesquieu's environmental criteria which determine 'I'esprit des lois' and permeate the whole work are to some extent geographical, such as above all the climate, but also the fertility of the soil, the

Teubner asserted that:

> "… the transfer of legal institutions is no longer the matter of interrelation of national societies where the transferred institution carries the whole burden of the original national culture. Rather it is a direct contact between legal orders within one global legal discourse. This explains the frequent and relatively easy transfer of legal institutions from one legal order to the other".[304]

In the second assumption, Watson identified legal transplants as the main source of legal change, tracing it back to the need of authority for the new imitated law.[305]

In the third assumption, from all the above-mentioned and his rich historical research, Watson concludes that legal change can be explained without reference to social change, and in this way he confronts contextualists and culturalists who see law as mirroring culture and society. "His findings resonate with sociological theories about cultural evolution, which rejects a historical trajectory for the whole of society and

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size and the geographical position of a country. Other factors are sociological and economic, such as 'le genre de vie des peuple, laboureurs, chasseurs ou pasteurs,' the wealth of the people, their 'number' (which must refer to the density of population), their trade. Still others are cultural: the religion of the people and what he calls 'leurs inclinations . . . leur moeurs ... leurs manieres.' But in this celebrated catalogue of national characteristics we also find purely political elements: 'la nature et . . . (le) principe du gouvernement qui est e'tabli, ou qu'on veut etablir,' - as an example he mentions 'le degre de liberte que la constitution peut souffrir,' clearly an anticipated reference to the political characteristics of the English constitution. And he concludes by emphasising the influence which the various laws of a country have on each other, and the extent to which all laws are influenced by their origin, the purpose of the law maker, 'l'ordre des choses sur lesquelles elles sont etablies.' In a later, programmatic and decisive passage of the work the catalogue appears in an abbreviated form, which again shows 'l'esprit des lois' as a compound of physical, cultural and political ingredients: 'le climat, la religion, les lois, les maximes du gouvernement, les exemples des choses passees, les moeurs, les manieres.' One sees that the political factor is here formulated in terms of principles rather than of institutions. Kahn-Freund 7

[303] Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences ' 16

[304] Ibid 16

[305] Watson, *Legal Transplants: An Approach to Comparative Law* 95

identifies instead separate evolutionary paths for different sectors of society, among them law".[306]

Watson has a point here but he has failed to explain the counter-examples of politically induced change of the law.[307]

Otto Kahn-Freund[308] suggested that we should differentiate between legal institutions that are deeply integrated in culture and ones that are separated from culture and society. Legal institutions can be separated into two categories: the organic ones where transfers are very difficult and mechanistic ones where the transfer is easier.

Teubner contended that the term "legal transplant" is misleading and suggested the term "legal irritants" would be a better fit. He argues: "legal transplant makes sense insofar as it describes legal import/export in organismic, not in mechanistic, terms".[309] The problem with the term "transplant" is that it gives the wrong impression – that, like a difficult surgical transplant, the transplanted organ will operate in the new body in the same way as it was operating in the previous body. However, this is not the case in transplanting the legal institutions. They cannot easily move and need careful implantation and cultivation in the new environment.

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[306] Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences ' 16

[307] For example, the political transformation of American public law in the Revolution analysed by Ewald: William Ewald, 'The American Revolution and the Evolution of Law' 42 American Journal of Comparative Law 1701 Ewald uses historical studies of legal changes in the American Revolution which corroborate roughly Alan Watson's findings in the field of private law but contradict them directly in the field of public law. See also J.W.F. Allison, *A Continental Distinction in the Common Law: A Historical and Comparative Perspective on English Public Law* (OUP Oxford; New Ed edition 2000), questioning Watson's empirical evidence. Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences ' 17

[308] Kahn-Freund 12

[309] Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences ' 12

Some have argued that when the foreign law is transplanted it will either lead to integration or repulsion. While Teubner argued that the transplanted institutions "work as a fundamental irritation, which triggers a whole series of new and unexpected events"[310] he further stated that "legal irritants" cannot be domesticated, they are not transformed from something alien into something familiar, not adapted to a new cultural context; rather, they will unleash an evolutionary dynamic in which the external rule's meaning will be reconstructed and the internal context will undergo fundamental change."[311]

3.4.2 LLSV Series of Studies: (Legal Origins)

Countries that are less prone to be influenced by other countries' legal systems are called *origins*, whereas the remaining countries are called *transplants,*[312] but which countries are *origins* is a matter of empirical controversy.[313]

Although there is no unanimity among legal scholars on how to define legal families, among the criteria often used for this purpose are the following:

(1) "Historical background and development of the legal system,

(2) Theories and hierarchies of sources of law,

(3) The working methodology of jurists within the legal systems,

(4) The characteristics of legal concepts employed by the system,

[310]Ibid 12
[311]Ibid 12
[312] Daniel Berkowitz, and the references therein.
[313] England, France and Germany are uncontroversial origins. There is some controversy concerning Austria, Denmark, Finland, Norway, Sweden, Switzerland and the United States, and a very serious dispute with respect to Portugal and Spain.

(5) The legal institutions of the system, and

(6) The divisions of law employed within a system".[314]

The debate about legal origins has been heated up by the article of La Porta, Lopez-de-Silanes, Shleifer and Vishny (Henceforth LLSV.) in which they argued that the differences in the nature and effectiveness of financial systems around the world can be traced in part to the differences in investor protection against expropriation by insiders, as reflected by legal rules and the quality of their enforcement.[315] They showed that countries with poor investor protection[316] have more concentrated ownership. They later tried to investigate if this unfriendliness towards investor protection (particularly in the French civil law sub-family) leads to less external finance and thus smaller capital markets.[317]

In order to answer this question, LLSV (1997)[318] tried to establish a link between the legal environment and financial markets. Using a sample of 49 countries with the focus on determinants of financial development, they showed that "countries with poorer investor protection, measured by both the character of legal rules and the quality of law enforcement, have smaller and narrower capital markets".[319] These results suggest that common law and French civil law operate in very different legal

[314] Glendon, M. A. Gordon, M and Osakwe, C. 1992. 'Comparative Legal Traditions in a Nutshell', St. Paul: West Publishing Company.
[315] Rafael La Porta 7
[316] For shareholders, some of the rules they examine cover: voting powers, ease of participation in corporate voting, and legal protections against expropriation by management. For creditors, some of these rules cover the respect for security of the loan, the ability to grab assets in case of a loan default, and the inability of management to seek protection from creditors unilaterally. In effect, these rules measure the ease with which investors can exercise their powers against management. They also consider measures of the quality of enforcement of legal rules in different countries and of the quality of their accounting systems. Florencio Lopez-de-Silane Rafael La Porta, Andrei Shleifer and Robert W. Vishny, 'Legal Determinants of External Finance' 52 Journal of Finance 1131 6
[317] Ibid and Rafael La Porta, 'Law and Finance' 7
[318] Rafael La Porta, 'Legal Determinants of External Finance'
[319] Ibid 11 31

environments. They have argued that a highly protective legal environment that secures the investors from expropriation by entrepreneurs raises their willingness to invest and thus expand the scope of capital markets.[320]

Theoretical accounts of why this might be true have been focused on two principal mechanisms. Mahoney[321] and Glaeser & Shleifer[322] emphasize judicial independence from the State and hence the capacity for courts to protect property and contract rights from incursion by the State; these authors claim that a common law regime generates greater judicial independence than does a civil code regime. Beck et al.[323] emphasize the "adaptability" factor and assert that common law regimes especially those in which judicial opinions are a source of law and judges can justify their results on equity and not merely statutory grounds are better able to respond to changing circumstances than are civil code regimes in which law is only found in statutes.

[320] Their studies show two major findings: First, common law countries afford the best legal protections to shareholders. They frequently (39%) allow shareholders to vote by mail, they never block shares for shareholder meetings, they have the highest (94%) incidence of laws protecting oppressed minorities, and they generally require relatively little share capital (9%) to call an extraordinary shareholder meeting. The only dimension on which common law countries are not especially protective is the preemptive right to new share issues (44%). Still, the common law countries have the highest average anti-director rights score (4.00) of all legal families. Many of the differences between common law and civil law countries are statistically significant.
Second, French civil law countries afford the worst legal protections to shareholders. Although they look average on one-share-one-vote (29%) and cumulative voting (19%), and better than average on preemptive rights (62%), they have the lowest (5%) incidence of allowing voting by mail, a low (57%, though not as low as German civil law countries) incidence of not blocking shares for shareholder meetings, a low (29%, though not as low as Nordic countries) incidence of laws protecting oppressed minorities, and the highest (15%) percentage of share capital needed to call an extraordinary shareholders' meeting. The aggregate anti-director rights score is the lowest (2.33) for the French civil law countries. The difference in this score between French civil law and common law is large and statistically significant. Interestingly, France itself, except for allowing proxy voting by mail and having a preemptive right to new share issues, does not have strong legal protections of shareholders. In Rafael La Porta, 'Law and Finance' Table 2. 18

[321] Mahoney 6

[322] Edward L. Glaeser and Andrei Shleifer, 'Legal Origins' 117 The Quarterly Journal of Economics 1193 9

[323] Thorsten Beck, Demirguc-Kunt, Asli and Levine, Ross, 'Law and Finance: Why does Legal Origin Matter' 31 Journal of Comparative Economics 653 3 &28.

Anderlini, Felli & Riboni[324] make a similar claim for case-law-based systems, arguing that *ex post* judging is better able to respond to local information than ex ante legislating, although judicial responsiveness to *ex post* evidence may generate a time-inconsistency problem that reduces the value of case law relative to statutory law. Djankov et al.[325] also understood that stronger economic performance can be attributed to the capacity of judges to exercise discretion; their measures of formalism in the procedures for deciding simple disputes attempt to capture the extent to which judges are required to look to established legal rules, whether in statute or case law, and to follow externally imposed procedures to decide or justify decisions.[326]

In order to further prove their argument, after having shown that law and its enforcement varies across countries and legal families, La Porta and others investigated how the countries with poor laws or their enforcement cope with the problem of poor investor protection. They argue that these countries adopt substitute mechanisms of corporate governance, which they call "bright line" rules. "Bright line" rules are to legally introduce mandatory standards of retention and distribution of capital. Out of all legal families, French civil law countries have mandatory dividends and German civil law countries are the most likely to have legal reserve requirements.[327]

[324] Leonardo Felli and Alessandro Riboni Luca Anderlini, 'Statute law or case law?' LSE Research Online http://eprintslseacuk/4433/ 1 7
[325] Rafael La Porta Simeon Djankov, Florencio Lopez-De-Silanes and Andrei Shleifer, 'The Regulation Of Entry' 117 The Quarterly Journal of Economics 1 29
[326] Gillian K. Hadfield, 'The levers of legal design: Institutional determinants of the quality of law' 36 Journal of Comparative Economics 43 1-2
[327] Rafael La Porta, 'Legal Determinants of External Finance' 7

Levine traced the effect of legal origin on financial development through long-run economic growth. He suggested that legal origin influences economic growth by shaping national financial systems. [328]

In a research conducted by Beck and others, they focused on the channels through which legal origin influences finance. They used "broad cross-country regressions to assess whether legal tradition shapes finance primarily by affecting the power of the State relative to the judiciary or primarily by influencing the adaptability of the law to evolving conditions".[329] They have assessed two theories of why legal origins influence financial development.

First, the "Political Channel" which stresses that (I) legal traditions differ in terms of the priority they attach to the rights of private property owners vis-à-vis the rights of the State and (II) this has consequences on protection of private contracting rights as the basis of financial market development.[330] In other words, the political channel argues that the civil law tradition tends to emphasize the development of institutions that advance the State's power rather than private property rights, which adversely affected financial development.[331] Similarly, LLSV state that: "(A) civil legal tradition, then, can be taken as a proxy for an intent to build institutions to further the power of the State..."[332] A powerful State will tend to create policies and institutions that divert the flow of society's resources towards favoured ends and, even with a

[328] Ross Levine, 'The Legal Environment, Banks, and Long-Run Economic Growth' 30 Journal of Money, Credit and Banking 596and Ross Levine, 'Law, Finance, and Economic Growth' 8 Journal of Financial Intermediation 8 36-67
[329] Beck 5
[330] Rafael La Porta, Lopez-de-Silanes, Florencio, Shleifer, Andrei and Vishny, Robert, 'The Quality of Government' 15 Journal of Law, Economics and Organization 222 9 & 24
[331] Beck 7
[332] Florencio Lopez-de-Silanes and Andrei Shleifer Rafael La Porta, 'Corporate Ownership Around the World' 54 The Journal of Finance 471 2 31-2

responsive civil regulation, it will have difficulty not interfering with the market. Thus, according to the political channel, the common law's emphasis on private property rights and limiting the State's power tends to support financial development to a greater degree than the civil law.[333] In civil law nations and socialist nations, the principal mechanism of resource allocation is central planning. In common law nations and capitalist nations, this mechanism is the market.[334]

Securing private property rights by the State has two opposing effects. On the one hand is controlling disorder, which means that investment must be secured, typically by the government, from expropriation. On the other hand is controlling the abuses of State intervention, implying that a government capable of protecting property against private infringement can itself become the violator. As both the Marxist and the public choice literature have identified long ago, politicians choose policies and institutions to stay in power and to get rich.[335]

The second theory about the effect of legal origin on financial development, is the "Adaptability Channel", which holds that (I) legal systems that adapt quickly to minimize the gap between the financial needs of the economy and the legal system's ability to support those needs, will foster financial development more effectively than would more rigid legal traditions, and (II) the major legal traditions differ in terms of their ability to evolve in changing commercial conditions. Several scholars argue that common law systems embrace case law and grant substantial discretion to judges, inefficient laws are challenged in the courts and "... through the process of litigation

[333] Beck 7
[334]Simeon Djankov Andrei Shleifer, Edward L. Glaeser, Rafael La Porta and Florencio Lopez de Silanes 'The New Comparative Economics' number ysm355 Yale School of Management Working Papers 2
[335]Ibid 2-6

and re-litigation inefficient rules will be replaced by efficient rules"[336]; therefore, it tends to be more responsive to changing economic conditions. These authors suggest that "legal systems that (I) reject jurisprudence – the law created by judges in the process of solving disputes – and (II) rely instead on changes in statutory law will tend to evolve more inefficiently with negative implications for finance".[337]

In sum, the political and adaptability channels are inter-related. They are both part of law and finance theory and both predict that legal origin strongly influences financial development; however, they focus on different mechanisms. "The political channel focuses on the power of the State. In contrast, the adaptability channel focuses on the process of law-making. Of course, legal origin may operate through both channels; the political and adaptability channels are not mutually exclusive".[338]

At the same time, there are differences between the political and the adaptability channels. First, they provide conflicting predictions regarding French versus German civil law countries. The political channel holds that French and German civil law countries stand for more power for the State as opposed to private property rights, leading to too much State intervention in the market and consequently less development in their financial markets. In contrast, the adaptability channel states that common law and German civil law based countries are more adaptable to changing commercial conditions than the French civil law-based countries. Second, the political channel stresses that the differences in countries' financial development lie in the

[336] Beck 11
[337] See, for instance, Rubin (1977, 1982), Priest (1977), and Bailey and Rubin (1994) in ibid 2
[338] Ibid 4

independence of the judiciary's power. In contrast, the adaptability channel stresses that these differences arise from the flexibility of the law.[339]

According to Cheffins La Porta's Law Matters thesis suffers from a major historical oversight. He uses the example of the UK as the most similar system of corporate governance to the US and argues that there is no need of a particular set of laws in order to ensure the separation of ownership from control. Instead, alternative institutional structures can induce the same conclusion.[340]

Cheffins argued that a fair and reliable judicial system would ensure that the minority shareholders feel comfortable enough to invest. As it was the case in the UK, law did not do a great deal to help the investors to feel more comfortable, it was the wholesale regulatory reform resulting from activities of financial professionals and London Stock Exchange.[341] Additionally in order to ensure the directors observe the duty of loyalty legal restrictions on managerial self-dealings would be required. Another additional means to enhance the confidence of outside investors would be attributing legal mechanisms to minority shareholders to protest against perceived oppression.[342]

Cheffins further argues that strong corporate law might not be a necessary condition for a corporate system dominated by widely held companies since investors draw confidence from substitutes, such as stock market listing rules and quality control

[339] Ibid 15
[340] Brian R. Cheffins, 'Does Law Matter?: The Separation of Ownership and Control in the United Kingdom' 30 Journal of Legal Studies 37
[341] Ibid 41
[342] Ibid 10 and Brian R. Cheffins, 'Corporate Law and Ownership Structure: A Darwinian Link?' 25 UNSW Law Journal 346 45

carried out by financial intermediaries. Historical developments in the UK illustrate the point.[343]

Another major weakness of LLSV studies is the fact that it is based on cross-sectional data since there were not many comparative studies available at that time. A study by Armour and Deakins criticizes the methodology used by LLSV. This study suggests that many civil law countries showed a greater increase in shareholder protection proving that the legal origin effect is declining over the time. This study also finds no link between legal origin and stock market development.[344]

They further found that the vast majority of rules in the areas of company law are statutory both in the common law systems and civil law systems. In a sample of 20 countries they did not find any link between shareholder protection and stock market development. They also proved that civil law countries are quickly catching up with common law countries in the issue of shareholder protection and the gap is becoming smaller.[345]

In the same fashion, Siems criticizes the research techniques used by LLSV. He argues that LLSV failed to take into account two factors:

1. Particular rules are not identical in different countries and in a comparative study one should not impose one's conception on a foreign system. "Legal rules must

[343] Cheffins, 'Corporate Law and Ownership Structure: A Darwinian Link?' 15
[344] John Armour, Deakin, Simon F., Sarkar, Prabirjit, Siems, Mathias M. and Singh, Ajit, 'Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis' 108 University of Cambridge, CBR Working Paper; ECGI 11
[345] Ibid 39

not be regarded in an isolated way, because the functioning of legal systems can only be under- stood as a whole."[346]

2. To identify functional substitutes; in other words identifying legal rules that has similar effect.[347]

3.4.3 Pistor et al. Series of Studies

Another approach to assessing the quality of corporate laws is classifying them from mandatory to enabling corporate law.[348] Mandatory law means that private actors may not be able to choose whether or not to work within the allocation of control rights prescribed in statutory law. By contrast, an enabling law allows private actors to opt out the statutory provisions and enables parties to reallocate control rights.

A mandatory legal system means that legislatures function as lawmakers while its judges' responsibility is just to implement these pre-made rules and have little law-making function. By limiting the ability of private agents to experiment with new legal forms and restricting a court's ability to review them, a legal system adversely affects statutory legal change, which serves to implement abrupt radical legal change and consequently it limits the source of legal innovation. In contrast, a highly enabling legal system gives private actors significant discretion regarding the control rights and increases the amount of innovation on the side of private actors. Courts need to keep up with this fast pace accordingly and failing to do so may result in market failure since it fails to resolve the disputes among competing claims. Put differently, "a highly enabling law provides a fertile ground for legal innovation.

[346] Mathias M. Siems, 'What Does Not Work in Comparing Securities Laws: A Critique on La Porta et al.'s Methodology' International Company and Commercial Law Review 300-305, 304
[347] Ibid 7
[348] Coffee (1989) and Gordon (1989), in Katharina Pistor, 'Innovation in Corporate Law ' 9

Unless a legal system proves capable of responding to the new challenges arising from legal innovation, this strategy may be self-defeating".[349]

Pistor and others propose that "the capacity of legal systems to innovate is more important than the level of protection a legal system may afford to particular stakeholders at any point in time".[350] The more innovative and adaptable a legal system is, the more likely it is able to respond to a changing environment.

This innovative character of a legal system gives firms the possibility to explore new opportunities while ensuring a minimum level of investor protection. However, this minimum protection may be taken as a first indicator to assess the quality of legal systems since such protections have proven to be soon outdated, especially in areas such as corporate law and financial market regulation because socio-economic and technological change is rapid and challenges the legal system continuously.[351]

Pistor and others found that there are substantial differences in three aspects in the capacity of legal systems to innovate:

1. The rate of statutory legal change, which is significantly higher in the origin countries than the transplant countries, with the common law countries having the highest level of statutory change compared with civil law countries. They also found that the differences in legal change is actually greater with two countries with one system (which would mean origin country and transplant country) than between the legal families;

[349] Ibid 11
[350] Ibid 7
[351] Ibid 5-8

2. The flexibility of corporate law/enabling laws vs. mandatory laws; that is, the more mandatory a legal system, the less legal innovation will take place and vice versa, and;

3. The development of new enforcement mechanisms via developing new legal institutions. This would mean that the more enabling is a corporate law, the greater is the need for the institutional innovation. [352]

The question that comes to the surface here is why the transplantation of law has not solved the problem of legal backwardness. The point that should be taken into consideration is that "the strength of a legal system is not encapsulated in particular legal provisions found in statutory law but in the extent to which it promotes innovation and change without creating a control vacuum".[353] The findings of Pistor et al. suggest that legal transplants cannot function in the transplant countries in the same way as they do in the origin countries. They argue that "Socio-economic conditions, including overall economic development, the size of the corporate sector, the ownership structure of firms, and the patterns of firm finance, differ from country to country. Institutions that make the law work smoothly in one country, such as courts and regulators, may be absent, weak, or corrupt in another".[354] Socio-economic change takes place within the constraints of existing formal and informal institutions and thus is highly path-dependent.[355] Therefore, even radical sudden legal change will

[352] Ibid 6-12
[353] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 97
[354] Ibid 99
[355] North, D, C, 1990, *'Institutions, Institutional Change, and Economic Performance'*, New York: Cambridge University Press.

not change pre-existing legal institutions overnight. This will take time and may not even succeed fully since rent-seeking may get in the way. Those who enjoy rents in the pre-existing legal system and not in the new one will use all their lobbying power to either block the new rule-making or make it practically ineffective and ignored. Typically, this type of change occurs in response to a crisis. Although crises are important motors for legal reform, crisis-driven legal reforms can mean that lawmakers overreact in a backlash fashion.[356]

Pistor el al. asserted that in the process of transplantation, the main difficulty would be whether transplant countries reveal different patterns of legal evolution than origin countries.[357] It has been shown that legal families have only limited predictive power with regard to the effectiveness of legal systems.[358] Pistor et al. further suggest that "the answer might lie in the propensity of different legal systems to innovate by allowing sufficient room for experimentation, and responding to the need to close loopholes that may open up in this process".[359] Moreover, transplant countries need to develop appropriate complementary institutions. Some transplant countries have sought to make up for the gap of legal institutions by strengthening formal laws or by allowing very little flexibility in their laws which will adversely affect the capacity for innovation and retards the development of other complementary institutions, which are necessary when a country moves from a rigid to a more flexible regime.[360]

[356] Mark J. Roe, 'Backlash ' 98 Columbia Law Review 217041
[357] Katharina Pistor, 'The Evolution of Corporate Law: A Cross-Country Comparison ' 37
[358] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 97
[359] Katharina Pistor, 'The Evolution of Corporate Law: A Cross-Country Comparison ' 4
[360] Ibid 7

However, different studies[361] have suggested that getting the "right" laws on the books will boost financial market development. However, there are reasons to caution against such simplistic conclusions. The results of these studies could not be replicated in transition economies since massive legal change, especially in corporate law, has had remarkably little impact on the development of financial markets.[362] Moreover, the law-on-the-books has not always been the cause for economic growth. It has been argued that countries with strong shareholder protection (mainly common law countries) have had better economic growth but there is no straightforward evidence showing that these countries necessarily had better laws on the books when they developed their corporate law. Indeed, they improved the law in response to challenges posed by the growth of the corporate and financial sectors. In this situation, key questions arise as to "why do some countries develop better laws over time than do others? More generally, how does law evolve? Can we observe systematic differences in the evolution of law between different legal families (common law and civil law) on one hand and between countries that have their legal systems transplanted from other countries and countries that develop their own systems on the other?"[363]

Pistor and others argue that:

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[361] 'Empirical research based on a sample of 49 countries, most of them OECD member states, suggests that the level of shareholder protection is positively correlated with the development of stock markets, as measured by standard indicators, such as market capitalization and turnover ratio (La Porta and others 1997, 1998). Another empirical study (Johnson and others 2000) concludes that East Asian economies with more effective corporate laws were able to weather the 1997/98 financial crisis better than those in which shareholders were afforded fewer protections by the law on the books and the effectiveness of legal institutions, as measured by perception data'. In Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 89-90

[362] Martin Raiser and Stanislaw Gelfer Katharina Pistor, 'Law and Finance in Transition Economies' 8 Economics of Transition 325 32

[363] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 90

> "The fact that the transplantation of similar if not identical laws within decades after their enactment in the Western origin countries did not produce similar results questions the importance of formal law on the books for economic development. However, there may be more to effective law-making than getting the rules on the books right. Without a demand for law, which could be spurred by socio-economic development, the law will live a book-life, but will be ignored in practice".[364]

Pistor et al.[365] answered these questions by proposing that "the process of legal change is crucial for the development of effective law". By this proposition they imply that the mere changing of the law on the books is not enough. "For law to be effective, it must become part of the institutional fabric of a society, contributing to the process of institutional innovation and change". Law will be effective when it changes as a response to "changing demands or socio-economic conditions, such as changes in the size or ownership structure of firms or in the patterns of finance". They continue by arguing that "the success of a legal system is not determined by having miraculously enacted good law at the outset but by developing the capacity to continuously find solutions to new problems".

It has been difficult to prove empirically that law and legal institutions have contributed to economic growth and legal development.[366] Case studies on individual countries or regions are numerous but, due to lack of reliable data, a broader empirical research on the development of law and legal institutions is rare. In recent years, some studies have been conducted showing that "perception data that measure effectiveness of legal institutions – the absence of corruption, the rule-based exercise and transfer of State power, the absence of expropriation and contract repudiation by the State, and

[364] Katharina Pistor, 'The Evolution of Corporate Law: A Cross-Country Comparison ' 9
[365] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 90
[366] Pistor, K, and Wellons, P, 1999. '*The Role of Law and Legal Institutions in Asian Economic Development, 1960-1995*', New York: Oxford University Press.

the effectiveness of the judiciary – are positively correlated with the level of per capita GDP."[367]

Berkowitz et al.[368] have argued that the successful adaption of transplanted law to local conditions has a major impact on economic development. In origin countries the process of change tends to happen continuously and gradually but this process in transplant countries tends to stick for a long period of time and when it happens, it is usually extreme, unstable and inconsistent. This pattern of legal change has been referred to as the "transplant effect", which implies that the imported rules have been rejected in the host country[369] and failed to become an integral part of the transplant country's socio-economic infrastructure; that is, effectiveness is not merely a function of the characteristics of formal law, but is also a function of various potential inefficiencies of implementation of the transplanted law which makes it "alien" in the environment.[370]

Stagnation may actually show the irrelevance of the formal legal system, which might be an indication of the effectiveness and efficiency of informal governance mechanisms which render the formal law irrelevant, or there is little or no demand for that particular set of rules therefore their governments might decide not to invest in institutions necessary to implement the new legal change, or the economic conditions of the transplant country are sufficiently different from the origin country, or the State may direct economic activities through administrative rules and regulations, leaving too little room for private actors to make differences in the market. Whatever the

[367] Knack and, Keefer 1994; Mauro 1995 in Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 92-93
[368] Daniel Berkowitz 3 & 17
[369] Ibid 3
[370] Schauer 6

reasons, legal stagnation signals rejection or only partial reception of legal transplants.[371] At the same time, some countries for several reasons may be "transplant resistant", meaning that the legal culture is strong in a particular area of law and it is parochial, leading to a monopoly-like situation in which legal alternatives are ignored.[372]

Transplant countries try to solve the problems that occur due to sequences of abrupt legal change by following other countries' legal development and importing foreign law, which has proven to be a repeated failure. Differences in legal systems produce different legal institutions over time. Substantial sudden legal change by importing new laws impairs the effectiveness of these legal institutions leading to rejection of the imported rules.[373] In other words, countries that adopt foreign law are frequently unprepared for it or for the changes it brings.

Implicit in this argument is that "the causality runs from the legal family to good law to good economic outcomes".[374]

If this proposition were true, policy advice would be straightforward. But unfortunately this proposition has proven to be wrong in different development projects. "In transition economies the level of shareholder or creditor rights protection on the books does not have a statistically significant impact on the development of

[371] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 108
[372] Mattei, 'Efficiency and Equal Protection in The New European Contract Law: Mandatory, Default and Enforcement Rules' 4-6
[373] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 92
[374] Ibid 93

stock or credit markets".[375] On the contrary, the effectiveness of legal institutions and the process of law-making have been empirically proven much better predictors of financial market development than the content of legal rules. Even in transitional economies the effectiveness of legal institutions has proven to be a strong predictor of financial market development.

Berkowitz and others[376] show that legal families have little impact on the effectiveness of legal institutions. In contrast, there are significant differences between origin and transplant countries. Today origin countries have more effective legal institutions than do transplant countries that imported their laws. "Among legal transplant countries, the countries that adapted law in the process of importing it, as well as countries that had a population in place that was already familiar with the basic principles of the law being imported, have more effective legal institutions today than do countries that did not, even after controlling for GDP".[377] They suggest that legal families have only limited predictive power with regard to the effectiveness of legal institutions and those differences between origin countries and transplant countries account for differences in legal effectiveness.

As the size of transactions, and consequently markets, grow the informal governance mechanisms become less effective.[378] That is, if formal rules are not in place to govern the market, informal mechanisms surface, which in order to be effective reduce the size of the transactions and consequently of markets. Applying this

[375] Katharina Pistor, 'Law and Finance in Transition Economies' 32
[376] Daniel Berkowitz 3
[377] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 94
[378] David Charny, 'Nonlegal Sanctions in Commercial Relationships' 104 Harvard Law Review 373142

proposition to corporations would mean that the more formal the law in place to increase shareholder and stakeholder protection, the more prosperous the economy will become.

3.5 Costs of Legal Change

Each legal change requires an adjustment in corporate statutes or business strategies therefore it imposes a cost.

The costs of adjusting to new laws include:

> "(I) Direct cost from acquiring information, importing (e.g., drafting a new law) and learning foreign legal rules and practices; (II) rent-seeking costs from those who plausibly lose from changing legal rules and are willing to waste resources to avoid those changes; (III) indirect costs due to the potential loss of legal coherence and potential contradictions within the emergent law given that some areas of the law will be more changed than others".[379]

Recently, Garoupa and Ogus[380] pointed out that free-riding might be the cause of the lack of full adjustment by legal systems. If one country transplants, it alone bears all the costs whereas other countries gain from reduced legal deformity. Thus, each country prefers to harmonize by exporting their own legal rules, rather than the importing of others' legal rules.[381]

These costs are one of the reasons that countries delay or avoid a process of legal harmonization that could reduce barriers to international trade. In the present

[379] Nuno Garoupa and Anthony Ogus, 'A Strategic Interpretation of Legal Transplants' 35 The Journal of Legal Studies 339 10
[380] Ibid 23
[381] Emanuela Carbonara and Francesco Parisi, 'The paradox of legal harmonization' 132 Public Choice 367 5

globalized market, countries face conflicting incentives. Although it is widely recognized that there is an increasing need to homogenise commercial laws for a uniform regulation of transnational trading flows, there are also substantial switching and adaptation costs that may induce countries to preserve their local laws.[382]

According to Legrand, social and political adaptation costs may be so high to make harmonization and unification impossible: legal traditions may be so distant from each other that society would simply resist the proposed legal change.[383]

The impact of transition costs on the process of legal change has been the subject of a lengthy literature. These costs should be taken into account in any rational decision-making on the form and structure of proposed changes in law because of their potentially significant impact. The costs might be so high that it brings into question the adoption of otherwise superior alternatives and the entire reform project. At the same time, proper analysis of transition costs make lawmakers aware of the effects of undisciplined changes and help them with the drafting and implementation techniques that can mitigate these costs to bring about stability for the market.[384]

However, some degree of legal certainty is argued to be essential for a capitalist system to function properly. Clear and stable legal norms bring benefits to legal actors in a variety of ways: First, they promote efficient decision-making by affecting firms and individuals in the arrangement of their affairs. Second, they also can lead to a decrease in the costs associated with obtaining professional advice for transactions.

[382] Michael P. Van Alstine, 'The Costs of Legal Change' 49 UCLA law review 789 795
[383] Pierre Legrand, 'The impossibility of legal transplants ' 4 Maastricht journal of European and comparative law 111
[384] Alstine 793-5

Third, familiarity with an established body of law among legal actors themselves may lead to a reduction of transaction costs through strengthened bonds of interim trust.[385]

3.6 The Effects of Legal Tradition and Legal Culture

Lawmakers, especially in small jurisdictions, are aware of a country's need of investment by multinational corporations and domestic industries, which usually threaten to migrate and operate under another jurisdiction (assuming that there are no barriers to the freedom of establishment and movement of capital) if the national legal system imposes higher costs on them than those incurred by their competitors operating in different jurisdictions. This pressure, which is the consequence of competition between different legal suppliers (and it is argued that the chief engine for change is competition between national legal orders[386]), can heavily influence politicians and subsequently motivate lawmakers; however, competition might not always prevail if having more competitive laws endanger key players' potential benefits. One of the most common ways of opposing a legal change process is to argue that they are against the domestic "legal culture".[387]

Comparative lawyers have become increasingly obsessed with notions of "legal culture". By this, they mean "those historically conditioned, deeply rooted attitudes about the nature of law and about the proper structure and operation of a legal system that are at large in the society".[388] Consequently, it has been argued that

[385] Ibid 813
[386] Anthony Ogus, 'The Economic Basis of Legal Culture: Networks and Monopolization' 22 Oxford J Legal Studies 419 420
[387] Ogus, 'A Strategic Interpretation of Legal Transplants' 4-5
[388] Ogus, 'The Economic Basis of Legal Culture: Networks and Monopolization' 419

harmonization between fundamentally different legal cultures is inherently impossible; therefore, "transplants" will be rejected.[389]

Undeniably, mutual adaption between different cultures will not be easy but, in Ogus' words, the "culturalists" exaggerate the problem and fail to take into account the economic forces behind the phenomenon they are describing. He argues: "the acknowledged characteristics of "legal culture", a combination of language, conceptual structure and procedures, constitute a network which, because of the commonality of usage, reduces the costs of interactive behaviour. Further, if exploited by a dominant group with monopoly power, these phenomena can give rise to rents for the suppliers and inefficient outcomes".[390]

But one might rightly question: what is "legal culture"?

"Legal culture refers to those elements in law that go beyond the mere content of statutory or case law. It includes the historical background of a legal system, the emergence of sources of law, the systematization of the law, the style of argument and codification, legal education, and the ranking of law in a country's social order." Siems emphasizes that one should not underestimate the importance of these factors since it is because of them that legal transplants are claimed not to be feasible "in the sense that even formally identical rules, being interpreted and applied differently in

[389] Legrand, P, in several papers, notably: Legrand, 'European Legal Systems Are Not Converging' For less extreme but broadly similar views see Kahn-Freund, and Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences '
[390] Ogus, 'The Economic Basis of Legal Culture: Networks and Monopolization' 420

different legal systems, do not survive the journey from one legal system to another unchanged".[391]

Post-modernists adopt a definition derived from systems theory, stating: "the framework of intangibles within which an interpretative community operates, which has normative force for this community... and which, over the *longue duree*, determines the identity of a community *as community*".[392] In practical terms, this is a set of linguistic, conceptual and procedural phenomena which serves to distinguish the legal community from other "communities"; which becomes the principal means of communication of legal principles and decisions in a particular jurisdiction.

An economic interpretation of "legal culture" leads us to the notion of "network".[393] Networks reduce transaction costs between market actors. The more actors accept them, the more valuable they become, which might cause monopolization by the actors within that network and lead to rent-seeking. A driving force behind the network characteristic of legal culture is that there are significant scales of economic benefits for those using a specific network. The added value that the network actors draw is from the fact that large numbers of other agents also use that network.

"Nevertheless, in general, economists are not convinced that the existence of networks will restrict or retard innovation, at least where there are competing suppliers to the network, or others ready to create alternative networks. Those

[391] Mathias M. Siems, 'Legal Origins: Reconciling Law & Finance and Comparative Law' 52 McGill Law Journal 55
[392] Legrand, *Fragments on Law-as-Culture* 27
[393] Ogus, 'The Economic Basis of Legal Culture: Networks and Monopolization' 423

developing new technologies will know that buyers will be ready to abandon one system, if they will benefit substantially from a new system".[394]

Blankenburg argues that "legal culture" can be explained in the following terms:

"A complex interrelationship on four levels:

- The level of values, beliefs and attitudes towards law
- Patterns of behaviour
- Institutional features
- The body of substantive as well as procedural law".[395]

3.7 Legal Transplants in Developing Countries

Designing the right legal system is a fundamental challenge when attempting to promote economic growth in a developing country. "Law will not solve all the ills of the developing world – it will not provide food for the hungry or electricity for those without power – it will, however, allow developing countries to have a legal infrastructure to assist their development in order to attain these very important social rights".[396]

Law-making is thought of as one of the main features of national sovereignty. If this belief prevails, nations, especially transforming transitional economy nations, may believe that indigenous law-making is an important feature of a successful

[394] Ibid 424
[395] Valderrama 274
[396] Jeremy J. Kingsley, 'Legal Transplantation: is this What the Doctor Ordered and are the Blood Types Compatible? The Application of Interdisciplinary Research to Law Reform in the Developing World- A Case Study of Corporate Governance in Indonesia' 21 Arizona Journal of International & Comparative Law 493 498

transformation, and consequently may choose to reject other nations' influence, even under circumstances in which this influence is perceived to be valuable to the economic development, in favour of "doing it themselves", even if that means doing it less well.[397] "The image of law as specially related to sovereignty, to national self-expression and self-determination, to national reputation, and to national self-esteem will produce pressures towards indigenous law-making that are greater than the pressures towards indigenous institution-creation in non-law domains".[398] Law reforms imposed upon developing nations have traditionally failed to meet the indigenous commercial and social needs because the reforms have focused on the needs of the colonizer or international community, rather than on facilitating the development of domestic communities, commerce and markets.[399] Legal borrowing is easier in the case of commercial and economic development than in the case of constitutional law that has a lot to do with the core values of that nation.

A very preliminary issue with moving towards a unified legal system for international business has always been with the definition of corporate governance: What is corporate governance? There is no consensus on the definition of corporate governance. This means that it is complicated to implement reforms in this area because there is no consensus as to what has to be done. Unfortunately, it is usually the case that the reform requests in relation to corporate governance are ambiguous due to the lack of clear legal structure and clear definition. There is a fundamental problem without any real solution being offered.[400]

[397] Schauer 3
[398] Ibid 6
[399] Kingsley 498
[400] Ibid 502-503

Another important question here is whether there is going to be a "global convergence that eliminates systemic difference" or "the emergence of a hybrid best practice system" or whether both of these alternatives are inappropriate. William Bratton and Joseph McCahery in their influential work on comparative corporate governance assert that each national corporate governance system is a significant system in itself.[401] Each legal system is not a "loose collection of separable components" but rather all the components are related and complete one another.[402] No empirical research demonstrates a clear necessity or requirement for convergence of corporate governance laws.[403] Therefore, there is a place for developing individual national models of corporate governance and no need for developing nations to simply cut and paste Western laws into their law books.[404]

On the contrary, some have argued that legal harmonization and transplantation can help increase trade flows. They argue that:

> "A unified legal system avoids the conflict of laws problems and the often difficult application of private international law and foreign substantive law. This reduces the legal uncertainty associated with international business, generating greater legal predictability and security".[405]

However, the assumption that legal harmonization will lead to legal institution improvement has been questioned by several authors. It has been argued that these attempts tend to ignore the main elements of successful economic development,

[401] William W. Bratton and Joseph A. McCahery, 'Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference ' 38 Columbia Journal of Transnational Law 213, 219
[402] Ibid 219
[403] Ibid 222
[404] Kingsley 499
[405] Parisi 3, Ribstein and Kobayashi list the benefits due to harmonization and transplantation. In Larry E. Ribstein and Bruce H. Kobayashi, 'An Economic Analysis of Uniform State Laws' 25 The Journal of Legal Studies 131

which are the constant change, innovation and adaptation of institutions and organizations in a competitive environment. Instead of improving domestic legal systems, standardization or harmonization may actually undermine the development of effective legal systems. Pistor has argued that "for developing effective legal systems, the contents of the supplied laws is of only secondary importance to the process of law development and the compatibility of the new laws with pre-existing conditions, including existing legislation and legal institutions".[406]

There are two reasons that account for the importance of compatibility. These two reasons are embedded in features of legal systems: (I) the interdependence of legal rules and concepts that comprise a legal system, meaning that legal rules cannot be fully understood and enforced without reference to other legal terms and concepts. This means that without developing necessary complementarities for implementing the new rules, they might actually distort the domestic legal system. (II) Law is a cognitive institution meaning that for it to be effective and actually change behaviour, the application and enforcement of rules must be fully understood and embraced not only by law enforcers, but also is determined by the perception of those using the law.[407]

As it has been suggested by Pistor and other authors, since the financial law standards tend to be general in nature, rather than harmonizing highly specified rules, the

[406]katharina Pistor, 'The Standardization Of Law And Its Effect On Developing Economies' number 4 Paper provided by United Nations Conference on Trade and Development in its series G-24 Discussion Papers Abstract
[407] Ibid

standards should aim only at establishing the principles for such rules and leave lawmakers free to modify them where appropriate.[408]

As for the design of reform packages, two camps have emerged in the debate: on the one hand, there are proponents of the "big bang" approach, who argue for a quick and all-at-once introduction of all reforms. On the other hand, there are those who stand for a "gradualist" approach and emphasize step-by-step sequencing of reforms. The advocates of the big-bang approach and political arguments often base their case on the assumption that reform packages complete one another and should be introduced simultaneously and comprehensively; thus, introducing partial reforms would eliminate their positive effects and disorganize the economy.[409]

On the other hand, the proponents of gradualist reform have argued that (I) gradualist reform packages have generally higher *ex ante* feasibility and may be easier to get started, and (II) sequencing of reforms may create constituencies for further reforms and increase ex post irreversibility of enacted reforms.[410]

The constant concern of gradualist reformers is the cost of reversal in case of rejection. From an *ex post* point of view, since a big-bang strategy involves high reversal costs, it reduces the reversibility of enacted reforms. From the *ex ante* point of view, however, high reversal costs in the case of aggregate rejection may make a big-bang approach politically unfeasible. Gradualism gives an additional option of

[408] Ibid 3
[409] Kevin M Murphy, Shleifer, Andrei and Vishny, Robert W, 'The Transition to a Market Economy: Pitfalls of Partial Reform' 107 Quarterly Journal of Economics 889 905
[410] Mathias and Roland Dewatripont, Gerard, 'The Design of Reform Packages under Uncertainty' 85 American Economic Review 1207 1208

early reversal at a lower cost. This quite general advantage of gradualism may explain why politicians so often take a gradual approach to large-scale reforms.[411]

Developed and developing countries, presuming lawmakers' key responsibility is to control the activities of members of the society, vary in the amount of activities that will be regulated by the law. As Glaeser and Shleifer put it: "a key goal in the design of a legal system is to control law enforcers".[412] Starting from this premise, it is arguably reasonable to conclude that simple, bright-line rules are optimal for developing countries[413] since these kinds of laws facilitate the monitoring and control of incompetent and corruptible judges and politicians, who are more likely to be found in developing countries than in developed countries.[414]

But, as it has also been argued before, developing countries should be wary of adopting legal transplants. Scholars who have written about the economic implications of legal transplants have demonstrated varying degrees of enthusiasm for the practice. For example, Berkowitz, Pistor and Richard claim to show that countries that have transplanted laws without adaptation and applied them to a population that was not already familiar with the laws tend to have relatively ineffective legal institutions.[415] Closer to the other end of the intellectual spectrum on this issue is Richard Posner, who "while emphasizing the importance of adopting transplanted laws to local culture, endorses transplantation as a means of creating a legal code in

[411] Ibid 1209
[412] Shleifer25
[413] Richard A Posner, 'Creating a Legal Framework for Economic Development' 13 World Bank Research Observer 1
[414] The claim that bright-line rules facilitate monitoring is widely accepted. See, for example, Mele267; Wood559 and Shleifer in Friedman 1-2
[415] Daniel Berkowitz 4

circumstances where merely local laws and customs are unsuitable or where legislative drafting skills are scarce".[416]

A pluralistic and localized approach to law reform is something that the international community needs to consider for developing countries. The problem has always been how to translate the "living law" to an intellectual and practical framework. In order to achieve this, Kingsley has proposed three steps: the first step is the acceptance of a conceptual framework: legal culture. The second step is the establishment of core parameters, in which the current laws and possible deficiencies arising out of these laws are reviewed. The third step is the application of interdisciplinary research. [417]

It has been argued that legal harmonization programmes will lead to economic development. Development programmes are supposed to incorporate proposed legal reforms into domestic legal systems in order to improve the existing legal framework and to accelerate the process of legal convergence. They are supposed to result in economic development with the double benefit of reducing transaction costs for transnational investors and increasing the quality of legal institutions in countries whose institutions are less developed. [418]

While there are also some empirical evidences showing that securities markets are important determinants of economic growth,[419] comparative data also suggest that countries need to reach a certain threshold in their income levels to develop securities markets. "Securities regulations have also remained underdeveloped. While some

[416]Posner: In Friedman 27
[417]Kingsley 496
[418] Pistor1
[419] Siegel and Levine, 'The Legal Environment, Banks, and Long-Run Economic Growth'

countries experimented with establishing a legal regime prior to the advent of market development, others have lagged behind even as markets developed more rapidly. Several countries ensured direct State control over the markets by vesting a ministry or other executive agency with the right to regulate markets rather than establishing an independent regulator".[420] Moreover, these countries do not tend to liberalize their laws. Indeed, in many countries the body in charge of securities market regulation is not an independent agency, but rather under the direct control of the Ministry of Finance, or an equivalent governmental organization. That is, "rather than using securities regulation as a complementary control device for shareholders and investors, it was frequently used as an instrument of direct State control".[421]

"The development of effective domestic institutions is crucial for the governance of global markets, because without a supranational enforcement system, law enforcement is dependent on local institutions".[422] Most of the proposed reforms depend on the existence of a developed and well-functioning legal infrastructure. That is, nations need to have a well-functioning legal foundation in order for the reforms to operate properly within the legal system, which will increase income level and development of the securities market and lead to economic growth.[423]

In recent years a prominent strategy for economic development has been strengthening the rights of shareholders. Two arguments account for this. First, as studies have confirmed, a relationship exists between a developed securities market

[420] Katharina Pistor, 'The Evolution of Corporate Law: A Cross-Country Comparison ' 53
[421] Ibid 53
[422] Pistor 2
[423] Ibid 2

and economic growth.[424] Put in a nutshell, corporations grow and prosper if financial capital is available. The second link in the analysis is that investors will be more willing to invest if they are adequately protected from expropriation. Accordingly, for developing countries, the basic policy argument has been to adopt reforms that protect shareholders.[425]

But the important question here is what *particular* reforms and what type of corporate governance system is required in a developing country and is more likely to foster securities markets?

To start, one can usefully ask whether a market-oriented approach to corporate governance is feasible for developing countries looking to develop equity markets. For many authors, the answer to this question has been negative since the market-oriented approach assumes the existence of markets with non-legal market institutions infrastructure to protect shareholders instead of formal laws. The existence of non-legal complementarities represents little need for strong laws. However, developing countries do not yet have the mature market institutions that make a market-based model of governance with weak legal safeguards for protecting shareholders possible. Indeed, the whole endeavour is to create markets.[426]

In order to answer this question, Paredes has suggested "instead of an enabling corporate law, a much more mandatory corporate law regime for developing countries that basically fills the void left by the lack of market institutions in these countries".[427]

[424] See generally: Levitt Salazar and Ann K. Buchholtz
[425] Deakin40 1
[426] Kiarie 1911-1913
[427] Deakin 407

3.8 Conclusion

Differences in different legal systems do not imply inefficiencies.[428] Different legal systems may develop different solutions to the same problem that is consistent with their legal tradition, which may be as efficient as the agreed legal theory by the competitive market. It is not a rule of "one size fits all".

In this paper, the definition of legal transplants was presented and attempts were made to show its development and its influence in the study of legal culture and legal systems, taking into account the variations of a transplantation process based on social, legal, economic, fiscal, financial and technical circumstances prevailing in each country's "legal culture" and legal system. Different series of arguments including Watson's argument, LLSV's argument and Pistor et al.'s arguments and the arguments for and against their points of view were presented to demonstrate the role of legal transplants. Additionally, the effect of costs that a legal system incurs through the legal transplantation process was discussed. Furthermore, the development of legal transplants in developing countries was discussed. It was suggested that legal transplantation is not an easy and short-term solution for developing countries in order to fill in the gap of less developed legal systems. "For law to play a role in economic activities and long-term economic development, it must be incorporated, meaning that it must develop solutions to problems that exist in the home jurisdiction".[429]

[428] Mattei, 'Efficiency and Equal Protection in The New European Contract Law: Mandatory, Default and Enforcement Rules' 6

[429] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 109

As noted by Levine, financial systems exist to mitigate information and transaction costs in order to improve the allocation of capital within the market. Different types and combinations of information, enforcement and transaction costs in conjunction with different legal, regulatory and tax systems have motivated different financial contracts, markets and intermediaries across countries and throughout history.[430]

The suggestion was made that in order to conduct a more comprehensive research project on legal transplants, three factors should be taken into consideration:

1. The effect of "legal culture"
2. The fact that some countries mix legal origins and import law from different countries e.g. Japan's legal system is transplanted from France but the new Corporate Law is taken from the US model.
3. The process of transplantation plays a more important role in its success than the rules that are being transplanted.[431]

[430] Deetz 178.
[431] Valderrama 263

Chapter 4: Corporate Social Responsibility in Developing Countries

4.1 Introduction

In this chapter Key proposition 3.3 will be further discussed. Attempts will be made to see whether transitional economies, such as Iran, present a major obstacle to the adoption of a dispersed ownership model of the corporation. Additionally, Key proposition 1.2 will be further examined. This holds that the so-called "law-matters" thesis needs to be assessed by reference to what has been called "functional equivalents" to law in transitional economies such as Iran.

In order to do this, first, globalization and its effect on the developing country will be discussed. In the first section, the different nature of CSR policies in developing countries will be demonstrated and an attempt will be made to define a conceptual framework for studying comparative CSR. Second, the Anglo-American nature of reforms and the two contributing factors to development of this model of corporate governance including the failure of Import Substitution Industrialization (ISI) and the influence of international financial bodies will be discussed. Third, three main social reporting theories:[432] – legitimacy theory, stakeholder theory and institutional theory – will be presented. In stakeholder theory, team-production theory as a credible challenge to the principle-agent model of corporate law and the arguments for and against it will be discussed. Fourth, social development as a result of economic development or vice versa will be discussed while drawing attention to cultural dimensions influencing the society's CSR agenda. Fifth, attempts will be made to see

[432]Deegan

if corporations have the responsibility to promote development. In this section the "private government" assumption of corporations will be discussed.

The normative analysis of corporate governance[433] falls into two categories: first, the analysis of corporate governance responsibilities within the context of a given system or model of corporate governance; and second, the comparative evaluation of different models of corporate governance. Analysing CSR (Corporate Social Responsibility)[434] policies in developing countries perhaps covers a little bit of both categories. While one needs to analyse the contingencies of corporate governance in a given country, comparisons should be made with more successful implementation in other countries.

The corporate governance reforms in emerging markets/developing countries[435] are said to be important for several reasons: first, reforms legitimize the liberalization

[433] Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders, the board of directors, employees, customers, creditors, suppliers, and the community at large.

[434] "CSR" is a term that defies precise definition. But nearly everyone can agree that it is about the business contribution to sustainable development – how business can take into account the economic, social and environmental impact that their operations will have on society.
It is a form of corporate self-regulation integrated into a business model. Ideally, CSR policy would function as a built-in, self-regulating mechanism whereby business would monitor and ensure its support to law, ethical standards and international norms. Consequently, business would embrace responsibility for the impact of its activities on the environment, consumers, employees, communities, stakeholders and all other members of the public sphere. Furthermore, CSR-focused businesses would proactively promote the public interest by encouraging community growth and development, and voluntarily eliminating practices that harm the public sphere, regardless of legality. Essentially, CSR is the deliberate inclusion of public interest into corporate decision-making, and the honouring of a triple bottom line: people, planet, profit.

[435] The term "emerging market/economies" was originally coined by IFC (International Finance Corporation) to describe a fairly narrow list of middle-to-higher income economies among the developing countries, with stock markets in which foreigners could buy securities. The term's meaning has since been expanded to include more or less all developing countries. The World Bank (2002) says that developing countries are those with a Gross National Income (GNI) per capita of $9,265 or less. The World Bank also classifies economies as low-income (GNI $755 or less), middle-income (GNI $756–9,265) and high-income (GNI $9,266 or more). Low-income and middle-income economies are sometimes referred to as developing countries. Sandeep K. Krishnan and Rakesh Balachandran,

movements and the governments' cuts. Second, they decrease inefficiencies and promote competitiveness by allowing domestic firms to enter the global market. Third, they result in gaining investors' confidence to gradually eliminate the debts by development banks.[436]

The point that should be taken into consideration is that the emerging markets present both opportunities and risks for MNCs (Multinational Corporations).[437] On the one hand, almost two billion consumers in emerging markets put forward a huge market opportunity for MNCs. Indeed, the best way now to generate both profits and create societal value by promoting development is to focus on emerging markets.[438] On the other hand, MNCs operating in these countries face some challenges and difficulties. Doing business in emerging markets will be difficult because many of them are characterized by either bad or weak public governance and administration, lack of public transparency, high levels of bribery and corruption, poor records on human rights, inadequate environmental, safety and labour standards and high levels of poverty and inequality.

Three factors should be taken into account when studying CSR in developing countries: first, the multinational corporations are increasingly competing to gain first mover advantage in developing countries; second, in most developing countries, "the State still holds the key to business success because of the existence of trade and business regulations restricting the freedom of multinational corporations to

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'Corporate Social Responsibility as a determinant of market success: An exploratory analysis with special reference to MNCs in emerging markets' Indian Institute for Management5

[436] Darryl Reed, 'Corporate Governance Reforms in Developing Countries'' 37 Journal of Business Ethics 223 229-230

[437] "MNC" (Multinational Corporation) has been broadly defined as any corporation with operations in more than one country.

[438] Balachandran13

incorporate their previously successful business doctrines which have been tried and tested in the developed nations"[439]; third; emerging markets have been identified as a source of enormous talent with the increased level of education.

4.2 Globalization

Globalization has been defined as the process of intensification of cross-border social relations between actors from very distant locations, and the process of growing transnational interdependence of economic activities with the State losing most of its political and monetary power, leading to economic integration and convergence.[440]

The advocates of globalism are convinced that an unlimited and borderless global economy will lead to better common good. They argue that the primacy of market imperatives over political regulation will leave everybody better off.[441] The economist Adam Smith in "The Theory of Moral Sentiments"[442] believed that the "invisible hand"[443] of the market will direct private corporations to do less harm and move towards the common good; therefore, one might assume they can be considered as the solution to the global regulation gap and public well-being.

It is generally presumed that the State in a capitalist society is in charge of setting out the rules and preconditions for proper working behaviour. This presumption is undermined by different factors. Governments informally use corporations' help in

[439] Ibid2
[440] Palazzo, 'Globalization and Corporate Social Responsibility'' 415
[441] e.g. Irwin, 2002; Krauss, 1997; Norberg, 2003. Citing ibid
[442] Adam Smith, *The Theory of Moral Sentiments* (Prometheu Books 2000)
[443] For Smith, the invisible hand was created by the conjunction of the forces of self-interest, competition, and supply and demand, which he noted as being capable of allocating resources in society. This is the founding justification for the laissez-faire economic philosophy. James Stewart Olsen, *Encyclopedia of the Industrial Revolution* (Greenwood Publishing Group 2002) 153-154

implementing public policies, which will likely cause excessive dependence of the State on big corporations. Additionally, the World Trade Organization (WTO) has prevented governments from restricting imports on the basis of the environmental or labour standards which are practised in the exporting country even if they were willing to do so. Moreover, Moon and Vogel have also argued that corporations tend to prefer to be one step ahead of the State and develop their own policies in response to community problems since they know if they do not do so, the State will, and this would mean new regulations and more intervention in the market. [444]

In the modern era, there is a new movement described as "the new regulatory state",[445] which is a combination of different kinds of decentralizing regulation (including self-regulation) and the State "command and control" regulation. There is no single system that can be considered as the only solution to societal issues; therefore, there is "the rise of multiple sources of power and a world in which institutions with regulatory authority must compete".[446] Due to this multi-nationality of corporations and emergence of NGOs with political power, one State or one set of regulations cannot cover the newly emerging issues. It needs multilateral and beyond-national-borders regulation and governance.

Some have argued that CSR is "mutually exclusive" with the role of the State as regulator since CSR is going beyond regulation, and in contrast some insist that CSR is the relationship between the State and market actors.[447] In contrast, Black argues that different national and international regulation is what CSR is dealing with and it

[444] Vogel 308
[445] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 59
[446] Kraakman 34
[447] Vogel 304

does not necessarily come from the State since it is a broader social phenomenon.[448] In other words, regulation includes law but not limited to it. In this way she holds that the role of the State in CSR regulation is limited by nature.

Most of the current literature and discussions on CSR are based on the assumption that socially responsible corporations operate in a more or less properly working political context with proper regulations. But, as it has been argued, most of the time this is not the case in the developing countries due to globalization, the difference in global regulations and framework, reduction in State enforcement power, and massive activities beyond national borders, business corporations have an additional political responsibility to contribute to the development and proper working of global governance.[449] As Stiglitz puts it: "politics and economics are intricately interwoven: corporations have used their financial muscle to protect themselves from bearing the full social consequences of their actions".[450] The critics of "corporatism" emphasize that corporations pose a threat as rivals to governments, resulting in a condition in which "individual citizens become secondary rather than primary democratic participants".[451] In other words, the power of politics that should be directed towards common good by the government, is directed towards gaining private interests by the corporations.

Some critics have attempted to connect a corporation's legitimacy to wider societal regulations. Dahl maintains "every large corporation should be thought of as a social

[448] Kraakman 18
[449] Palazzo, 'Globalization and Corporate Social Responsibility'' 414
[450] Joseph Stiglitz, *Making Globalization Work: The Next Step to Global Justice* (Allen Lane (Penguin Group) 2006) 209
[451] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business*78

enterprise; that is, as an entity whose existence and decisions can be justified only insofar as they serve public or social purposes".[452] According to Parkinson, "to describe companies as social enterprises is thus to make a claim about the grounds of their legitimacy…"[453] – that is, if corporations get their legitimacy from society, they should make sure that their activity is aligned with that society's interests.

On the contrary some have argued that assuming a political responsibility for corporations in a liberal market will cause problems since they are not considered democratic but rather private non-political actors, and if they enter politics it is due to strategic decisions to maximize profits; therefore, they are not accountable before the public.[454]

According to Palazzo, the power of multinational corporations is not just based on their enormous expansion and the amount of resources they control. Their power is further enhanced by their mobility and their capacity to shift resources to locations and legal systems where they can generate more profits.[455] He further argues that multinational corporations, in their role as investors, innovators, experts, manufacturers, lobbyists and employers, play a key role in shaping every aspect of society, from media and entertainment to the environment and employment conditions.[456] However this profit-making goal is also the constraint on their power as well; that is, the traditional view of corporations which holds that corporations are for

[452] Robert Dahl, 'A Prelude to Corporate Reform' 17 Business and Society Reviewquoted in Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business*
[453] John Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Clarendon Press 1993) 23
[454] Palazzo, 'Globalization and Corporate Social Responsibility''
[455] Palazzo, 'Toward a Political Conception of Corporate Responsibility - Business and Society Seen from a Habermasian Perspective ' 22
[456]Kaplan 434

the sole purpose of profit maximization also insists less profit will lead to disinvestment and might put the corporation at the risk of takeovers. This kind of market pressure puts socially responsible managers under pressure to press for more profitable activities instead of socially responsible behaviour in order to satisfy the investors. Another issue is that when corporations go global, they do not face homogenous social values but rather different sets of social (sometimes contradictory) expectations.

Business engagement in social responsibility is either for financial reasons or political ones. As for the economic reasons, the discussion is about the relationship between CSR and Corporate Financial Performance (CFP) but empirical studies[457] have proven that there is a weak relationship between the two. This weakness in economic argument draws attention to the political reasons. It has been argued that CSR is a response to political pressure. Engaging in political process "allow business to not only deflect or dilute certain pressures but also be in the driving seat to ensure that change took place on terms favourable to business".[458]

4.2.1 The Effect of Globalization on CSR Policies in Developing Countries

Arguably, the process of globalization by which regional economies, societies and cultures have become integrated through a global network of political ideas through communication, transportation and trade has made it impossible for developing countries to continue with their previous development programmes due to the interconnectedness of these markets.

[457] Griffen and Mahon, 1997; Guerard, 1997; Waddock and Graves, 2000 quoted in ibid
[458] Ibid 436

Reed[459] has categorized the process of globalization into three interrelated structural processes involving methods of production and forms of State and international economy.

The first process of change, "methods of production", can be explained through the "outsourcing" concept, giving more flexibility to corporations through cutting costs of production and accessing other markets while increasing capital mobility. More specifically, firms retained the central aspects of production processes such as research, development and financial issues while contracting out the marginal aspects, such as production of component parts and maintenance.

Second, the process of change, "forms of state" involves change from social reproduction policies to economic and business policies. That is, the priority is given to innovation and competitiveness rather than welfare rights and social expenditures, leading to a shift towards market-oriented industrial policies.

The third process, "international economy", arose when many countries liberalized their economies through international multilateral and bilateral (the most prevalent) economic agreements.[460] The main characteristic of these agreements is strictly limiting government interventions imposing restrictions. These agreements were also necessary for the "outsourcing" process.[461]

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[459] Reed6
[460] e.g. NAFTA, the Uruguay round of GATT, the WTO, etc.
[461] Thomas J. Biersteker, 'The 'Triumph' of Liberal Economies in the Developing World' in Barbara Stallings (ed), *Global Change, Regional Response: The New International Context of Development* (Cambridge University Press 1995) quoted in Reed 7

The key argument here is that these processes lead to increasingly standardized and rationalized practices beyond the borders of a nation because they are considered legitimate. This legitimacy happens through three processes: first, the external regulations especially issued by bodies such as the UN, the OECD, the ILO or compliance with certain environmental standards like ISO 14000, give legitimacy to new management to involve them in their decision-making; second, copying the process that is considered "best practice" in their organizational field; and third, academic and professional authorities directly or indirectly set standards for "legitimate" organizational behaviour.[462]

4.2.2 The Different Nature of CSR Initiatives in Developing Countries

The definition of CSR has been discussed in previous chapters and earlier in this chapter, but CSR in developing countries represents a different set of challenges:

> "The formal and informal ways in which business makes a contribution to improving the governance, social, ethical, labour and environmental conditions of the developing countries in which they operate, while remaining sensitive to prevailing religious, historical and cultural contexts".[463]

Various reasons have been enumerated for the importance of CSR initiatives in developing countries:[464]

[462]Dirk Matten and Jeremy Moon, '"Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility' 33 Academy of Management Review 10-17

[463] Dirk Matten Wayne Visser, Manfred Pohl and Nick Tolhurst *The A to Z of Corporate Social Responsibility: The Complete Reference of Concepts, Codes and Organisations* (John Wiley & Sons 2007) Wayne Visser, 'Corporate Social Responsibility in Developing Countries' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 474

[464] Visser 474

1. Developing countries are rapidly growing and therefore can be considered as one of the best playing fields for multinational corporations.

2. Most of the dramatic social crises happen in developing countries; hence, these are where multinational corporations are likely to have the most impact.

3. The challenges that these corporations face while trying to implement CSR policies in developing countries usually differ from the ones they face in developed countries.[465]

These challenges together demonstrate a picture of how different CSR is in developing countries:[466]

1. The first difference of CSR in developing countries is that in developed countries the focus of CSR is on ethical and environmental themes such as consumer protection, fair trade, green marketing, climate change concerns or socially responsible investments, while in developing countries, due to serious socio-economic issues, the focus is on social-economic themes including poverty alleviation, health-care provision, infrastructure development and education.

2. The second difference of CSR in developing countries is in the empirical research. In developed countries the CSR literature is dominated by quantitative methods (80%) whereas in developing countries it is more likely to be qualitative.

[465] Ibid 474
[466] Ibid 480-488

3. The third difference of CSR in developing countries is in what Visser[467] has categorized into two groups as ten major drivers of CSR in developing countries:

    1. The first group are "internal drivers," which show themselves in six different ways:
        a. Cultural tradition: despite the common belief that CSR is a new concept, it has been argued that business ethics have a deep root in developing countries' ancient cultures.
        b. Political reform: as mentioned before, any kind of reform in developing countries cannot take place without taking into account the socio-political reform process.
        c. Socio-economic priorities: it has been argued that most of the imported CSR approaches are inappropriate since they fail to take into account social and environmental problem in the region.
        d. Governance gap: some have argued for the CSR policies' capacity to work as better national regulation in developing countries. While some have argued much reliance on their social services is wrong since, first, a corporation's priority is towards their shareholders and they might change the country they are operating in because of issues of profitability. Second, since corporations are profit-oriented, they might support either directly or indirectly the State's corrupt activities. Third, CSR is a concept beyond territorial mechanisms which addresses the limitations of the nation state in regulating the global economy.
        e. Crisis response: these crises are considered as catalysts of CSR.

[467] Ibid 480-488

f. Market access: with the rapid growth of globalization, companies in developing countries should comply with the global requirement of good business.

2. The second group of major drivers of CSR in developing countries are "external drivers," which show themselves in four different ways:
    a. International standardization
    b. Investment incentives: it goes without saying that the more is the social welfare in a country, the more multinational investments they attract.
    c. Stakeholder activism: these stakeholders are 'development agencies, trade unions, international NGOs and business associations. These four groups provide a platform of support for local NGOs, which are not always well developed or adequately resourced to provide strong advocacy for CSR[468]. Civil regulation is perhaps the most effective role of these stakeholders.
    d. Supply chain.

4. The fourth difference of CSR in developing countries is in Carroll's CSR pyramid[469]. It has been argued that compared to the developed countries this pyramid's levels have different significance and order in developing countries. These differences are:

a. Economic responsibilities remain the most important level, which involves providing investments, creating jobs and paying taxes. The danger is still the fact

[468] Ibid 487
[469] Archie B. Carroll, 'A three dimensional model of corporate social performance' 4 Academy of Management Review 497

that states might economically depend on the multinational corporations, leading to less attention to social issues.

b. Philanthropic responsibilities, the last level of Carroll's CSR pyramid, here takes the second importance. These responsibilities would involve providing funds for social projects to improve the quality of life.

c. Legal responsibilities, the second level of Carroll's CSR pyramid, here takes the third place. These responsibilities would involve ensuring good relationships with government officials. "In developing countries, legal responsibilities generally have a lower priority than in developed countries. This does not necessarily mean that companies flaunt the law, but there is far less pressure for good conduct. This is because, in many developing countries, the legal infrastructure is poorly developed, and often lacks independence, resources and administrative efficiency".[470]

d. Ethical responsibilities, the third level of Carroll's CSR pyramid, here takes the last place. These responsibilities include the adoption of voluntary codes of governance and ethics. [471]

4.2.3 Conceptual Framework for Comparative CSR

There are two different corporate responsibility policies: explicit and implicit. Firstly, *explicit* CSR refers to the corporate policies which reflect the company's own discretion and initiative for certain societal interests. These policies normally consist

[470] Visser 497
[471] Wayne Visserquoted in Visser 489

of voluntary programmes and strategies articulated by corporations in attempts to combine business goals and social values. In contrast, *implicit CSR* has been referred to as the corporations' policies as a reflection of wider policy arrangements embedded in *formal and informal institutional environments*. Implicit CSR normally occurs in the form of values, codified norms and rules which result in mandatory and customary requirements defining proper obligations of corporate actors.[472]

The elements of CSR in implicit frameworks have been recognized in workers' rights, the role of trade unions, corporate taxation and environmental legislation; the corporations operating in this system are, however, acting responsibly, as noted by Carroll.[473]

Corporations in the US generally have explicit CSR frameworks, while European ones have rather implicit CSR frameworks, with a recent shift to more explicit CSR. It has been argued this adoption of explicit CSR has to do with "the wider national (and supranational) European institutional re-ordering which provides incentives to adopt corporate-level managerial solutions".[474]

As for the developing countries, if the above-mentioned argument was correct, with the increasing market liberalization and entering into the international business environment, they should have also moved towards a more explicit CSR. But evidence from these countries shows that with "weak civil society and market institutions and sometimes over-arching governments there has only been a slow and

[472] Moon 2-10
[473] Carroll, 'A three dimensional model of corporate social performance' 458
[474] Moon 17

tentative development of explicit CSR"[475] For example, in Russia the absence of long-term social capital and of habits of business responsibility are the main reasons for slow CSR development. "But where markets, civil society and the government are relatively autonomous, mutually reinforcing and non-parasitic, explicit CSR may emerge within the range of governance solutions as evidenced in the Czech Republic and Hungary (coincidentally countries which retained some vestiges of civil society through communism)."[476]

Power and participation are two key issues that require further exploration in the CSR and development debate. CSR is an arena of political contestation "both in the 'macro' sense of defining relations between the market and the State, and [in "micro" sense] between different actors and social groups, and in relation to participation in decision-making".[477] Who has the power to make decisions, what power structures are implicit in CSR, and who has a voice in the debate are all questions that we need to consider.[478]

The developing countries are often characterized by weak institutions and poor governance whose national business systems often delegate responsibility to private actors because they are the dominant families or the religious groups. In general terms, it has been suggested that the rise of explicit CSR in many developing countries has been due to the increasing pressure that many MNCs face in their home

[475] Ibid 18
[476] Jan Jonker André Habisch, Martina Wegner, René Schmidpeter (eds), *Corporate Social Responsibility Across Europe* (Springer Berlin 2004) quoted in Moon 18
[477] UNRISD, 2003, '*Conference news: corporate social responsibility and development: towards a new agenda',* Geneva: UNRISD, P, 21.
[478] Peter Lund-Thomsen Marina Prieto-Carron, Anita Chan, Ana Muro and Chandra Bhushan, 'Critical perspectives on CSR and development: what we know, what we don't know, and what we need to know' 82 International Affairs 977 984

countries to operate under the standards of European and North American environmental, health and safety and human rights. The extent to which explicit CSR will be adopted by corporations in these countries "may depend on the strengths of traditional institutions (e.g. family, religious, tribal institutions) and the governments"[479] that have shaped implicit CSR. [480]

4.4 The Anglo-American Nature of Corporate Governance Reforms

The corporate governance reforms in developing countries are largely in line with the Anglo-American model of corporate governance.

Historically, Anglo-American models have been characterized by: 1) a single-tiered board structure resulting in shareholder primacy; 2) a dominant role for financial markets as the main investor; 3) a weak role for banks; and 4) little or no industrial policy involving firms co-operating with government agencies or labour unions.

In the Anglo-American system of corporate governance the market is said to act as the ultimate "disciplinarian" of wrong behaviours, such as the short-termism and opportunism of managers. Underlying this claim is the neoclassical preference for market forces over State intervention, under the belief that "the market provides the most flexible and least disastrous co-ordinating and adaptive mechanism in the face of complex interdependence and turbulent environments".[481] In other words, the more

[479] Moon 19
[480] Ibid19
[481] Bob Jessop, 'The Dynamics of Partnership and Governance Failure' in Gerry Stoker (ed), *The New Politics of Local Governance in Britain , pp* (Macmillan, Basingstoke 2000) 13

exposure corporations and banks have to market forces, the more pressure is placed on family-run firms in developing countries to act responsibly. It is argued that this is an inevitable squeeze on profits brought about by increased competition, which acts inventively for the benefit of consumers, through making the best use of scarce resources.[482]

The main source of development in an Anglo-American model is expected to be private corporations, which have been arguably seen as the "primary agents of development" and a key element in unleashing the "development potentials".[483]

In this literature, development is understood to be the result of economic growth, which in developing countries' case happens through the process of economic liberalization. Reed argues that reform policies in developing countries have three intentions: first, to increase capital flow by attracting investment; second, to increase competitiveness through market pressure on domestic firms; third, to decrease "rent-seeking" behaviour of politicians by decreasing the number of transactions between business and the government.[484]

The main question here is why are some developing countries moving towards an Anglo-American model? Read accounted for several inter-relating reasons that might have contributed to the development of this model. First, there may be strong historical ties between an Anglo-American model and many countries. Second, the

[482]Alexandre Lamfalussy, *An Essay on Financial Globalisation and Fragility: Financial Crises in Emerging Markets* (Yale University Press 2000) citing Susan Soederberg, 'The promotion of 'Anglo-American' corporate governance in the South: who benefits from the new international standard?' 24 Third World Quarterly 7 19
[483] Reed 231
[484] Ibid232

failure of alternative systems that they experienced in the past,[485] [486] and third, the debt crisis caused by poor economic performance which put them under the direct influence of international financial institutions such as the IMF and the World Bank.[487]

4.4.1 The Failure of Import Substitution Industrialization (ISI)

The ISI approach was preferred by many developing countries after the Second World War. The underlying policy of ISI was to "develop industrial base" to foster emerging domestic productions by strongly intervening with the industrial policies to flow capital in key sectors to protect them from foreign competition. In order to achieve this goal, they made imports more costly and domestic products cheaper through introducing high tariffs and overvalued exchange rates while subsidizing the industry infrastructures.[488]

The ISI strategy proved to be unsuccessful for several reasons. First, lack of competition led to poor quality and expensive products. Second, the government subsidizations led to an increase in debts. Third, inefficiency further increased due to ineffective allocation of resources, corruption, political interventions leading to rent-seeking behaviour, the ability of firms to influence governments to act in their interest instead of the interests of the society and the lack of an effective legal system.[489]

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[485] Lance Taylor, 'Economic Openness: Problems to the Century's End' World Institute for Development Economics Research 57
[486] Reed 228
[487] Thomas J. Biersteker, 'Reducing the Role of the State in the Economy: A Conceptual Exploration of IMF and World Bank Prescriptions' 34 International Studies Quarterly 477 489
[488] Reed 225
[489] ames H. Davis in Reed 225-226

On the contrary, Soederberg explains that: "as in the case of East Asia, the State intervention in the economy is not viewed by market participants as detrimental to the efficient allocation of scarce resources, especially in terms of reducing competition ('crowding out'); instead it is seen as a necessary force to limit unavoidable obstacles in the principle of short-termism and greed-driven herd behaviour".[490]

4.4.2 The Influence of International Financial Bodies

Where the activities of international financial bodies are concerned, the first question that comes to the surface is "Whose interests are served?" It has been claimed that the international standard of corporate governance which tries to introduce 'universal principles' draws on the Anglo-American variant.

Soederberg argues that this imposed standardization of corporate governance serves two overlapping goals: "first, it seeks to stabilize the international financial system by ensuring that emerging markets adhere to the principles of a neoliberal open market economy. Second, by placing a greater emphasis on "shareholder value" than other types of corporate governance, it protects the interests of institutional investors based in market-centric systems such as that of the USA".[491]

Financial liberalisation is posited as a desirable policy since, it has been argued, it leads to economic growth. It has also been argued that debtor countries should be exposed more directly to transnational finance, so that the former may be forced to undertake market-based solutions to their current economic and political problems.[492]

[490] Soederberg 20
[491] Ibid 7
[492] Ibid 8

As a recent World Bank publication puts it, policy modifications are necessary so that the governments, financial sectors and market participants in the global South "adapt themselves to the new, competitive open market economy".[493]

In the words of the former Chief Economist of the World Bank, Joseph Stiglitz:

> "The US Treasury had during the early 1990s heralded the global triumph of capitalism. Together with the IMF, it had told countries that followed the 'right policies' – the Washington Consensus policies – they would be assured of growth. The East Asia crisis cast doubt on this new world-view unless it could be shown that the problem was not with capitalism, but with the Asian countries and their bad policies. The IMF and the US Treasury had to argue that the problem was not with the reforms-implementing liberalization of capital markets … but with the fact that the reforms had not been carried out far enough".[494]

The multilateral institutions responsible for the development of the prevailing corporate governance model have surveillance and disciplinary characteristics which are intended to push developing countries to an Anglo-American model of corporate governance. The World Bank is able to police the implementation of what is considered "good" corporate governance practices in debtor countries on a regular basis by essentially making them an integral part of its anti-poverty and growth strategies, and withholding funds as the ultimate act of punishment.

[493] Ha-sung Jang, 'Corporate governance and economic development: the Korean experience',' in Farrukh Iqbal and Jong-Il You (ed), *Democracy, Market Economics & Development: An Asian Perspective* (World Bank Group 2001) 73
[494] Joseph Stiglitz, *Globalization and its Discontents'* (Penguin; New Ed edition 2002) 213

4.4.3 Problems of Implementing the Anglo-American Corporate Governance Model

There are number of problems associated with implementing the Anglo-American model of corporate governance in developing countries:

First, the agency theory shapes the baseline of the Anglo-American corporate governance system. The nature of the agency problem in this system means aligning directors' interests with shareholders' interests, while this problem in developing countries has been historically between majority and minority shareholders where one of the families is the controlling shareholder, ignoring the interests of the small shareholders.[495]

Second, one of the major concerns here is maintaining competition; that is, when MNCs enter developing countries' markets, because of their advantages, e.g. size, access to other markets, more experience, etc., they will take over a business sector and push the domestic firms out of the market.[496]

Third, some global corporations are becoming bigger than some national governments. The fear here is that with the undermined public policy autonomy of the State, corporations will be able to influence these governments as equal negotiators.[497] At the same time, "the emphasis on corporate governance is being used as a justification on the part of governments (in both developed and developing countries)

[495] Rafael La Porta, 'Corporate Ownership Around the World' 27
[496] Reed 234
[497] Susan Strange, 'Rethinking Structural Change in the International Political Economy: States, Firms and Diplomacy' in Richard Stubbs and Geoffrey R. D. Underhill (eds) (ed), *Political Economy and the Changing Global Order* (McClelland & Steward 1994) 103-115 citing Reed 235

to avoid discussion about the possible need for more effective (binding) international regulation (e.g., in such areas as climate control, biodiversity, international labour standards, antitrust law, etc.)"[498]

Fourth, is the phenomenon that Blair[499] characterizes as "market myopia". The basic problem is that managers are under strong pressure to profit shareholders and this prevents long-term planning and induces short-sightedness.

More importantly, there has been no conclusive evidence in the literature which suggests that the Anglo-American model leads to more stability in financial markets or greater competition than the bank-orientated model found in Germany and Japan. "In a Brookings Institution study, Mitsuhiro Fukao demonstrates that the underlying structure of Japanese and German companies is more conducive to stronger shareholder participation, and more stable management and corporate relations with creditors, suppliers and employees than are common in the USA and the UK".[500]

At the same time, even expecting most corporations to live up to the stronger understandings of a responsibility in developing countries is rather naive. Developing countries struggle with major challenges in their efforts to implement mechanisms to enforce Anglo-American corporate governance reforms and promote development: first, this model has developed some conditions, such as monitoring systems, to function effectively. How can developing countries introduce the same conditions? Second, even if they introduce these basic conditions, do they need to introduce other

[498] Reed 235
[499] Margaret M. Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Brookings Institution Press 1995)quoted in Reed 241
[500] Soederberg 20

features to supplement the Anglo-American model in order to match with their special needs and effectively contribute to development? Third, whether the Anglo-American model is the best choice for promoting development in developing countries or whether, in the longer term, they need to consider alternatives.[501] It is currently being argued that the key to effectiveness does not depend on whether a country adopts one or the other model, but more on whether it has a well-functioning legal system which supports the appropriate and timely enforcement of contracts[502] to tie the reforms to the larger question of democratic political reforms which are being undermined by the notion of globalization. Developing countries in most cases suffer from the absence of explicit regulations, a loose and corrupt enforcement system, ineffectual monitoring at different levels, bribery and corruption, and weak education in legal knowledge. These problems impair transitional legal systems, leaving loopholes or "grey zones" which are exploited by MNCs.[503]

4.5 Social Reporting Theories

Social reporting sits within wider attempts to align business strategies and CSR and "disclosure and reporting of business-related elements that interact with social, environmental and other concerns".[504] In recent years the number of leading companies worldwide who report on CSR-related issues has increased irreversibly.

[501] Reed 240
[502] Freeman 4
[503] Dunfee and Warren, 2001; Harvey, 1999: in Meckling 5
[504] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business*185

There are three mainstream theories on social reporting: legitimacy theory, stakeholder theory and institutional theory. Islam and Deegan[505] have argued that these three theories should not be considered as very different from one another; rather, they are overlapping and have been developed from a similar philosophical background. All three theories see the organisation as part of a broader social system which they are impacted by. Considering all these three interrelated theories together provides deeper insights into the factors that drive social and environmental reporting practices.

4.5.1 Legitimacy Theory

The most widely used theory to explain social reporting is legitimacy theory. Legitimacy theory holds that corporations make sure constantly that they are perceived as acting within the boundaries and norms of the societies they are operating in; that is, they seek to ensure that their activities are perceived as being "legitimate".[506]

"Threats" to a corporation's perceived legitimacy are predicted to be of utmost importance for the management, leading to responsive actions to minimise the impacts of such legitimacy threats. Within legitimacy theory, "legitimacy" is considered to be a resource on which an organisation is dependent for survival.[507] Legitimacy is something that has been imposed on the corporation by a society; however, corporations are able to influence or manipulate disclosure through various strategies. Legitimisation strategies and how managers might react to particular events

[505] Deegan 850
[506] Ibid 853
[507] Gary O'Donovan, 'Environmental disclosures in the annual report: extending the applicability and predictive power of legitimacy theory' 15 Accounting, Auditing & Accountability Journal 344

may vary between countries considering the specific national, historical and cultural context.[508]

4.5.2 Stakeholder Theory

The second theory often utilized by researchers to explain what motivates organisations to disclose social and environmental information is stakeholder theory. Deegan[509] holds that stakeholder theory has two major branches: the ethical and managerial branches. There is a great deal of overlap between the managerial branch of stakeholder theory and legitimacy theory. These two theories can be distinguished by their scope of focus; that is, while legitimacy theory has a general focus upon the expectations of "society", stakeholder theory focuses on issues of stakeholder power which is narrower than the society.

Stakeholders' influence on corporations is determined by the stakeholders' degree of control over resources required by the organisation.

In describing stakeholder theory, and the role of information in controlling (and potentially manipulating) the actions of powerful stakeholders, Gray et al.[510] state: "Here (under this perspective), the stakeholders are identified by the organisation of concern, by reference to the extent to which the organisation believes the interplay with each group needs to be managed in order to further the interests of the organisation. (The interests of the organisation need not be restricted to conventional

[508] Craig Deegan, 'The legitimizing effect of social and environmental disclosures – a theoretical foundation' 15 Accounting, Auditing & Accountability Journal 282 291. In Ibid.
[509] Deegan, 'Motivations for an organisation within a developing country to report social responsibility information: Evidence from Bangladesh' 855-856.
[510] Owen Gray R.H., D.L and Adams, *Accounting and accountability: Social and environmental accounting in a changing world* (Hemel Hempstead: Prentice Hall 1996) 45

profit-seeking assumptions). The more important the stakeholder to the organisation, the more effort will be exerted in managing the relationship. Information is a major element that can be employed by the organisation to manage (or manipulate) the stakeholder in order to gain their support and approval, or to distract their opposition and disapproval".

Some scholars accept the legitimacy of stakeholders but argue that stakeholder theory's point of view that the objective of the company should be maximizing stakeholder benefit rather than shareholder benefits lacks scientific basis.[511] Henderson[512], while generally accepting CSR initiatives, argued that the pursuit of objectives other than shareholder profit maximization may reduce the society's general welfare due to multiple objectives. Jensen[513] suggests that long-term value maximisation is the solution for this, multiple objectives providing a trade-off between shareholder profit maximization and stakeholder needs.

This issue of shareholder's profit maximization is particularly related to the question of why public corporations took form and what their functionality is. The dominant theory holds that corporations have been chosen over other forms of business organization because of the benefit drawn from the separation of ownership from control, which results in "specialization of function". According to this account, corporate law and market mechanisms have been evolved to facilitate and support the

[511] Melsa Ararat, 'A development perspective for "corporate social responsibility": case of Turkey' 8 Emerald Corporate Governance 271 271
[512] David Henderson, *The Role of Business in the Modern World: Progress, Pressures and Prospects for the Market Economy* (Institute of Economic Affairs 2004) quoted in Ararat 2
[513] Jensen 9

"specialization" and reduce the agency costs. Additionally, shareholders are not just the suppliers of the capital; they also bear the risks that come with it.[514]

4.5.2.1 Team-Production Theory

Most of the conventional shareholder models of corporations are based on the idea that those "who invest in a company are its true 'owners', on whose behalf and whose interests alone corporations are managed".[515] The meaning of ownership is important in this context. Horrigan questions this conventional belief first by pointing out that choosing one set of contributors to a corporation's success (shareholders) is justified while investing something of value in the company cannot be limited just to shareholders; and second, why "ownership" is the correct way of describing shareholders' stake in a corporation. Shareholders do not "own" the company in legal terms. They own shares on contract-base terms.[516] Lord Macnaghten summarised the basic Anglo-American legal position in the famous UK *Salomon* case more than a century ago, stating that "the company is at law a different person altogether from the subscribers [and] though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive profits, the company is not in law the agent of subscribers or trustee for them".[517]

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[514] Alan J. Meese, 'The Team Production Theory of Corporate Law: A Critical Assessment ' 43 William and Mary Law Review 1629 3

[515] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 104

[516] Margaret M. Blair, 'Ownership and Control: Rethinking Corporate Governance for 21st Century' in Thomas Clarke (ed), *Theories of Corporate Governance: The Philosophical Foundation of Corporate Governance* (Routledge [1995]2004) 181

[517] *Salomon v Salomon & Co* AC quoted in Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 105

Furthermore, the opponents[518] of the principle-agent model of corporations observed that for the directors to be the agents, they should owe the shareholders (principal-agent) a "duty of obedience". However, directors are not required to follow shareholders' orders in any way. The only two ways that shareholders can exercise weak and indirect influence are: first, limited voting rights to choose the directors that are chosen by previous directors; and second, power to sell their shares. But if the company is run badly, this power does not offer much protection either.[519] Therefore, it has been argued that "directors' legal powers and responsibilities do not resemble those of agents, but rather those of trustees".[520]

One of the most major attacks on shareholder wealth maximization theory is the "team production" theory.[521] This theory has been defined as "production in which 1) several types of resources are used… 2) the product is not a sum of separable outputs of each co-operating resource… [and] 3) not all resources used in team production belong to one person".[522]

The underlying concept of this theory is a move from the mere focus on agency costs to "protecting specific investments," meaning that public corporations today need more than one individual or group to invest.[523] "The appropriate normative goal for a board of directors is to build and protect the wealth-creating potential of the entire corporate team – "wealth" that is reflected not only in dividends and share

[518] Robert C. Clark, *Corporate Law* (Little, Brown and Company 1986) and Dunfee
[519] Margaret M. Blair and Lynn A. Stout, 'Specific Investment: Explaining Anomalies in Corporate Law ' No. 05-27 UCLA School of Law, Law-Econ Research Paper 11-12
[520] Ibid 13
[521] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 101
[522] Dunfee 779
[523] Stout, 'Specific Investment: Explaining Anomalies in Corporate Law '

appreciations for shareholders, but also in reduced risk for creditors, better health benefit for employees, promotional opportunities and perks for executives, better product support for customers and good "corporate citizenship" in the community".[524] The team production scholars Blair and Stout suggest: "the essence is that the whole can be made bigger than the sum of its parts".[525]

This theory questions a 1976 classic article by Jensen and Meckling.[526] According to these two finance theorists, a corporation is not an entity of its own but instead a "nexus of contracts". This view of the firm can be confronted by what Kuhn called "paradigms".[527] According to Kuhn, one of the ways we interact with our surroundings is to develop theories about the way it works and that certain causes lead to certain effects. Once these paradigms are accepted in a society, most of the individuals in that society will stick to it. He argues that the "nexus of contracts" and principal-agent model of corporations is one of these paradigms.[528]

At the same time, the team-production theory embraces and develops the argument by Kuhn asserting that:

> "The public corporation can be viewed most usefully not as a nexus of implicit and explicit contracts, but as a nexus of firm-specific investments made by many and varied individuals who give up control over those resources to a decision-making process in hopes of sharing in the benefits that can flow from team production".[529]

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[524] Ibid 35
[525] Margaret M. Blair and Lynn A. Stout, 'A Team Production Theory of Corporate Law' 85 Virginia Law Review 247 296
[526] Boatright
[527] Dean in Stout, 'Specific Investment: Explaining Anomalies in Corporate Law '
[528] Stout, 'Specific Investment: Explaining Anomalies in Corporate Law '3-5
[529] Stout, 'A Team Production Theory of Corporate Law' 285

The team production theory has been strongly criticized by the advocates of shareholder wealth maximization theory. One criticism of the team production theory argues that this theory has the same problem as other stakeholder theories, under which it is impossible to mediate between different claims on the corporation. Bebchuk treats the team production model of the board as a vehicle for protecting stakeholders' interests, then criticizes the model on the ground that it leaves stakeholders with too little power and directors "accountable to no one."[530] Other critics have doubted the applicability of this theory and argue that given the pressures of stock markets and the power of shareholders, it is not clear how one can shift from shareholder wealth maximization to team wealth maximization without changing the ownership structures.[531] Stout has replied to this criticism by stating that the team production theory is not about giving undue control to either shareholders or stakeholders but rather on benefiting both groups by voluntarily submitting to "mediating hierarchy" with the board sitting on the top of it; therefore, directors must enjoy a wide range of discretion "to balance the competing interest in a way that keeps the team together and keeps it productive".[532] She further explains that "because if either shareholders or stakeholders were given greater leverage over boards, they might use that leverage to pressure boards to opportunistically threaten the interests of other members of the corporate 'team'".[533]

4.5.3 Institutional Theory

The other theory of Social Reporting overlaps with stakeholder theory and legitimacy theory a great deal and used by social and environmental accounting researchers is

[530] Lucian A. Bebchuk, 'The Myth of the Shareholder Franchise' 93 Virginia Law Review 675 57
[531] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 102
[532] Stout, 'Specific Investment: Explaining Anomalies in Corporate Law '34
[533] Lynn A. Stout, 'The Mythical Benefits of Shareholder Control ' 93 Virginia Law Review3

institutional theory. Institutional theory is usually used to explain existing organisational structures regarding their operation or reporting policies. These policies are followed by influential stakeholder groups as a means to exert pressures on corporations to have particular practices in place. This might be the reason for similarities in organizational structures between different corporations.

One key aspect of institutional theory is the concept of isomorphism, which refers to "the apparent adoption of [these] practices is deemed to provide an organisation with a level of legitimacy that would not otherwise be available if it was to deviate from 'accepted' organisational forms or policies". Dillard et al. also explain that "isomorphism refers to the adaptation of an institutional practice by an organisation".[534]

4.6 Social Development

Society's expectations of business vary considerably between countries, depending on their level of economic and social development. Minimum expectations are embedded in the legal framework, more specifically in company law, implicitly or explicitly describing who the organisation is there to serve and how the organisation's purposes and priorities should be decided. The legal framework is driven not only by economic considerations but also by culture and politics.[535]

[534] John T. Rigsby and Carrie Goodman Jesse F. Dillard, 'The making and remaking of organization context: duality and the institutionalization proces' 17 Accounting, Auditing & Accountability Journal 506 quoted in Deegan, 'Motivations for an organisation within a developing country to report social responsibility information: Evidence from Bangladesh' 856

[535] L Lucian, Bebchuk and, Mark, J, Roe, 'A theory of path dependence in corporate governance and ownership' 52 Stanford Law Review 127 7

As noted earlier, traditional Anglo-American growth and development theory has typically given priority to economic development over social development. The basic strategy here was that if liberalization occurs, then this will create economic development leading to more employment and people will have more money and will be able to take care of the social development they need, e.g. education and health. Recent empirical work in the field of development, however, has challenged this contention.[536] As a result, development economists like Noble-prize winner Amartya Sen[537], are increasingly arguing that development in social matters does not result in a considerable development in economic matters, as argued by advocates of the Anglo-American model. He argues that the most successful examples of economic development happened due to the early investment in education (especially primary education), health and other social programmes that allowed for their subsequent economic success. Similarly, Sen argues, China's rapid economic growth is caused by the previous investment in social programmes which prepared the playing field and provided the understanding for undergoing changes.[538]

Development economists like Sen argue that proponents of economic liberalization (who generally advocate Anglo-American corporate governance reforms as well) make a fundamental mistake by assuming that liberalization, which necessarily involves and legitimizes funding cuts and a reduced presence of the government in the provision of social welfare programmes, will induce economic development.[539] To the contrary, governments in developing economies have a key role to play. Because of

[536] Paul Streeten, *First Things First: Meeting Basic Human Needs in the Developing Countries* (A World Bank Research Publication 1982) and Jean Drèze and Amartya Sen, *India: Economic Development and Social Opportunity* (Oxford University Press 1999)
[537] Amartya Sen, *Development as Freedom* (OUP Oxford 1999)quoted in Reed 236
[538] Sen, *Development as Freedom*quoted in Reed236
[539] Reed236

the relatively low costs of health and education programmes in these countries, which provide the necessary basis for long-term growth and development, a tremendous impact can be made without affecting the efforts to stimulate economic recovery.[540] Liberalization policies of the Anglo-American kind are based on developments in private corporations which, however, undermine the social programmes undertaken by governments and are funded by tax revenue; they also are said to induce a "race to the bottom" by engaging in what has been termed "regulatory competition".[541]

Using a development-based and economic-based analysis, Campbell[542] asserted that institutional conditions, such as public regulations and private watchdogs, e.g. the presence of non-governmental and international organizations that monitor corporate behaviour, affect the degree of CSR. Similarly, Marquis et al.[543] observed that institutional pressures at the community level shape corporate social decision-making in large cities where corporation have their headquarters.

At the same time, developing positive relations with the local community is necessary to accumulate social capital, especially for non-local companies. These relations are increasingly used by multinational corporations in order to integrate their subsidiaries into various markets in which they operate. Deep understanding of the local community and social customs is an asset which can be utilized by the companies to gain strategic advantage.[544]

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[540] Ibid235

[541] i.e., playing one country off against another for such benefits as low tax rates, tax holidays, subsidies, less stringent regulatory standards for labour and the environment, etc.

[542] John L. Campbell, 'Why Would Corporations Behave in Socially Responsible Ways? An Institutional Theory of Corporate Social Responsibility' 32 Academy of Management Review 946946

[543] Mary Ann Glynn Christopher Marquis, Gerald F. Davis, 'Community Isomorphism and Corporate Social Action' 32 Academy of Management Review 925

[544] Balachandran10.

Batra[545] argues that the usual business strategy of using products that have been historically successful in developed nations will not work in emerging markets. Prahlad and Lieberthal[546] assert that corporations should change their business strategies from 'thinking globally' to 'thinking locally' as each of the emerging markets with its vast diversities in culture and socio-economic issues represents a challenge for marketing.

4.6.1 Effect of Cultural Dimensions

Hofstede identified five value-oriented dimensions that distinguish societal cultures: social inequality including the relationship with authority (power distance); the relationship between the individual and the group (individualism versus collectivism); performance orientation (masculinity versus femininity); and ways of dealing with uncertainty (uncertainty avoidance); and long-term orientation versus short-term orientation in life.[547] Power distance is a measure of society's tolerance and preference for unequal hierarchical power whereby inequality is endorsed by the followers. Low individualism translates into a collectivist society and is manifested by a close long-term commitment to the "group", that being a family, extended family, or extended relationships. Loyalty in a collectivist culture is paramount and overrides most other societal rules.[548]

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[545] Rajeev Batra, 'Marketing Issues and Challenges in Transitional Economies' 5 Journal of International Marketing 95110

[546] C. K. Prahalad and Kenneth Lieberthal, 'The End of Corporate Imperialism ' July-Aug Harvard Business School Press 68 7

[547] Geert Hofstede, 'The cultural relativity of organizational practices and theories' 14 Journal of International Business Studies 75quoted in Ararat 273

[548] Geert Hofstede, *Cultures and Organizations, Software of the Mind: Intercultural Cooperation and its Importance for Survival* (Profile Books 1996) quoted in Ararat 273

4.7 Do Corporations have the Responsibility to Promote Development?

The main question here is whether corporations have extra responsibility for social development beyond the development that comes after their responsibility to their shareholders to generate profit. Opinions vary from the strongest position, believing that corporations exist merely to promote development; to the weakest position, which does not consider development as a goal but just a condition to prevent social sanction from the society they are operating in; with the moderate view maintaining development as one of the goals of corporations.

Jamali and Mirshak[549] found evidence to support the argument that CSR understandings and practices are likely to be affected by specific national and institutional realities that reflects the problematic socio-economic and socio-political situation in the developing economies where MNCs operate. They have argued that the "level of societal development is also likely to influence the prominence and sophistication of CSR discourse within a particular society".[550] These authors suggest concerted efforts towards collaboration between the private sector, public sector and NGOs.

Similarly, Cordeiro[551] emphasized that positive public perception and support from multiple stakeholders is necessary for MNCs to be successful in emerging economies and, therefore, MNCs should not only act responsibly to establish their long-term

[549] Dima Jamali and Ramez Mirshak, 'Corporate Social Responsibility (CSR): Theory and Practice in a Developing Country Context' 72 Journal of Business Ethics 243 2
[550] Ibid 18
[551] William P. Cordeiro, 'Should Business Ethics Be Different in Transitional Economies? ' 47 Journal of Business Ethics 327 1

reputations, but also bear the additional ethical responsibility to proactively encourage ethical practices and promote development. It goes without saying that assuming this kind of responsibility for corporations is not accepted by the advocates of the Anglo-American model. [552]

The question here is what is it that corporations need to take into account in order to be considered responsible? The answer is not easy.

The main objective of corporations has been considered as making profit. The problem here is not just that the corporations are reluctant to contribute to development of an economic or social nature but more what these contributions should consist of. Developing countries are normally very complicated to study and making changes should be according to all inter-relating issues such as community, culture, history, special needs, political system, religion, etc. Making changes in one sector might impair the function of the other sections, leading to political or social backlash or to worsening the situation. Corporations do not have the knowledge, expertise, time and responsibility to invest and take care of all these issues at the same time. Corporations are corporations, not governments. It has long been argued that assuming the responsibility of government for corporations is a mistake, taking into consideration the primary role of a government, which is governing a State, and a corporation, which is gaining profit. Therefore, one can argue that programming for development is the responsibility of the government, with corporations contributing to some parts of it. Assuming a general responsibility for development by corporations

[552] Reed 238

should, therefore, be replaced by allocating particular responsibility in specific sectors, which will prevent confusion as to the nature and extent of the actions taken.

There are two approaches to this situation: one is asking corporations to work closely with NGOs to play more roles in development programmes. This suggestion might not work for two reasons: first, corporations increasingly provide more funding for development but this co-operation is not frequent and is usually done for marketing and public reputation reasons. Second, NGOs are well-motivated but they do not have the capacity to meet these needs since they are being asked to take over some of the responsibilities of the State.[553] The second approach is, therefore, State involvement.

On the contrary, some have recognized the great corporations as "political systems". Earl Letham maintains that big corporations have all the requisite characteristics: legislature, executive, judicial system and political factions, while their growth has produced a power tension in the sense that they have become a competitor to the sovereignty of the State.[554] Pluralists have famously asserted the necessity of assuming political life for corporations. According to their argument – if we assume the same ground – first, the State is considered one of the many associations that are operating in a society. Second, they insist that the activities and purposes of private associations are equally important. Some of them have higher moral purposes than the State while some of their activities are more important than the State. Therefore, there

[553] Ibid 242
[554] Peter F. Drucker, 'The New Meaning of Corporate Social Responsibility' 26 California Management Review 53 44

is no reason that one might deny granting political life to private associations unless we assume another ground for the authority and political life of the State.[555]

Although the economic aspects of the corporation have received the widest notice, the concept of the corporation as a political system is by no means unknown. Walton Hamilton argues against the Hobbesian concept of the corporation (which argues that the corporation is a lesser commonwealth), holding that in some cases the corporation is an even greater commonwealth. Merriam has observed business enterprises as private governments, concluding that in some cases this private government has controlled the public government. C. Wright Mills has also referred to corporations as political institutions. Berle also found politics in all manner of corporations, a view that he shares with Aristotle.[556]

Richard Eells contends that assuming political life for corporations brings about inescapable political issues. In the light of this political life, the responsibilities of corporate managers should be correctly spelled out, while new ways should be recognized to hold them accountable. But there is still the constitutional crisis that arises from political life.[557] Eugene V. Rostow has argued against corporate democracy as a solution to constitutional crisis. He holds that "shareholder democracy" is impractical and there is no solution for it even in theory. He further argues that the best way to hold corporate managers accountable is to restrict their ability to direct the corporation for the sole purpose of profit maximization for their

[555] Barry A. Colbert and David Wheeler Elizabeth C. Kurucz, 'The Business Case for Corporate Social Responsibility' in Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds) (ed), *The Oxford Handbook of Corporate Social Responsibility* (OUP Oxford 2008) 22
[556] Drucker 45
[557] Dennis A. Gioia, 'Business Organization as Instrument of Social Responsibility' 10 Organization 435 in F Stormer, 'Making the Shift: Moving from "Ethic Pays" to an Inter-System Model of Business' 44 Journal of Business Ethics 279 60

shareholders. By this he implies that the employee interests should be taken care of by unions while protecting public interests is the matter of concern for the public government.[558] Corporations can make a huge contribution to social problems; therefore, it is unreasonable to limit their role to profit-making and leave social reforms to others. The only issue here seems to be the concept of accountability that needs to be redefined.[559]

Based on a review on CSR of MNCs in developing countries, Amba-rao[560] argued that the solution is the institutional interactions among MNCs, the governments of developing countries, the respective governments of MNCS, international organizations and other stakeholders and activists in developing countries. Aaronson[561] observed that since "many developing countries do not have strong human rights, labour and environmental laws, voluntary corporate responsibility initiatives are insufficient to address problems MNCs confront in their overseas operations".

Many researchers have hypothesised that CSR in emerging economies is still in a very early stage and suitable mechanisms do not exist to ensure that companies practice CSR with anything other than a charitable outlook. Kemp[562] states: "there are numerous obstacles to achieving corporate responsibility, particularly in many

[558] Orlitzky, 'Corporate Social Performance and Firm Risk: A Meta-analytic Review' in Stormer 268
[559] Orlitzky, 'Corporate Social Performance and Financial Performance: A research Synthesis' in Stormer 76
[560] Sita C. Amba-Rao, 'Multinational Corporate Social Responsibility, Ethics, Interactions and Third World Governments: An Agenda for the 1990s' 12 Journal of Business Ethics 553 557
[561] Susan Ariel Aaronson, 'Minding Our Business: What the United States Government Has Done and Can Do to Ensure that U.S. Multinationals Act Responsibly in Foreign Market' Journal of Business Ethics 175 185
[562] Melody Kemp, 'Corporate Social Responsibility in Indonesia: Quixotic Dream or Confident Expectation?' Technology, Business and Society Programme Paper United Nations Research Institute for Social Development 15

developing countries where the institutions, standards and appeals system, which give life to CSR in North America and Europe, are relatively weak." Chambers et al.[563] measure the extent of CSR penetration in seven Asian companies and show that the mean value for the seven countries (even including industrially advanced Japan) is just 41% compared with, say, a score of 98% for a developed nation like the United Kingdom.

Moon[564] has identified three types of CSR reporting: "community involvement", "socially responsible production processes" and "socially responsible employee relations". He argues that at the very beginning stages of development of CSR in emerging economies is the "community involvement," which requires a minimum amount of communal goodwill to operate in the business environment. Similarly, the results of the comparative study by Chambers et al.[565] show that currently Asian nations are still engaging strongly only in the first parameter of community involvement.

In particular, it could be argued that the incorporation of more participation into governance structures, e.g. the German model which allows employee participation, would place a much greater practical emphasis on creating employment and protecting jobs. Similarly, it could be argued that encouraging more co-operative models of governance might be a better solution for developing countries.[566]

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[563] Wendy Chapple Eleanor Chambers, Jeremy Moon and Michael Sullivan, 'CSR in Asia: A seven country study of CSR website reporting' No. 09-2003 ICCSR Research Paper Series 14
[564] Jeremy Moon, 'Corporate Social Responsibility: An Overview' in Europa (ed), *The International Directory of Corporate Philanthropy* (Europa Publications Ltd 2002) quoted in Eleanor Chambers 17
[565] Eleanor Chambers 18
[566] Reed 243

The German model of corporate governance, or better put, "the bank-orientated model's" underlying principle is the proposition that the purpose of the firm should be defined more widely than the maximisation of shareholder interests alone. This type of corporate governance is characterized by: 1) the dominance of private companies; 2) ownership concentration of public listed companies; 3) the emphasis on family; 4) rare hostile takeovers; 5) allocating a high degree of importance to bank ownership of equity; 6) the assumption that there should be some explicit recognition of the well-being of other groups which have had long-term co-operation and business relationship with the firm and therefore an interest, or 'stake', in its long-term success, such as employees, financiers, suppliers and even customers.[567]

In this model of corporate governance "moral hazard is ostensibly overcome through attempts at achieving efficiency within management and through control. By developing a reputation for the ethical treatment of suppliers, clients and employees, corporations are able to build up trust relations which support profitable investments and mutually beneficial exchanges".[568]

4.8 Conclusion

In this paper, it has been argued that there is an urgent and persistent need for a critical study of the potentials, challenges and limitations of CSR initiatives in developing countries. The specific issues in different developing countries should be taken into account.

[567] Soederberg 17-20
[568] Ibid 20

In this paper, first, globalization and its effect on developing countries has been discussed. In this section, the different nature of CSR policies in developing countries were demonstrated and attempts were made to define a conceptual framework based on explicit and implicit CSR policies for studying comparative CSR.

Second, the Anglo-American nature of reforms and the two contributing factors to development of this model of corporate governance, including the failure of Import Substitution Industrialization (ISI) and the influence of international financial bodies, were discussed. It was concluded that this model, besides the unavailability of evidence to confirm that it results in economic development, is not the ideal model for a variety of reasons. The Anglo-American model needs a number of modifications to adapt to the special needs of developing countries. It has also been suggested that developing countries might need to take these modifications of the Anglo-American Model into account in the future.

Third, the three main social reporting theories were presented, concluding that they are interrelated and should be used in conjunction with one another. Moreover, team production theory as an alternative to shareholder wealth maximization and arguments in favour and against it were discussed, making more general assumption about what the source of value creation is and who bears the risk and who benefits.

Fourth, the stream arguing that social development is a result of economic development and counter-arguments was demonstrated. It was suggested that social development is not necessarily the result of economic development; on the contrary, stable economic development is a result of prior social foundations.

Fifth, arguments in favour and against assuming a responsibility for corporations to promote development were presented, leading to the technical issue: namely, whether corporations are sufficiently equipped to take on community development roles.[569]

[569] Marina Prieto-Carron 986

Key propositions

1. The process of transplanting CSR into another legal system is likely to be affected by local socio-economic-legal conditions, cultural values and institutional arrangements;
    1.1. The connection between corporate legal rules and CSR principles is largely a reflexive one;
    1.2. The so-called "law-matters" thesis needs to be assessed by reference to what has been referred to as "functional equivalents" to law in transitional economies such as Iran;
    1.3. The act of borrowing is usually simple, while building up a theory of borrowing on the other hand is more complex;
2. The impact of CSR values upon corporations in transitional economies, such as Iran, is likely to be shaped by the internal norms in these corporations;
3. The political determinants of CSR are fundamental to explaining its impact; these will vary from developed to transitional economies;
    3.1. The State has a major influence in developing countries, such as Iran, upon the adoption of CSR in many companies;
    3.2. Transitional economies, such as Iran, present major obstacles to the adoption of a dispersed ownership model of the corporation;
    3.3. The relationship between the legal rule to be transplanted and the socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.

Chapter 5: Iran: Analysis of Societal and Legal Characteristics of Iran's Society

5.1 Introduction

In order to implement CSR policies in a country, in the first instance a study of how corporate governance systems work in that country is necessary.

The corporate governance system in Iran is not similar to the ones in the Western countries. Upon studying this system, it was concluded that there are several obstacles embedded in the Iranian corporate governance system that makes the development of corporate social responsibility policies very difficult, if not impossible. Two of the most significant obstacles are: the lack of a proper private sector and the lack of a proper taxation system.

Despite the serious call for "privatization" under Principle 44 of Iran's Constitutional Law, most corporations in Iran are either completely owned by the government or the government holds the majority share (the so-called "half private/half public companies"). In governmental economies, corporations do not see the necessity of developing good governance policies or acting responsibly towards stakeholders and society in general. The Iranian government claims that they are implementing Principle 44 strongly by selling governmental corporations to the private sector; however, in reality all of the big former governmental companies are sold to either "Social Security Organization" or "Retirement Organization," which are practically private sectors of the government and therefore a part of the government.

The lack of a proper taxation system comes from the government's attitude towards tax. Tax can be used for controlling corporations through a punishment and reward system. Also paying tax as a social duty will make corporations fulfil their social duty as an education means and might also remind corporations of their other social duties. At the same time, taxes can be used further down the road by the government to provide better welfare for society. But the Iranian government's income is from oil and gas, not tax; therefore, the government simply does not care about collecting taxes.

In order to see how CSR polices can be implemented in Iran, one needs to study how the existing socio-legal system can be improved and how a new socio-legal system could be implemented. CSR is a way of behaving and one needs to see how this way of behaving can be influenced and directed towards more socially responsible behaviour in society as a first step to be able to find its way to corporations in the next step.

In order to demonstrate this, first, the historical-political process and aspects of Constitutionalism Revolution in Iran will be discussed. Constitutionalism in Iran is a historically tested experience of introducing a new system in the legally underdeveloped Iran of that time. It brought all the contradictory social and political issues to the surface. How the Iran of that time responded to that introduction might tell us a lot about how it might respond to the introduction of another new system. Moreover, Constitutionalism was a quasi-successful movement in Iran. How it gained its success and where it made mistakes that led to the not-very-successful results can be very helpful in figuring out what obstacles CSR will be encountering while being

introduced in Iran, and how that will be dealt with. Additionally, studying Constitutionalism Revolution, as a way of limiting the State's power, will help us understand how the Iranian government can be influenced. Is it by way of pressure from inside, or external forces such as globalization?

The challenge between traditionalism and modernism in Iran, how it is going through this phase and how Iranian society is dealing with modernism is an important element in discussion of any change in Iran. Iran is a deeply religious society. In the eyes of many Iranians and the government, modernism has always been seen as a tool used by Western countries to impose their values and ideologies, which has always been considered as a threat to Islamic values in Muslim developing countries such as Iran. Modernism has been either totally disapproved of by the clerics or partially approved on the grounds of necessity. It goes without saying that partially approved modernism values have been very strictly Islamized, leading to changing the whole underlying concept and main purpose of those values.[570]

The danger in implementing CSR policies in Iran is that it might be considered another aspect of modernism; therefore, it might either get totally rejected or, if implemented, strictly Islamized. This situation might compromise the underlying concepts and purpose of CSR. Some scholars have questioned the validity of the argument that considers modernism as Western values. They argue that if modernism was purely Western, people would not internalize it in their life and there would be no reason for the government's intervention by spending precious time, energy and money on trying to talk people out of it and convince them that modernism is a bad

[570] Abdollah Laroui, *Islam et Modernite* (Ali Rezayi tr, Ghaside sara Publishing 2002) 205

thing. They further maintain that in reality all these attributions of modernism values to the West, which is called "Western moral corruption" by the government, is but "people's desires and critical spirit".[571]

Then, Corporate Law (included in the Commercial Code) and the corporate governance system will be presented. Attempts will be made to see if Iran's Corporate Law and corporate governance system is an impediment to good governance and what changes should be made in order to encourage more socially responsible behaviour by corporations.

One type of corporation in Iran, co-operatives, appears to be designed to meet corporate social responsibility purposes. The very reason of its existence is to enhance public welfare by reducing prices and ensuring the quality of products. At the same time, the nature of these companies supports their employees since it makes lay-offs and dissolution harder compared with other companies. This chapter will present a full study of this type of corporation.

One issue that should be taken into consideration while studying corporate governance in Iran is that there are not many corporations in Iran in the Western meaning of 'corporation'. For example, in the United States a corporation, in order to be named a corporation, should either have more than 100 employees or a certain annual turnover. In Iran's case, theoretically, private corporations in this meaning do not exist extensively and are not encouraged by the government. There are a few privately owned corporations and a lot of governmental corporations. Practically,

[571] Montesquieu, *Persian Lettters* (Andrew Kahn ed, Margaret Mauldon tr, Oxford University Press 1973) 189

however, there are a decent number of privately owned corporations, but since their shares are not traded on the stock exchange they are not known. One of the complications about studying Iran is the fact that there are many differences between the theory on the books and common practice.

Some have argued that Islamic finance does not correspond with corporations in its Western form since these corporations are modelled based on the capitalist policies which do not require bringing true "justice" to people, while Islamic finance requires the economy and its main actors (corporations) to consider bringing "justice" to the society as their main purpose. "Justice" means that all levels of the society should be treated equally no matter how wealthy or educated they are. Some have gone so far as arguing corporations in the capitalist way will undermine Islamic principles.

In contrast, another school of thought believes that "justice" does not mean that we should divide everything evenly in the society. They argue that real justice will only be provided if wealth is distributed according to each person's education, the efforts that they put into achieving something and their social status. They argued that the true "justice" is not "economic justice" but "social justice" and if any government claims that it will provide its people with the former, they have promised the impossible.[572]

Having outlined the above-mentioned Islamic finance issues, studying Islamic finance and how Iran's government abides by it (or at least claims to do so), will be helpful for the purpose of this thesis. The point that should be taken into account is that there

[572] Hossein Naraghi, *Follow-ups on the Insider Sociology* (7 edn, Akhtaran publishing 2006) 68

are some differences in Shia's conception of Islamic finance and Sunni's conception of it. Shia (Iran's sect of Islam) has stricter rules, resulting in the decline of privately owned corporations as compared to their growth in Sunni countries.

5.2 Constitutionalism in Iran

Due to ignorance and lack of knowledge from leaders, the contemporary history of Iran is marked by the use of violence to further the interests of conflicting and incompatible ideologies. There has never been balance, from the Qajar[573] dynasty until the present moment.[574] Violence forms an important part of this sensitive historical period. It goes without saying that violence only results in violence. Being caught in this vicious circle of violence will lead to the most dangerous point in time for a nation, in which people know nothing other than violence and using violence to express their ideas will seem like a natural thing.

Constitutionalism in Iran was accompanied by many misuses on the part of some intellectual avant-gardes and opportunistic persons. They pushed this movement to the extreme from the very beginning by using the consequent openness of ambience to harass and ruin many people's reputation. They also questioned many Islamic principles under the name of Constitutionalism. This situation went on and on to the extent that the very people who triggered the Constitutionalism turned against it, resulting in the banning of parliament by "Mohammad Ali Shah Qajar".[575] Ajoodani

[573] The dynasty preceding the Pahlavi dynasty (the last dynasty before the Islamic Revolution)
[574] Majid Ajoodani, *Iranian Constitutionalism Revolution* (Akhtaran Publications 2004) 25
[575] Mohammad Ali Shah Qajar was the Shah of Persia from January 8, 1907 to July 16, 1909. He was against the constitution that was ratified during the reign of his father, Mozzafar-al-Din Shah. In 1907 Mohammad Ali dissolved Majles (Iranian parliament/National assembly) and declared the Constitution abolished because it was contrary to Islamic law.[1] He bombarded the Majles with the military and political support of Russia and Britain. Available at "BBC Persian" website: http://www.bbc.co.uk/persian/iran/story/2006/07/060724_pm-ma-constitution-sem.shtml

maintained that forcefully dissolving the parliament was actually to the benefit of the whole Constitutionalism movement and rescued it. He argued that if Mohammad Ali shad had not done so, people would have done it themselves anyway. If that had been the case, nobody could have been able to even breathe a word about Constitutionalism for another century in Iran.[576]

Some have argued that the wrongdoings of a few persons should not have questioned the whole Constitutionalism movement. But these scholars have misunderstood the main reasons for people's concern about Constitutionalism. The main issues were not a few wrongdoings but rather the fact that the advocates of Constitutionalism were trying to impose their ideologies and personal understandings of Constitutionalism through violence and the very non-democratic ways that people wanted to put an end to them by Constitutionalism. Similarly, questioning Islam through Constitutionalism was the very first mistake that led to disapproval of it from the clerics and people.[577]

It goes without saying that any prudent person would have realized that in the time of autarchy and in such a deeply religious society, in order to develop Constitutionalism principles and have a parliament, conformity with Islamic principles was a necessity. That is why in order to rescue the movement at the time, several papers were written to defend Constitutionalism. They tried to justify it by religion. Even the atheist leaders of Constitutionalism put a lot of effort into corresponding Constitutionalism principles with Islam. They suggested not only that Constitutionalism is not against Islam but also that it originated from Islamic customs.[578] Moreover, in order to

[576] Ajoodani 24
[577] Ali Mirsepassi, *Intellectual Discourse and the Politics of Modernization: Negotiating Modernity in Iran* (Cambridge University Press 2000) 114
[578] Ajoodani 27

implement a new system in any country, understanding the phonetics[579] of its people is of huge importance.

What has been said about the Islamic justification of Constitutionalism demonstrates quite fairly how things work in Iran. Some have argued that a real Islamic government and true "justice" can only be provided when the Twelfth Imam (Mahdi)[580] rises again; therefore, giving the title of "Islamic" to any government is false and indeed against Islam. In their point of view, ruling by a cleric leader on Muslims is Islamic rule, not an Islamic government, and if such a ruler enjoys absolute power, he will be corrupt absolutely. In conclusion, having a parliament which restricts the leader's power will reduce the amount of corruption and will contribute to guarding the root of Islam from corruption. In other words, Constitutionalism not only does not infringe Islamic principles, it also provides people with more justice.[581]

Many have argued for the "Iranianizing of Constitutionalism". One can easily realize what this school of thought meant by "Iranianizing of Constitutionalism" was, in fact, Islamizing Constitutionalism by reducing its fundamentals to the least possible so it can be in conformity with Islam. They did not want Iranian Constitutionalism follow the Western way of Constitutionalism since, as has been mentioned earlier, Western values have always been considered a threat to Islam.[582] In contrast, even from the very beginning of the attempts at justifying Constitutionalism, there were some

[579] By "Phonetics" is meant "the basic patterns of behaviour".
[580] According to the Shi'a and Sunni versions of the Islamic eschatology, the Mahdi (meaning: "Guided One") is the prophesied redeemer of Islam who will stay on earth seven, nine or nineteen years (depending on the interpretation) before the coming of the day ("Day of the Resurrection" or "Day of the Standing"). Muslims believe the Mahdi will rid the world of error, injustice and tyranny alongside Jesus.
[581] Ajoodani 36
[582] Mirsepassi 170

intellectuals trying to remind the scholars of the dangerous road they were stepping into. They argued that these reductions to the least possible would lead to misunderstanding and to the undermining of the fundamental concepts underlying Constitutionalism, among which the equality between men and women and the equality between Muslims and non-Muslims were the prefect examples.[583]

Having stated all the above-mentioned facts, one should bear in mind that achieving a modern civilization would not happen simply by adapting the look of modernity or Constitutionalism such as parliament, industry or commerce; society needs to understand the fundamentals of the modern way of thinking. As long as society and people hold onto their traditional perception of life and are not willing to change the way they see the world, the real change will not happen.[584]

Another point that should be taken into consideration is that there is no one unique reason behind a historical event and its consequences. Iran has always been a very complicated society; therefore, regarding one happening as the sole reason of legal underdevelopment would be unrealistic. One of the indications of the complexity of issues in Iran is in the very fact that, on one occasion, the leading sociology and history scholars consider autarchy as the main reason for the separation of the State from people, leading to underdevelopment, while, on another occasion, they consider the ruling of clerics as the main reason for underdevelopment.

[583] Laroui 249
[584] Dariush Ashoori, *The Inside and Outside of Our Historical Experience* (1988) 76

5.3 The power of clerics

The necessity of the existence of the authority of law is beyond question. Ideally, people should obey the law not because they have to but because they want to. This can be very hard to achieve in the case of Iran because the nation sees itself as different from the State. There is a huge gap and separation between the State and the society for a couple of reasons: first, autocracy and second, Shia's conception of the State, which believes that unless there is ruling by an Islamic government, true "justice" will never come to the surface. The clerics have been cultivating this in people's heads for so long that it has turned into a culture. Always being unhappy with the government is deeply embedded in Iranian culture, even now that Iran has an Islamic government.[585]

Another reason for this separation is that Iran has a deeply religious society; that is, the clerics are very powerful. This power has a historical root. In Qajar's time, "Mohammad Ali Shah", during the war with Russia, needed strong support from the people. In order to mobilize people, he needed the clerics to use their influence on people and ask them to go to war by justifying the war through religion.

In return for the clerics' favour, the king made them very powerful by giving them judiciary power; that is, if people wanted to solve a problem, they could go to the clerics instead of the government, and as time went by the necessity of having a government faded away. Consequently, two different courts came into existence in Iran: the "Religious Court" and the "Customary Court". The "Religious Court" was governed by the clerics and its jurisdiction would involve anything that was related to

[585] Laroui 230

Islam and a Muslim's personal life. One can easily see how broadly this jurisdiction can be interpreted. The "Customary Court" looked into the cases that were related to the State and the well-being of the nation in general. Obviously, one can also easily figure out the clash of interests between these two jurisdictions. The Constitutionalism Revolution in Iran tried to fill this gap between these two courts by putting the authority of law above the power of these two courts but, as mentioned earlier, it did not gain the expected success.

The experience of the Iran-Russia war in "Mohammad Ali Shah" time made both the State and the clerics aware of the clerics' deep influence in society and their power over people. However, in Iran's society of that time, where there were no political parties and no possibility of establishing one, these powerful clerics formed the only opposition against the government. Sometimes if they had the necessary power and status, they would go so far as claiming the ruling power since according to Shia: true "justice" can only be achieved through Islamic ruling. But if they did not have the necessary power they would co-operate with the government under the condition that government would only take serious decisions after consulting them and having their assent. Of course, if the government breached this arrangement, clerics would cause disturbance by using their influence on people. They would boycott that decision by using religion.[586]

As long as the separation between the State and people continues to exist, the conflict between them will never be resolved. It had been argued that as long as the litigation power stays with the clerics, people see no reason to go to the State for solving their

[586] Ajoodani 102

problems; therefore, the State would be non-essential and even the follower of the clerics.[587] This is the reason behind the big gap between the government and people. This is the reason why Iranians have always considered the government an unjust and against-its-own-people phenomena.

Another reason for bad perceptions about the government in Iran is the embedded Shia's assumption that any non-cleric ruler is unjust rather than Iranian culture. In ancient Iran's culture, the head of the State has always been considered a messenger from God and a righteous person, not someone cruel. Moreover, one might logically conclude that people's bad image of the government might be simply because the government acted badly towards them.[588] In autocratic governments, people have no security regarding their lives and properties. One night they are the richest and the next they might lose everything. This was true about the Iranian government of that time and it is true even now.

It has been argued that the quasi-successful experience of the Constitutionalism Revolution proved that the religious intervention of the clerics in the political governance of the situation was not to the advantage of the whole movement since the clerics' intervention was based on religion policies, which in most of the cases was not democratic.

Admyiat, while agreeing with the above-mentioned argument, emphasized that even implementing this correct argument by reformists through violence and through non-

[587] Mirza Fath-Ali Akhoondzadeh, *New Alphabet and the Writings* (Hamid Mohammad zadeh ed, Mehr Publishers 1979) 199-201
[588] Fereydun Adamiyat, *The Ideas of Mirza Fath Ali Akhund Zadeh* (1970) 162-3

democratic ways was as wrong as the religious interventions.[589] At the same time, considering the role of religion in Iran's society, Constitutionalism in Iran would have never lasted without taking Islamic fundamentals into account.

5.4 Freedom of thinking

The notion of "Freedom of thinking" has always faced the most powerful opposition in Iran. Each time that a bit of political freedom was achieved in Iran, it led to political chaos. This chaos reached the extent that some newspapers threatened to murder the king of the time and nobody even bothered to tell them that they were crossing a borderline. But the interesting point in these times of political freedom, even in that to-the-extreme political freedom, none of the extremist newspapers dared to talk about the basic freedoms, such as the freedom of thinking or the freedom of way of life.

The prerequisite for asking for any kind of freedom in Iran has always been justifying that freedom according to Islamic principles.[590] Also, freedom has always been accompanied by attacking the political autarchy. Reformists have always tried to solve the problem of not having the basic freedoms by political solutions, among which were replacing the autocratic system with the parliament system.

In general, freethinking in Iran, in which noble and genuine ideologies would grow, has never been possible. New social and philosophical ideologies could not be developed while the new political ideas could freely grow, be used and customized. That explains why the intellectuals, who never had the chance to develop their own

[589] Ibid 122
[590] Ibid 138

ideology, in case of occasional freedom of expression would think of using the western ideologies to rescue Iran. The main issue with these ideologies was that they were not grown in an Iranian background and failed to take into account its culture, mindset and history. Consequently, these ideologies were totally foreign to the people, which finally in most cases led to them being disapproved of by the people. Predictably, this situation ended in many contradictions between the intellectual scholars' words and their actions.[591] They could not practice their words since society would be opposed to them.

5.5 The Corporate Governance System in Iran

In order to analyze the corporate governance system in Iran, studying the company law (embedded in the Commercial Code) is prerequisite. A summary of the most important and relevant articles of the Iranian corporate governance code has been attached to this thesis as Index 1.

Iran's company law was codified in 1933. It is a part of Commercial Code (Articles 20-222). The public joint stock company and private joint stock company part of company law was amended in 1969, adding three hundred articles to the Company Law.

There are five main types of corporations in Iran:

1. Public and private joint stock company
2. Limited liability company
3. General partnership

[591] Ibid 142

4. Joint stock partnership
5. Co-operatives

The biggest companies in terms of capital are either Public Joint Stock Companies or Co-operatives, which in the case of Iran, both types of corporations either belong to the government or the government holds the biggest block of shares, enabling it to control the big investments especially in the natural resources-related industries. The biggest companies in terms of number are the private joint stock companies and the limited liability companies which are run by private investors. Most of the time the leading shareholders of these types of corporations are either family members or that company's founder's trustees.[592]

These five types of companies are rooted in the French Commercial Code. A short summary of each type of company will follow:

5.5.1 Public and Private Joint Stock Company:

A joint-stock company is a company whose capital is divided into shares and the responsibility of shareholders is restricted to the nominal amount of their shares.[593]

There are two types of joint stock companies: The public and the private one. The main difference between these two types is in the method of issuing shares. In public joint stock companies the starting capital can be drawn from the public and they are tradable in the Stock Exchange. This type of company is also capable of issuing

[592] Mahmood Erfani, *Commercial Law*, vol Second (Mizan Pubblishing 2002) 94
[593] Art. 1 of R. A. C. C. (Abbreviation stands for Reformative Articles of Commercial Code, passed on March 4, 1969)

debentures; whereas in the private joint stock company, only the founders should provide the starting capital and the shares are not tradable in the Stock Exchange.

Every public joint stock company has an Articles of Association, which sets out the preliminaries for establishing a company and share descriptions. The Articles of Association also declares that the company is established by the decision of the General Assembly and being registered at the Company Registration Office.

Company law has explained the assemblies, the procedures they should go through in their meetings, their authority, the participation of shareholders and the shareholders' right to be informed beforehand what is going to be discussed in the meetings.

The assemblies play an important role in the joint stock companies since they have the authority to make critical decisions. At the same time they are the most influential tool for the shareholders to supervise the directors. Assemblies choose the directors and the inspectors, who are required to report their activities back to these assemblies and seek the assembly's approval in special cases.[594]

There are three assemblies:

1. Founder's General Assembly, which takes place just once among the founders at the very beginning of establishing the company. They decide on whether the company is ready to be established or not.

[594] Rabia Eskini, *Commercial Law*, vol Second (Samt Publishing 2001) 126

2. Ordinary General Assembly, which has the authority to take decisions about all the matters related to the company except the ones that are specifically attributed to the Extraordinary General Assembly.

3. Extraordinary General Assembly, which makes decisions about the changes that should be made in the capital, the changes that are proposed to be made in the Articles of Association and dissolving the company.

Both types of joint stock companies are managed by a Board of Directors, whose members are appointed by the shareholders at an Ordinary General Assembly meeting. The Board of Directors consists of five persons in the public joint stock companies and three persons in the private joint stock companies. The directors may make decisions about all matters related to the company except those decisions that are especially attributed to the Ordinary General Assembly meetings or the Extraordinary General Assembly meetings.

The interests of shareholders are protected by the presence of inspectors in the company who were previously chosen in the General Assembly meeting. They ensure that the company's accounts are in order and being managed properly and shareholders receive accurate information at the shareholders' Assembly meetings. If an inspector breaches his duties, he may be held liable both under civil or criminal liability.[595]

[595] Ibid 129

The Commercial Code provides the details of civil and criminal liabilities for breach of duties upon the part of any member of the company.

5.5.2 Limited Liability Company

In limited liability companies, the capital is not divided into normal shares but into "Partnership shares," which means each partner's responsibility towards the company's debts is as much as his capital. Family members or groups of friends usually form this type of business association. It is built based on their mutual trust.

Any transfer of shares needs three-quarters of shareholders' consent; a condition that makes share transfers very hard to carry out. This characteristic of limited liability companies is what differentiates them from public joint stock companies where shares are freely tradable either by the shareholder himself or through the Stock Exchange.[596]

According to Article 105 of the Direct Taxes Law, both joint stock companies and limited liability companies are subject to the same tax rate. However, public joint stock companies whose shares are traded in the Stock Exchange enjoy 10% income tax exemption. This is one of the government's policies to encourage big companies to trade their shares in the Stock Exchange.

As for the governance structure of limited liability companies, the managing director has large discretion as to the decisions he makes. The courts are reluctant to hold them liable for their business decisions. Although there is no legal requirement for holding a shareholders' meeting for taking major decisions, in practice most of the

[596] Erfani 84

limited liability companies in their Articles of Association articulate that any major decision should be authorized by a majority of at least half of the companies' capital owners. In this way, they try to make sure the managing director (who might be chosen from the capital owners or outside of them) does not misuse his discretion.

At the same time, it is required by the law that where a limited liability company has more than twelve partners, there has to be a board of supervisors, which has the same responsibilities as the inspectors in the public joint stock companies.

5.5.3 Co-operatives

Cooperation and helping others have been the leading motto of all the different governments in Iran. At the same time, in Iranian culture, helping others has always been an important social value, which compared with the Iran of today, was more predominant in the past. This social arrangement found its way into company law in the form of Co-operatives. Moreover, Article 44 of the Constitutional Law emphasizes that Co-operatives hold a special place in the heart Iran's economy.[597]

Co-operatives are a form of business association between artisans who mutually produce and sell the same goods. Profits are divided according to each member's shares.

The most well-known Co-operative in Iran is the Dwelling Co-operative. Most of the mayors, at the beginning of their office tenure, establish a big Dwelling Co-operative

[597] Ibid 80-100

through which they promise to provide people with low-cost housing. In this way, they gain people's support for their future career opportunities and promotions.

Other Co-operatives are: Producers' Co-operatives, which covers agriculture, industries, mines, properties, fishing industries and the like; Rural Co-operatives; Worker's Co-operatives; and Consumer's Co-operatives, through which arrangements for the selling of goods needed by certain types of people will be made.

The importance of these kinds of companies has been to the extent that a ministry has been established for supervising them. The Co-operatives Ministry authorizes the establishment and dissolution of Co-operatives.

The law is harder on the Co-operatives. The directors are chosen by the General Assembly meeting. Any decisions regarding any change in the Articles of Association, dismissal of directors, dissolution and mergers is only at the discretion of the Extraordinary General Assembly with the Ministry of Co-operatives holding a decisive position in the procedure.

The company is internally supervised by inspectors that should be chosen for the course of two years. Their duties include auditing the company's books and accounts, hearing the complaints and preparing the annual report.

Co-operatives, in general, appear to be more in accordance with corporate social responsibility policies. The very reason of their existence is to enhance public welfare by reducing prices and ensuring the quality of products. At the same time, the nature

of these companies supports employees since it makes lay-offs and dissolution harder than in other companies.

5.6 Co-operatives

Co-operatives in Iran have been defined as a sort of corporation that is established by natural persons, legal persons or a combination of both. These kinds of corporation are supposed to be non-governmental but in the case of Iran, they are all governmental. Their goal is to produce or to distribute in order to achieve the goal of improving economic and social welfare by encouraging co-operation between different ranges of actors.[598]

The main purposes of Co-operatives are stipulated in the Co-operatives Law:

1. Entrepreneurship
2. Helping to fulfil social justice
3. Helping to provide investments and facilities for the workforce
4. Improving the sense of co-operation and public involvement in society
5. Preventing hoarding, inflation and monopoly.[599]

Principle 44 of the Constitutional Law is the leading legal guidance for the economic governance of Iran. According to this principle the main economic sectors in Iran are ranked:

1. Governmental
2. Co-operatives

[598] Ali Hassani, *The Co-operatives* (University of Tehran Press 1995) 67
[599] Co-operative Economic Sector Law of Islamic Republic of Iran, 1370. Reformed at 1377 by Ministry of Co-operatives.

3. Private

It goes without saying that mentioning Co-operatives as the second main economic sector shows its importance in Iran's economic and legal policies.

The state sector includes all large-scale industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like. These will all be publicly owned and administered by the State. Cooperative companies and enterprises concerned with production and distribution in urban and rural areas form the basis of the Co-operative sector and will be operated in accordance with Shariah law. As of 2008, 120,000 Co-operatives were in operation across the country employing about 15 million people.[600] The private sector consists of enterprises concerned with construction, agriculture, animal husbandry, industry, trade, and services that supplement the economic activities of the State and Co-operative sectors.[601]

Since strict interpretation of Article 44 has never been enforced in Iran, the private sector has played a much larger role than that outlined in the Constitution.[602] As a result, in recent years the role of this sector has increased, whilst a 2004 amendment to the Constitution allows 80% of State assets to be privatized. Forty per cent of such sales are to be conducted through the "Justice Shares" scheme and the rest through the Tehran Stock Exchange. The government will retain ownership of the remaining

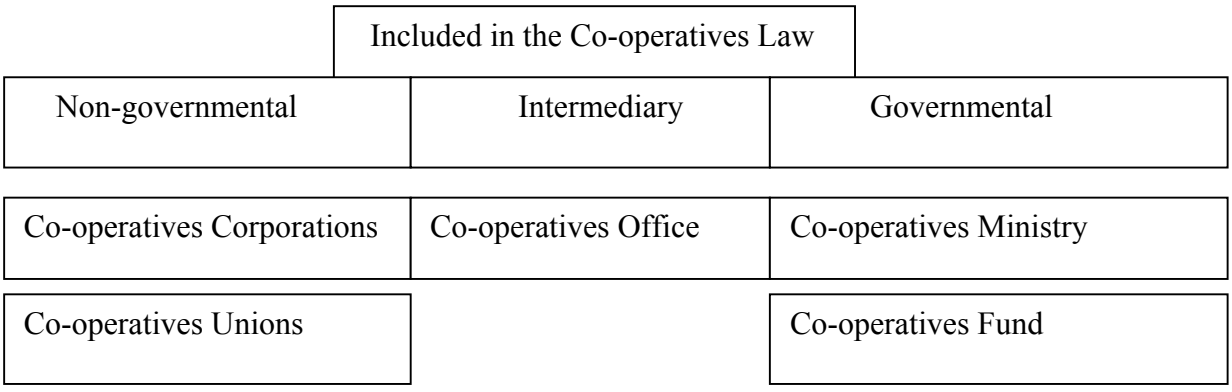
[600] '120,000 Cooperatives Operating in Iran' (*Iran Daily*, 30 June 2008) <http://www.nitc.co.ir/iran-daily/1387/3162/html/economy.htm>
[601] Iranian Constitution adopted on 24 October 1979
[602] 'Call for Prioritizing Vision 2025' (*Iran Daily*, 12 February 2009) <http://www.nitc.co.ir/iran-daily/1387/3340/html/economy.htm>

20%.[603] In 2005, the government assets were estimated at around $120 billion. Some $63 billion of such assets were privatized in the period 2005–2010, reducing the government's direct share of gross domestic product (GDP) from 80% to 40%.[604]

The Co-operatives have based their activities on the following principles:

1. Voluntary membership for everyone.
2. Democratic governance by the members and free flow of information.
3. Economic participation of members: usually a part of investment is provided by the public.
4. Independence from governmental organizations.
5. Educating the members.
6. Co-operation between all the Co-operatives.
7. Being socially responsible.

The following charts show the Co-operative organization in Iran:



[603] 'Justice Shares Payment Soon' (*Iran Daily*, 23 December 2008) <www.nitc.co.ir/iran-daily/1387/3300/html/economy.htm>

[604] (*BBC Persian (in Persian)*, 16 January 2006) <http://www.bbc.co.uk/persian/business/story/2006/07/060716_ra-rm-article44.shtml> and 'Iran Privatizes $63bn of State Assets' (*Press TV*, 29 November 2009) <http://previous.presstv.com/detail.aspx?id=112444&sectionid=351020102>

Not included in the Co-operatives Law	
Rural Co-operatives	Co-operatives established by Agriculture Ministry

There are three types of Co-operative organizations in Iran:[605]

1. Governmental Co-operatives: governmental organization either supervises or supports these Co-operatives. They are managed by the government. The most important roles of these governmental organizations are first to make sure that Co-operatives abide by good governance principles and second, to provide financial aids for them. The Co-operatives Ministry and Co-operatives Fund are two major governmental organizations formed for this purpose by the government.

   The Ministry of Co-operatives can ask the court to suspend directors of a given Co-operative and if the court obtains the necessary evidence to prove the suspension was the right course of action, it will allow the Ministry to dismiss the directors and choose temporary new ones.

   The Co-operative Fund's duty is to provide Co-operatives with the necessary funds from the government and attract investments.

2. Non-governmental Co-operatives (People's Co-operatives): these organizations are voluntary organizations which are formed by people who have the same economic

[605] Mohammad Taleb, *The Cooperation Principles and Ideas* (The University of Tehran Press 1988) 35

and social needs. Despite the fact that these organizations enjoy financial aids from the government, they have dependent legal entities and are governed by their members. Co-operative corporations and Co-operative unions fall into this category.

3. Intermediary Co-operatives: Co-operatives Office is the only legal entity that falls into this group of organizations. The members of this organization are Co-operative corporations and unions. From a financial and administrative point of view, these organizations are non-governmental. But the government's relationship with this Office is different from its relationship with Co-operative corporations or unions. The Co-operatives Ministry plays an important role in the decision-making, managing and supervising of this Office. These characteristics of Co-operatives' Office practically qualify it as a governmental organization.

   The Co-operatives Office has the same role as the Chamber of Commerce but in the Co-operatives sector. At the same time, it should perform the duties that are devolved upon it by the Ministry. It also has the role of arbitration in disputes.

Chapter 6: Corporate Social Responsibility in Iran

6.1 Introduction

Iran, located in the Middle East, a politically troubled and unstable region of the world, has unique environmental characteristics. Moreover, Iran is a strict Islamic country basing its social and commercial activities on fundamentalist religious regulations. The 1979 Iranian Revolution changed the Iranian people's social values and corporate culture. For example, being faithful is one of the conditions to be selected as a high-ranking board member or director. In addition to religion and culture, the origin of French and Belgian civil law influences corporate culture in Iran.

In the recent years, because of the increase in general knowledge, education, exposition to international communities of national corporations and the presence of international corporations, Iran's market is becoming more competitive and gradually CSR is finding its way into company decision-making.

CSR in Iran is far removed from its strategic Western concept. It is mainly synonymous with philanthropy or sponsorship of different cultural/sports events and with donating money in natural disasters. Few companies have strategic CSR and if they do it is usually within the EFQM[606] framework.

Voluntary CSR in Iran is deeply interwoven with a strong culture of donating money to charities, building schools, mosques and hospitals. It is also profoundly embedded with Islamic religious customs of helping the poor by donating money under the

[606] EFQM (formerly known as the European Foundation for Quality Management) is a non-profit membership foundation based in Brussels.

Islamic concepts of Khums,[607] Zakat[608] and Waqf.[609] These Islamic concepts have not been specifically called Corporate Social Responsibility but socially responsible behaviour exists in Iranian culture and religious customs. Some argue that if these socially responsible cultural concepts combine with a new commercial concept of CSR, better results will be achieved[610] but this view is rather simplistic. The modern concept of CSR, like any other modern Western concept, is likely to be affected by socio-economic-legal conditions. The socio-political structure of Iran will determine the rejection or acceptance of CSR concepts. The act of borrowing from other legal systems is a complex matter.

The literature on CSR in Iran is very scarce. Even the few attempts at research are shallow and in many cases, contradictory. They do not explore CSR in an Iranian concept of CSR but rather try to explain why Iran does not have CSR in the Western style, arguing that Iran is not economically ripe for Western CSR concepts. While this argument might be partially correct when it comes to securing investments for large corporations, not having a Western style CSR is not in itself a bad thing. Implementing Western concepts in Iran is a complex matter that requires a lot of research on how foreign laws and regulations can be transplanted to Iran. Transplanting CSR policies in Iran without the above-mentioned considerations might end in their rejection. At the same time, Iran has special characteristics, a very different culture and a very different socio-legal system. Digging deeply into these

[607] Khums is the Arabic word for One Fifth (1/5). According to Shia Islamic legal terminology, it means one-fifth of certain items which a person acquires as wealth, and which must be paid as an Islamic tax.
[608] Zakāt or "alms giving", one of the Five Pillars of Islam, is the giving of 2.5% of one's possessions (surplus wealth) to charity, generally to the poor and needy. The Shia double this to 5% of one's possessions.
[609] A Waqf is an inalienable religious endowment in Islamic law, typically denoting a building or plot of land for Muslim religious or charitable purposes. The donated assets are held by a charitable trust
[610] An interview with Bagher Namazi, the head of Iranian Institute of Non-governmental Co-operatives: http://csriran.com/?page_id=26

elements might show that there exists an Iranian style of CSR that just needs to be strengthened and encouraged rather than changed or renewed.

In this chapter, first, CSR key players in Iran will be shown. Then, the main CSR activities in Iran and examples of domestic and foreign company activities will be presented. Furthermore, the State's role, the United Nations' role and the Stock Exchange role in promoting CSR policies will be discussed. Finally, the difficulties of promoting CSR policies in Iran will be debated.

6.2 CSR key players in Iran

6.2.1 Government

Organization	**Description**
Ministry of Industries and Mines	Government body
Ministry of Commerce	Government body
Ministry of Labour and Social Affairs	Government body
Environment Organization	This organization is a part of the government. Its duty is to protect and maintain the environment.
Institute of Standard and Industrial Research of Iran (ISIRI)	This Institute is a member of ISO.
Tehran Stock Exchange Co.	State owned
National Committee of Sustainable Development	This committee is part of the Environment Organization. Its purpose is to promote sustainable development in Iran.
Centre of Strategic Research	The Centre for Strategic Research was established in 1989 to compile and draw up the Islamic Republic of Iran's strategies in various fields. The

	main task of the centre is to carry out strategic studies in various international, political, economic, legal, cultural and social fields.

6.2.2 Corporations

Corporation	**Description**
TAM Irankhodro	TAM Irankhodro is a fully owned private subsidiary belonging to the publicly owned Irankhodro Industrial group offering know-how and engineering (EPC) services.
Saipa	Saipa is the second largest Iranian auto manufacturer.
Mashhad Leather	Mashhad Leather is the pioneer producer of highest quality leather accessories in Iran.
Mashhad Carpet	Mashhad Carpet Company is the largest manufacturer of machine-made carpets and area rugs in Iran.
Bahman Group	Bahman Group is one of the largest car producing and transport companies in Iran. The Environment Organization has awarded it as one of the environmentally friendly companies.
Melli Shoe Co.	Melli is one of the biggest shoe producing private companies in Iran which was confiscated by the government.
Tolypers Co.	One of the biggest detergent producers in Iran.
Golrang Industrial Group	Golrang is a major manufacturer of food and detergent products in Iran.
Damavand Mineral Water	Is the leader of bottling mineral water and producing soft drinks in the Iranian market.

Mobarakeh Steel Company	Iran's largest steel maker, and one of the largest industrial complexes operating in Iran.

6.2.3 Civil Society

Media Unions
Universities and research institutes

6.2.4 UN and International Organizations

UNDP
UNICEF
UNIDO
Regional Organization of Islamic Chamber of Commerce

6.3 CSR Activities in Iran

6.3.1 UN and International Organizations

Established a National MDG Committee
Held workshops for industrial and State managers about MDG
Trained a few volunteers on Global Compact
Published pamphlets about MDG
Established partnerships between UNICEF and the private sector in Iran

6.3.2 Unions and Associations

Held CSR conferences in co-operation with UNDP, World Bank and some MNCs
Held International Symposium on Business Ethics in the Age of Globalization
Held training courses for companies

Published books about business ethics

6.3.3 Government

Established Institute for Productivity and Human Resources Development
Awarded National Productivity and Business Excellence Award (EFQM) in co-operation with Ministry of Industries
Codified Social Accountability 8000 Standard
Established policies on privilege, punishment and empowerment of companies to consider environment issues
Established sustainable development committee with partnership of all ministries
Held annual conference on green industries and corporations
Held annual green film festival
Endowed Green Award
Established national environment conservation fund
Codified 'Good work' national programme by Ministry of Labour
Ratified Guild Law by Ministry of Commerce
Ratified consumer protection law
Awarded national consumer protection rights award with partnership of Ministry of Commerce
Codified Corporate Governance Regulation by Tehran Stock Exchange

6.4 Examples of Domestic Companies' CSR Activities

Organization	**CSR Activities**
Pasargad Bank	In Iran according to law, people can be imprisoned for not paying their debt, even a small amount. Usually charities pay the small debts to free these prisoners.
Mobarakeh Steel	Employer Assistance
Tak Makaron in co-operation with UNICEF	Nutrition Improvement Programme

Behrouz Food Industries in co-operation with UNICEF	Held workshop for deprived women
Pakshoo in co-operation with UNICEF	Supported nurseries in deprived areas of Iran
Butan	Ratified a Code of Ethics, Support for Mehr-e-Tehran Charity
Saipa	Performed the environmental project of "Planting of one tree for one car", Established Ramazan Charity, Donated money to cancer victims, Donated money to victims of the Bam earthquake, Obtained a variety of environmental certificates
Toulipers	Recycling and waste management, Use of advanced production technologies, Donated money to a variety of charities
Tam Iran Khodro	Implemented strategic CSR within EFQM, Co-operated with research institutes and universities to conduct CSR-related researches, Provided electronic equipment to the Ministry of Education to equip schools, Sponsored different educational seminars
Damavand Mineral Water in cooperation with UNICEF	Provision of educational facilities in 12 cities and 96 villages, Employee volunteer scheme

6.5 Examples of Foreign Companies' CSR Activities

Organization	**CSR Activities**
OMV	Donated money for refurbishment and equipment of schools
Hydro	Organized journalist visits to Norway
Shell	Provided educational grants to medical students,

	Constructed a children's facility in Bam, Donated money for improving internet connection to Ahvaz schools, Donated money to footballs clubs of Ahvaz schools
Statoil	Organized the invitation of Ilam Football team to Norway, Provided technical and educational courses for Oil & Gas companies' managers, Trained lifeguards for the IRIS
BP	Published a sophisticated book on Persian painting
BBC	Provided journalism training to 15 Iranian journalists leading to the launch of the ZigZag website

6.6 The State Role in Promoting CSR Policies

In developing countries such as Iran, directors of corporations and society do not have any control in how the macroeconomics of the country are managed. This is where the role of the State shows itself. The State needs to have sustainable economic outlook while making sure that the managers of large public corporations are behaving responsibly in order to be a pioneer for other corporations.

In many developing countries such as Iran, the State has not yet provided stable socio-economic conditions leading to proper social services and supporting disadvantaged people. At the same time, the State rather than being an unbiased player in the market, is a major competitor in the market, leading to the excessive distribution of commodities or services that the private sector is able to provide. Considering the advantageous situation of the State as compared to the private sector, a competitive

market is unlikely to happen.

The importance of the role of the State in promoting CSR policies in developing countries such as Iran is undeniable. In a survey done by Alireza Omidvar,[611] it was proven that in spite of constant complaints of managers in Iran about intervening policies of the State in their business, 92% of managers agreed that the State has a vital role in promoting CSR policies in Iran. Seventy-five per cent of managers thought that CSR regulations should be in place. Fifty-six per cent identified the State as the most important organization to promote CSR policies. He has also argued in favour of mandatory CSR policies in Iran, stating that most corporations in Iran do not take into account the least mandatory requirements of taking care of the environment and paying minimum wages, let alone voluntary CSR. But the point he fails to take into consideration is the fact that if corporations do not take preliminary regulations into account, what is the use of more regulations? If the State is capable of implementing regulations, it should implement the preliminary ones first. And second, if socially responsible behaviour has its root in cultural and religious beliefs in Iran, changing them to mandatory regulations might discourage the businessmen involved in them, since they see it as a burden or an expense from the government on their business.

The State can play different roles in promoting CSR policies. First, it can lead by providing guidelines showing how CSR goals can be best achieved. Second, making an example by pioneering CSR-related activities in the State corporations to create a model that could be followed by private corporations. Third, the State can facilitate

[611] A survey by Alireza Omidvar: The questionnaires were sent to 101 managers of big corporations in Iran, of which 37 answered the survey.

the introduction of CSR policies by encouraging and facilitating a competitive market while moving towards provision of a stable and predictable market where return on investments can be secured. Moreover, the State should not intervene with the traditional styles of CSR in Iran but rather encourage the traditional ways.

The Industrial Development and Renovation Organization of Iran's government established the Institute of Productivity and Human Resource Development Institute. The purpose of this institute is to improve management quality in Iran. This institute is responsible for the Iranian National Productivity and Excellency Award, which is very desireable to obtain by Iranian corporations. One of the conditions of receiving this award is being socially responsible. This award targets managers of corporations. It defines productivity and excellence in taking into account the benefits of stakeholders. Stakeholders consist of the State, consumers, employees, competitors, shareholders, creditors and society. The logic of this award is that if one of these stakeholders does not perform well because of dissatisfaction, the whole production line will be harmed; therefore, a productive and excellent manager is the one who identifies the key stakeholders and strategically co-operates with them.[612]

6.7 The UN Role in Promoting CSR Policies in Iran

UNPD have institutionalized sustainable development in its programmes, leading to the "UN Millennium Project" in 2002 in order to develop a concrete action plan for the world to achieve the Millennium Development Goals and to reverse the grinding poverty, hunger and disease affecting billions of people. After final reports on "UN Millennium Project" in 2005, a specialist team worked in an advisory capacity to

[612] An interview with Masood Homayounfar, the head of the Industrial Development and Renovation Organization: http://csriran.com/?page_id=25

support the implementation of the Project's recommendations, leading to the "Millennium Development Goals" with the deadline of 2015. The Millennium Development Goals are the world's time-bound and quantified targets for addressing extreme poverty in its many dimensions – income poverty, hunger, disease, lack of adequate shelter and exclusion – while promoting gender equality, education and environmental sustainability. They also cover basic human rights – the rights of each person on the planet to health, education, shelter and security.

In Iran, the UNPD have started co-operating with the private sector. They have held educational workshops for managers, non-governmental organizations and the public in different cities. They have also translated UN leaflets on the "Millennium Development Goals" and given them to the participants.

The main purpose of these undertakings is improving the general knowledge about the concept of sustainable development and the "UN Millennium Goals". The UN in Iran has recognized a couple of issues impeding the enhancement of sustainable development;[613] the main issue is the general lack of education and understanding. That is why most of the UN programmes are directed to address this issue. Another issue is to increase the amount of co-operation between the private sector and the State. One of the ways to resolve this issue has been identified as promoting socially responsible behaviour so that the private sector will undertake some functions of the government. If the relationship between the State and private sector is not ameliorated and macroeconomics is extremely faulty, expecting the private sector to be socially

[613] An Interview with Dr. Mohammad Ali Farzin, the head of the UNPD projects in Iran: http://csriran.com/?page_id=20

responsible is simplistic since they face more important obstacles to overcome than being socially responsible.

Another issue that the UN tries to address in Iran is to promote team thinking and teamwork. The main purpose here is to put the managers of large corporations under the pressure of public opinion to act socially responsible.

At the same time, in order to promote CSR polices and sustainable development in Iran, a long-term mindset should be encouraged.[614] In the current economic conditions in Iran, the element of time is closely related to interest rate. In other words, there is a relationship between management capacity in optimizing expenses for future investments and interest rates, which are controlled by the State. Therefore, if the interest rate is low, managers' time horizon for investment is longer and if the interest rate is high, the managers have to circulate the investment quickly to get quick results. In this situation, managers do not think long term and are not ready to look at human resources or the environment as investments but rather as expenses and consumptions.

6.8 The Stock Exchange's Role in Promoting CSR Policies

In late 2004, the Tehran Stock Exchange Research and Development Centre published the first edition of the Iranian Code of Corporate Governance. This code consisted of 22 Articles including: definitions, board of directors and shareholder responsibilities, financial disclosure, accountability and auditing. The Code was amended in 2005 to further include ownership structure, capital market and the

[614] An Interview with Dr. Mohammad Ali Farzin, the head of the UNPD projects in Iran: http://csriran.com/?page_id=20

relationship with the Trade Law.[615] The implementation of the Code is not mandatory but many corporations have done so. The ratification of this code of practice was the most important step towards accountability and responsibility of the corporation.

The code of practice has two major underlying purposes: first, risk reduction by enhancing accountability, closure and responsibility, and second, enhancing long-term performance by avoiding dictatorship and irresponsibility by top managers. The code guards shareholders' benefits against misappropriation by the directors while attempting to direct the company to take into account long-term benefits rather than the short-term ones.

A study on Iranian corporations' boards in 2008 has shown that the average number of members on the board of directors is 7.96, with about 22% of them being non-executive or independent members, in 42% of cases the CEO is also the Chair and in 46% of the cases, there is an institutional investors' representative on the board. The firms' average size is 12.88 people, EPS is 1832 Rials,[616] ROA (Return On Assets) is 12%, and ROE (Return On Equity) is 65%. Iranian corporations have a high debt ratio of 60%, indicating their high default risk. The average life of corporations listed in the Tehran Stock Exchange is 8.88 years.[617]

6.9 Difficulties of Promoting CSR Policies in Iran

One of the most important obstacles to improving CSR policies is the short-termism that is cultivated in our commercial culture. Most business enterprises are established

[615] Bita Mashayekhi and Mohammad S. Bazaz, 'Corporate Governance and Firm Performance in Iran' 4 Jorunal of Contemporary Accounting and Economics 156 159
[616] Iranian local currency, 1 Rial is approximately 0.0000966979 US Dollars
[617] Bazaz 163

under general titles that enable them to operate within a huge variety of business activities. This allows them to do a bit of everything and to leave after a bit of profit is made.

Another difficulty is the lack of general knowledge about CSR. The pressure from the public is the most effective pressure on corporations to act socially responsible in Iran since it is acceptance from the public which brings legitimization. The increase in general knowledge and education is the most important element in promoting CSR policies in developing countries such as Iran since it accelerates sustainable development, leading gradually to institutionalize the concept of CSR.

At the same time, there is a gap in the civil society in Iran. There is almost no co-operation between civil society and the public sector. In a gathering in 1998 in Booshehr (south of Iran) between representatives of the governmental organizations and representatives of non-governmental organizations some obstacles to the relationship between the society and the government were recognized:

1. Excessive bureaucracy
2. The State's suspicion of associations and unions
3. Lack of general knowledge
4. Lack of co-operation between the private sector and public sector

6.10 Conclusion

This chapter discussed CSR policies' current status in Iran. Iran is an Islamic country located in the Middle East with strong Persian cultural elements and a French-Belgian

commercial legal system. Iran's special characteristics make transplantation of new concepts a very complex matter. The new concepts will be affected by local socio-legal-political conditions leading to their acceptance or rejection. Digging deeply into these elements might show that there exists an Iranian style of CSR that just needs to be strengthened and encouraged rather than changed or renewed.

Literature on CSR in Iran is very rare. Even the few attempts at research that do exist are shallow and in many cases contradictory. They do not explore CSR in an Iranian concept of CSR but rather try to explain why Iran does not have CSR in a Western style, arguing that Iran is not economically ripe for Western CSR concepts. While this argument might be partially correct when it comes to securing investments for large corporations, not having a Western-style CSR is not in itself a bad thing.

In this chapter, first, CSR key players in Iran were shown. Second, the main CSR activities undertaken by CSR key players in Iran were demonstrated. Third, examples of domestic and foreign company activities were presented. Fourth, the State role in promoting CSR policies was discussed, concluding that the State has an important role. Fifth, the UN role in promoting CSR policies was debated, showing different initiatives that were taken by the UNDP in Iran to encourage sustainable development. Sixth, the Stock Exchange role in promoting CSR policies was demonstrated. In this section a summary of the Iranian Code of Corporate Governance ratified by the Tehran Stock Exchange was presented. Seventh, the difficulties of promoting CSR policies in Iran were discussed. Finally, CSR in oil companies in Iran and the role of ministry of oil was debated.

Chapter 7: Data Analysis

Key proposition 1: The Effect of Socio-Economic-Legal Conditions on CSR Transplantation

The process of transplanting CSR into another legal system is likely to be affected by local socio-economic-legal conditions, cultural values and institutional arrangements.

Introduction

Pistor et al's findings emphasized the importance of the role that socio-economic-legal conditions, cultural values and institutional agreements play in promoting CSR policies in developing countries. They suggested that legal transplants cannot function in the transplant countries in the same way as they do in the origin countries.[618]

In the same fashion, Blankenburg stressed the importance of "legal culture". He explained "legal culture" as a complicated inter-relation between different levels in a society such as the level of values, beliefs and attitudes towards law, patterns of behaviour, institutional characteristics and the body of substantive and procedural law.[619]

Mattei maintained that different legal systems may develop different solutions to the same problem that is consistent with their legal tradition, which may be as efficient as

[618] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 99
[619] Valderrama 274

the agreed legal theory by the competitive market. It is not a rule of "one size fits all".[620]

In contrast, Alan Watson argued that legal change might happen without any relationship with social change. His view is contrary to the views of contextualists and culturalists who see law as mirroring culture and society.[621]

In the analysis of the first Key proposition, attempts will be made to analyse the effect of local socio-economic-legal conditions, cultural values and institutional arrangements in the process of transplanting CSR into another legal system.

In order to analyse this Key proposition, initially the interviewees were asked if they believe there is a demand for CSR in Iran, where they think this demand comes from and what they believe would stand as the key feature of CSR in Iran. Additionally, the interviewees were asked about the extent to which they believe that successful CSR policies depend on the existence of social structure (such as unions, professional associations, etc) sometimes referred to as "civil society". Moreover, in order to further assess the social and cultural aspect of this Key proposition, the interviewees were asked how flexible they believe Iran's legal and cultural system is in response to changing economic and cultural conditions.

Is there a Demand for CSR in Iran?

[620] Mattei, 'Efficiency and Equal Protection in The New European Contract Law: Mandatory, Default and Enforcement Rules' 6

[621] Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences ' 16

In order to assess the effect of socio-economic-legal conditions and cultural values, the interviewees were asked if they believe there is a demand for CSR. If they believe there is a demand, where they think this demand comes from and if they believe there is no demand for CSR, what their reasons are for this negative answer. Finally, the interviewees were asked to give their opinion regarding what they believe would stand as the key feature of CSR in Iran.

In the answer to the question of "Is there is a demand for CSR in Iran?", half of the interviewees answered "No" and the other half answered "Yes".

Most of the interviewees who believed there is no demand for CSR in Iran, believed CSR concept already exists in Iran's ancient culture and religious values such as Waqf.[622] This is in line with Visser's[623] argument that categorized "cultural traditions" as one of the major internal drivers of CSR in developing countries, arguing that despite the common belief that CSR is a new concept, it has been argued that business ethics have a deep root in developing countries' ancient culture.

The interviewees admitted that there are several cases of CSR in Iran but pointed out that these cases are personal preferences of individual managing directors rather than an accepted culture or an institutionalized concept. They also strongly presumed that the attitude of a managing director constitutes the most important driver for CSR in Iran.

[622] Waqf is an inalienable religious endowment in Islamic law, typically denoting a building or plot of land for Muslim religious or charitable purposes.
[623] Visser 480-488

They enumerated the following reasons for believing there is no demand for CSR in Iran:

1. *Iran's economic and cultural development level is low. Economically, Iran has not gone through the necessary transitional period for transformation of companies that would lead to CSR. Moreover, the structures necessary for CSR to happen do not exist in Iran.*

   Culturally, Iran's society is not at the cultural level to be able to balance benefits that companies draw from society with benefits they give back to society in return. Some of the interviewees held that Iran's society has been going through a huge regression in morality and spirituality compared to 40 years ago, mainly for three reasons: first, combining religion with politics. Second, religious concepts like Waqf have been used as a tool by companies to protect themselves from misuses[624] *of the government and to defraud the government in order to escape their legal duties. Third, due to Iran's social problems, paying attention to "myself" has increased while paying attention to "others" has considerably decreased.*

According to the World Bank, the economy of Iran is the eighteenth largest in the world by purchasing power parity (PPP) [625] and according to Iranian officials' claims is going to become the 12th largest by 2015.[626] The economy of Iran is a mixed and transitional economy with a large public sector and some 50% of the economy

[624] The interviewees believed and brought many examples of government taking over businesses by force when they boom and become successful.
[625] WorldBank, 'Statistics ' (2010)
[626] Press TV, 'Iran to be World's 12th Economy in 2015' (24 December 210) <http://www.presstv.com/detail/156979.html>

centrally planned.[627] It is also a diversified economy with more than 40 industries directly involved in the Tehran Stock Exchange.[628] Yet, most of the country's exports are oil and gas, accounting for a majority of the government's revenue in 2010.[629]

A unique feature of Iran's economy is the presence of large religious foundations, whose combined budgets make up more than 30% of central government spending.[630]

2. *It is widely believed that there is no competition in Iran due to the governmental economy in which the State is the key force of the economy. The interviewees believed that the recent move towards privatization in Iran is at the very earliest stage; that is, big companies are half private-half governmental and still strongly influenced by direct intervention of government in their business or governmental organizational culture.*

Iran's economic system is a "State capitalism" system. State capitalism is a system in which state-owned business enterprises are the dominant form of corporations. The most significant examples of this kind of economy are corporatized government agencies and a State that owns controlling shares of publicly listed corporations. The State usually uses markets primarily for political gains.[631] In Iran the primary actors of State-owned capitalism are national oil corporations and State-owned enterprises.

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[627] The Economist, 'A Survey of Iran: Stunted and Distorted' (*The Economist*, 2003) <http://www.economist.com/node/1522098> and Press TV, 'Iran Offers Incentives to Draw Investors' (26 April 2010) <http://previous.presstv.com/detail.aspx?id=124450>

[628] TV, 'Iran Offers Incentives to Draw Investors'

[629] Press TV, 'Iran Oil Exports Top 844mn Barrels' (16 June 2010) <http://previous.presstv.com/detail.aspx?id=130736&sectionid=351020102>

[630] Bonyad-e Mostazafan va Janbazan, 'Oppressed and Disabled Veterans Foundation (MJF)' (6 February 2011) <http://www.globalsecurity.org/military/world/iran/mjf.htm>

[631] Ian Bremmer, 'State Capitalism Comes of Age' 1 Foreign Affairs 3

In Iran, like Russia, any large corporation who wants to succeed in their business must have a good relationship with the government.

According to the CIA World Factbook, following the cessation of hostilities with Iraq in 1988, the Iranian government declared its intention to privatize most State industries in an effort to stimulate the war-torn economy. The sale of State-owned factories and companies proceeded slowly, mainly due to opposition by a nationalist majority in the Iranian Parliament. By 2006 most industries, some 70% of the economy, remained State-owned. The majority of heavy industries including steel, petrochemicals, copper, automobiles and machine tools remained in the public sector, with most light industry privately owned.[632]

This is in line with Visser's[633] argument that categorized "political reform" as one of the major internal drivers of CSR in developing countries. He argued that any kind of reform in developing countries cannot take place without taking into account the socio-political reform process.

Similarly, Beck emphasized the importance of the role of the State in financial markets. He maintained that legal traditions differ in terms of the priority they attach on the rights of private property owners vis-à-vis the rights of the State and this has consequences on the protection of private contracting rights as the basis of financial market development.[634] The civil law tradition countries such as Iran tend to emphasize the development of institutions that advance the State's power rather than

[632] CIA, 'The World FactBook' <https://www.cia.gov/library/publications/the-world-factbook/geos/ir.html>
[633] Visser 480-488
[634] La Porta 9 & 24

private property rights which adversely affected financial development.[635] Similarly, LLSV state that: "(A) civil legal tradition, then, can be taken as a proxy for an intent to build institutions to further the power of the State ..."[636] A powerful State will tend to create policies and institutions that divert the flow of society's resources towards favoured ends and even with a responsive civil regulation, it will have difficulty not interfering with the market. Thus, according to these authors, the common law's emphasis on private property rights and limiting the State's power tends to support financial development to a greater degree than the civil law.[637] In civil law nations and socialist nations, the principal mechanism of resource allocation is central planning. In common law nations and capitalist nations, this mechanism is the market.[638]

This is also in line with the World Bank description of Iran stating that it is the second largest economy in the Middle East and North Africa in terms of GDP – US$400 billion in 2011 (after Saudi Arabia) – and in terms of population – 78 million people (after Egypt). It is characterized by a large hydrocarbon sector, small-scale private agriculture and services, and a noticeable State presence in manufacturing and finance. In 2007 the service sector (including the government) contributed 56% to GDP, followed by the hydrocarbon sector with 25%, and agriculture with 10%. Iran ranks second in the world in natural gas reserves and third in oil reserves. It is the second largest OPEC oil producer; output averaged about 4 million barrels per day in recent years. Iran's chief source of foreign exchange comes from oil and gas. Thus, aggregate GDP and the government's revenues are intrinsically volatile, fluctuating

[635] Beck 7
[636] Rafael La Porta, 'Corporate Ownership Around the World' 2 31-2
[637] Beck 7
[638] Andrei Shleifer 2

with international prices of these commodities. So far, macroeconomic policies have typically not counteracted these boom and bust cycles in economic performance, which increase the uncertainty faced by the private sector, impeding investment and job creation.[639]

3. *There was a widely held view among interviewees that Iran is in a poor economic condition. There are more important basic matters that need to be taken care of before Iran moves to the next stages of development such as CSR. Employment is seen as the major problem facing Iran. The social responsibility of companies, if any, would be to generate jobs first, and second more investment on production, industry and agriculture.*

This is in accordance with Visser's[640] argument, which maintained that Carroll's CSR pyramid levels[641] have different significance and order in developing countries. He stated that "economic responsibilities" remain the most important level that involves providing investments, creating jobs and paying taxes.

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[639] WorldBank, 'http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/IRANEXTN/0,,menuPK:312966~pagePK:141132~piPK:141107~theSitePK:312943,00.html' (2011)

[640] Visser 491

[641] Carroll offered that "the social responsibility of business encompasses the economic, legal, ethical and discretionary expectations that society has of organizations at a given point in time". He categorized it into four layers in his famous "Pyramid of Corporate Social Responsibility": first, required economic function of making profit; second, legal requirement of obeying the law; third, expected ethical behaviour and fourth, desired philanthropic actions. Jones recognizes three aspects for implementing CSR policies according to Carroll's "Pyramid of Corporate Social Responsibility": first, principles aspect of recognizing social responsibilities, second, processes aspect of responding to social issues, and third, policies aspect of addressing those social issues. Carroll, 'The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders'' Jones, 'Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics'

In the CIA World Factbook, it was also emphasized that although inflation has fallen substantially since the mid-2000s,[642] Iran continues to suffer from double-digit unemployment and under-employment. Under-employment among Iran's educated youth has convinced many to seek jobs overseas, resulting in a significant "brain drain".[643]

Similarly, the IMF in its 2011 report on Iran maintains that the Iranian authorities also view job creation as a key challenge. Unemployment remains high at about 14.5% in 2010, and is particularly prevalent among the youth (at about 25%). There is also an increasing number of new entrants into the labour force, reflecting a high number of university graduates, and increasing female participation. Staff's preliminary estimates indicate that projected growth should allow new entrants in the labour force to be employed over the medium-term. With a more labour-intensive growth (that is, a higher elasticity of employment to growth), unemployment could decline in the medium term.[644]

4. *CSR comes to the surface in Iranian companies only when there is a situation that would end up either as a huge criminal matter that would bring about legal sanctions for the company or there is a situation that would threaten the political stability.*

[642] According to the IMF 2011 report on Iran, with prudent macroeconomic policies, the medium-term outlook is positive. On the strength of high oil prices and expected efficiency gains resulting from the domestic subsidy reform, growth is expected to rebound to about 4.5% in the medium term. Moreover, compensatory payments to households and limited import substitution because of sanctions and higher tariffs on consumption goods should help mitigate the immediate negative impact of the subsidy reform on growth. Average inflation is expected to rise to about 23% in 2011/12 because of the step increases in the price level, but should come down to 12% in 2012/13 if the authorities maintain tight macroeconomic policies. The current account surplus is projected to rise in line with the increase in oil prices to reach about 9% of GDP in 2011/12. In:
IMF11/241, *Islamic Republic of Iran: Selected Issues Paper* (August 2011) , 'Iran Privatizes $63bn of State Assets'
[643] CIA
[644] IMF11/241 12

Visser[645] has also categorized "crisis response" as one of the major internal drivers of CSR in developing countries arguing that these crises are considered as catalysts of CSR.

5. *Professional and moral behaviour described by Western institutions (such as PMI[646] or PMP[647]), which CSR is included in their programme and obtaining their certificate is a fashion for businessmen in Iran at the moment but does not match Iran's business customs*.

This is in line with Visser's[648] argument that categorized "socio-economic priorities" as one of the major internal drivers of CSR in developing countries. He maintained that the reason behind the failure of implementation of CSR policies is failing to take into account social and environmental problem in the region.

6. *There is a legal impediment against CSR. Companies that are established under Article 583 of the Commercial Law should work for the purpose of establishment of the company stipulated in the company's Articles of Association (for the purpose that their shareholders want). At the same time, Article 118 of the Commercial Law holds that managing directors have full discretion except in two cases: first, the issues that are in the discretion of company assemblies and second, the issues that are not stipulated in the company's subject of activities in the Articles of Association.*

[645] Visser 480-488
[646] The **Project Management Institute** (PMI) is a not-for-profit professional organization for the project management profession with the purpose of advancing project management.
[647] **Project Management Professional** (PMP) is a credential offered by the Project Management Institute (PMI).
[648] Visser 480-488

Therefore, if CSR is not mentioned in the subjects of the company's activities, the managing director will face legal sanctions.

This view is in accordance with one of the opposing theories behind the corporation's legal personality: Nexus of contract theory (shareholder-value theory). This theory rejects the legal personality of the corporation and the consequent imposition of a conscience and social responsibility. According to this theory, "the company is like a market; it is the product of a complex equilibrium process. In this theory company is viewed as a connection of contracts and all who deal with it are therefore expected to bargain for their respective positions via contract".[649] Since the corporation is created by shareholders and regulated by contract, shareholders as owners have the right to define the objective of the corporation. This theory explains why the only objective of the corporation and the sole purpose of the top managers have been considered to be profit maximization. Stakeholders in this view are supposed to secure their rights through contracts.

Friedman, who originally framed the issue of social responsibility versus profit maximizing behaviours in terms of whether business managers should be what he called "civil servants" or alternatively agents of their shareholders, further developed this theory. Basically, Friedman argues that managers as agents owe the owners of the corporation, the shareholders, a duty to pursue their interests. In other words, managers should spend a corporation's money in the way its owners would want. To the extent that CSR activities do not accord with the desires of shareholders, the agent violates that duty. His argument is a moral one, arguing that it is unethical for

[649] Hart 1757

corporate managers or an agent to engage in CSR activities because the agent violates his or her duty to act in the interests of the principal.[650]

In contrast, Visser[651] has categorized "governance gap" as one of the major internal drivers of CSR in developing countries, arguing that CSR policies work better as national regulation in developing countries. In response to Visser's argument, it has been contended that much reliance on corporations' capacity to render social services is wrong. A corporation's primary responsibility is towards its shareholders; therefore, the company might change the country it is operating in because of issues affecting its profitability. At the same time, since corporations are profit-oriented, they might support either directly or indirectly the national-state's corrupt activities. Additionally, CSR is a concept beyond territorial mechanisms that addresses the limitations of the nation-state in regulating the global economy.[652]

The interviewees who believed that there is a demand for CSR in Iran also confirmed that participation of business in social projects, so-called CSR, has been in Iran's culture and religious values for a long time through concepts such as Waqf and Khoms.[653] They also maintained that the CSR infrastructure in Iran is religion and is very different from the West. But one of the interviewees emphasized that the existing ideology in Iran that considers CSR as subsidising weaker levels of society, so-called "fatherly dictatorship", is wrong.

[650] Salazar 144
[651] Visser 480-488
[652] Andy Lockett 124
[653] According to Shia Islamic legal terminology, it means one-fifth of certain items which a person acquires as wealth, and which must be paid as an Islamic tax.

Similarly, Matten and others argued that CSR in developing countries represents "the formal and informal ways in which business makes a contribution to improving the governance, social, ethical, labour and environmental conditions of the developing countries in which they operate, while remaining sensitive to prevailing religious, historical and cultural contexts".[654]

The interviewees enumerated the following reasons for believing that there is a demand for CSR in Iran:

1. *In Tax Law companies are allowed to spend a certain percentage of their profit on charity projects and get tax exemption for that percentage of their profit.*

2. *CSR is a mutual co-operation between society and a company that brings success to the company through marketing. CSR is a form of doing business through advertisement. One of the effective methods of advertisement is making news. CSR is a way of making news. They held that this aspect of CSR is still weak in Iran because of lack of competition in the market.*

3. *CSR is covered by basic international laws such as human rights that have already been taken care of in Labour Law, Civil Liability Law and Criminal Law.*

Buhmann also argued that there are two roles that law can play within the scope of CSR: first, that corporations need to abide by the law primarily to be able to go beyond the law then, second, compliance with international law. Many CSR demands

[654] Wayne Visser

and corporate CSR actions appear to be based exactly on assessments of compliance with international law, especially human rights and labour law.[655] Buhmann sees the significance of international law in the role it plays "as guidance for CSR self-regulation and for reporting and benchmarking".[656]

4. *CSR is a sustainable development which means paying attention to the "human being" in the process of development. If a country wants to develop, it needs to develop in all aspects: society and economy. They held that this aspect of CSR is stronger in Iran.*

5. *CSR is necessary for the survival of a company since the social impact of a company's behaviour affects the public perception about the company.*

6. *CSR is increasing environmental standards, having happy neighbours, increasing employment, increasing intellectual ability and expertise of the company's immediate surroundings.*

Similarly, Moon and others argued that in developing countries, due to serious socio-economic issues, the focus is on social-economic themes including poverty alleviation, health-care provision, infrastructure development and education. Secondly, in developed countries the CSR literature is dominated by quantitative methods (80%) while in developing countries this literature more likely to be qualitative.[657]

[655] Buhmann 189
[656] Ibid 193
[657] Andy Lockett

The Dependence of the Success of CSR Policies on the Existence of Social Structures

In the second step, in order to assess this Key proposition and assess the effect of social conditions on the process of implementing CSR policies in Iran, the interviewees were asked the extent to which they believe that successful CSR policies depend on the existence of social structure (such as unions, professional associations, etc) sometimes referred to as "civil society".

Most of the interviewees (23 out of 28) believed that the existence of social structure such as unions is effective in having successful CSR policies. They underlined that unions have the specialist role in each profession. Unions defend and represent that profession in the government. They need to be innovative in guiding and suggesting new laws and regulations to the government. But they all emphasized that this is not happening currently in Iran.

International Labour organization also reported that although Iranian workers have a theoretical right to form labour unions, in actuality there is no union system in the country. Ostensible worker representation is provided by the Workers' House, a State-sponsored institution that nevertheless attempts to challenge some State policies.[658] Unions operate locally in most areas but are limited largely to issuing credentials and licences. The right of workers to strike is generally not respected by the State. Since 1979 strikes have often been met by police action.[659]

[658]International Labor Organization, (2001) <http://www.ilo.org/public/english/region/asro/bangkok/arm/irn.htm>
[659] Ibid

Visser[660] has also categorized "stakeholder activism" as one of the major external drivers of CSR in developing countries. These activities include: "development agencies, trade unions, international NGOs and business associations. These four groups provide a platform of support for local NGOs, which are not always well developed or adequately resourced to provide strong advocacy for civil regulations and CSR".[661]

The interviewees enumerated the following reasons for their answers:

1. *Unions are very corrupted and one of the sources of misuse in Iran. They are after their own benefits. They have the least moral values and do not have the proper professional behaviour. They are usually under the influence of one company and represent that company's interest instead of the whole profession's interests. At the same time, unions have not been able to co-operate with the government and persuade the government that in order to have stable sovereignty abiding by some rules is necessary.*

2. *Unions have lost their function, which is arranging the economy of their industry, in Iran. First Chambers of Commerce and then NGOs in the form of Friendship Councils, such as the Friendship Council of Iran and Japan, have replaced unions.*

3. *Iran's society and culture has a very weak group work and collective action culture. Civil society elements in Iran are still very weak.*

[660] Visser 480-488
[661] Ibid 487

4. *Unions in Iran, instead of being innovative, are the government's followers. At the same time, Iran's economy is governmental and big corporations are responsible towards government, not society, so social structures like unions could be effective in holding corporations accountable.*

5. *Managers reject accepting unions' authority and guidance. They want full authority to make decisions. Therefore, for CSR policies to be successful, co-operation within the company (internal) would be more effective rather than external forces such as unions.*

The interviewees (5 out of 28), who gave a purely positive answer and maintained that unions have been very effective, essential and are doing their best, were all managers of big, previously governmental corporations that were recently privatized (the so-called "half private-half governmental" corporation). One of the interviewees that gave a positive answer supported his answer by drawing attention to Consumer Protection Law 1388, in which the formation of unions has been stipulated. He believed that this shows that regulators have paid attention to unions. Another interviewee, who was the managing director of one of the biggest banks in Iran, mentioned that unions are the source of getting information about other companies.

The Flexibility of Iran's Legal and Cultural System to Change

In the third step, and in order to further assess the social and cultural aspect of this Key proposition, the interviewees were asked how flexible they believe Iran's legal and cultural system is in response to changing economic and cultural conditions.

Beck emphasized the importance of flexibility in a legal and cultural system in response to changing economic and cultural conditions. He argued that legal systems that adapt quickly to minimize the gap between the financial needs of the economy and the legal system's ability to support those needs will foster financial development more effectively than would more rigid legal traditions. He also maintained that the major legal traditions differ in terms of their ability to evolve changing commercial conditions.

Several scholars also argue that common law systems embrace case law and grant substantial discretion to judges, inefficient laws are challenged in the courts and "... through the process of litigation and re-litigation inefficient rules will be replaced by efficient rules";[662] therefore, it tends to be more responsive to changing economic conditions.

Most of the interviewees (22 out of 28) believed that Iran's legal and cultural system is not flexible to changing economic conditions. However, many of the interviewees highlighted that Iran's society will accept a new culture if it feels the imported culture is superior to Iran's culture. Valderrama[663] also classified "prestige and imposition" as one of the five drivers for legal transplantation. He argued that every legal culture has faith in itself and tries to impose its legal culture on other countries if it has the power to do so. For example, many developing countries with a civil law tradition have the desire to import the French system because it is considered a good-quality work and prestigious.[664]

[662] Beck 11
[663] Valderrama
[664] Sacco 398

One of the interviewees further explained that the reason for internal immigration to big cities in Iran is cultural, such as prestige and more freedom, rather than economic since the main financial source of many immigrants is in their city.

They interviewees enumerated the following reasons for the lack of flexibility of Iran's legal and cultural system:

1. *Civil law legal systems are not flexible. Judges cannot take decisions on their own. They need to find support for their decisions in the law.*

This view is in accordance with LLSV's[665] findings that tried to establish a link between the legal environment and financial markets. They argued that "countries with poorer investor protection, measured by both the character of legal rules and the quality of law enforcement, have smaller and narrower capital markets".[666] These results suggest that common law and French civil law operate in very different legal environments. They have argued that a highly protective legal environment that secure the investors from expropriation by entrepreneurs, raises their willingness to invest and thus expand the scope of capital markets.[667]

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[665] Rafael La Porta, 'Legal Determinants of External Finance'

[666] Ibid 11 31

[667] Their studies show two major findings: First, common law countries afford the best legal protections to shareholders. They frequently (39%) allow shareholders to vote by mail, they never block shares for shareholder meetings, they have the highest (94%) incidence of laws protecting oppressed minorities, and they generally require relatively little share capital (9%) to call an extraordinary shareholder meeting. The only dimension on which common law countries are not especially protective is the preemptive right to new share issues (44%). Still, the common law countries have the highest average anti-director rights score (4.00) of all legal families. Many of the differences between common law and civil law countries are statistically significant.
Second, French civil law countries afford the worst legal protections to shareholders. Although they look average on one-share-one-vote (29%) and cumulative voting (19%), and better than average on preemptive rights (62%), they have the lowest (5%) incidence of allowing voting by mail, a low (57%, though not as low as German civil law countries) incidence of not blocking shares for shareholder meetings, a low (29%, though not as low as Nordic countries) incidence of laws protecting oppressed minorities, and the highest (15%) percentage of share capital needed to call an extraordinary

In contrast, Pistor and others propose "the capacity of legal systems to innovate is more important than the level of protection a legal system may afford to particular stakeholders at any point in time".[668] The more innovative and adaptable a legal system is, the more likely it is able to respond to a changing environment.

2. *In Iran, everybody expects parliament to make all the changes, from enacting new laws to interpreting existing laws. This is wrong for two reasons: first, parliament simply cannot and does not have the time to do everything. Second, Iran's parliament is hugely affected by the slightest flow of emotions and excitement in the society and the slightest political ups and downs.*

Similarly, Mele argued that the limitations imposed on business by the law have very limited and even sometimes-imperfect influences. It is neither possible nor convenient to regulate everything in business life. Furthermore, laws generally come after some undesirable impact occurs. Moreover, loopholes can easily be found in the law and many regulations strangle business creativity and entrepreneurial initiatives. In addition, a strong interventionism with laws, rules and other governmental actions is opposed to minimalist regulation of markets, also required for strong free competition".[669]

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shareholders' meeting. The aggregate anti-director rights score is the lowest (2.33) for the French civil law countries. The difference in this score between French civil law and common law is large and statistically significant. Interestingly, France itself, except for allowing proxy voting by mail and having a preemptive right to new share issues, does not have strong legal protections of shareholders. In Rafael La Porta, 'Law and Finance'Table 2 18

[668]Katharina Pistor, 'Innovation in Corporate Law ' 7

[669] Mele 61-62

It has also been argued that the idea that the law might make business responsible for CSR is not feasible in reality. Parker argues that CSR is supposed to ideally include 'compliance with business' legal responsibilities, society, economic expectations", "society's ethical expectations" and "even society's discretionary expectations".[670] If so, how is it possible for legislators to enact laws to encompass all the above-mentioned areas?

3. *Iran has a traditional society. There are many cultural issues, such as lack of knowledge, that prevent new concepts and technologies from being accepted. This fact makes doing business in Iran very hard. Moreover, resistance has strong social and cultural roots in Iran.*

4. *The cost of change in Iran is quite high. It has huge financial costs and is very time-consuming. Change in Iran means dismantling outdated structures that will take a long time and will need tolerance and patience; characteristics that are fading away faster every day from Iran's society because of the economic and political situation.*

5. *Many of Iran's laws are taken from other countries without studying Iran's society, culture and people's mindset about economy, well-being and people's attitude towards group work. These laws have not been customized to Iran's conditions. For example, Iran's Industrial Cities Law and Environmental Law are more developed than necessary, therefore very hard to abide by. They are not workable and not enforceable. Many businesses just do not understand them.*

[670] Parker 207

In a similar vein, Berkowitz, Pistor and Richard argued that if the laws were introduced in a legal system that was both unfamiliar with those laws and unreceptive to new laws, adherence to the rule of law today is significantly lower than in countries where the introduction of new laws was smoothed by cultural closeness and legal adaptation.[671]

Mattei argued that in developing countries the law cannot be considered the result of social rule-making. The mere fact that these imported laws actually do not work in the system shows that another interest, other than that of society's specific interests, has been followed. In these countries, legal process is often determined by political relationships. "The very notion of limiting powers by formal law is completely incontinent with the philosophy of rule-making in those countries".[672]

6. *Iran's society does not trust the government and corporations' managers to be flexible towards the changes they introduce. At the same time, Iran does not have proper officials to perform the changes either.*

The interviewees (6 out of 28) who believed that Iran's legal system is flexible to changing economic conditions, emphasized the Iranian character of adapting quickly to political and social pressures as an indication of flexibility. One of the interviewees, who was the managing director of one of the biggest insurance companies and a politician who has been involved in making many policies, maintained that Iran is trying to develop changes through "12-step Anonymous"[673]

[671] Daniel Berkowitz10
[672] Mattei, 'Three Patterns of Law: Taxonomy and Change in the World's Legal System' 28
[673] A Twelve-Step Programme is a set of guiding principles outlining a course of action for recovery from addiction, compulsion or other behavioural problems.

groups, aiming at preparing people internally for changes according to a new model for development called the "Islamic-Iranian Development Programme".

Conclusion

In the first step, most of the interviewees who believed there is no demand for CSR in Iran, believed CSR concepts already exists in Iran's ancient culture and religious values such as Waqf.[674] They enumerated the following reasons for their negative answer: low cultural and economic development, no competition and governmental economy, bad economic conditions.

The interviewees admitted that there are several cases of CSR in Iran but they are personal preferences of managing directors rather than an accepted culture or an institutionalized concept. They also strongly presumed that the attitude of a managing director constitutes the most important driver for CSR in Iran.

The interviewees who believed that there is a demand for CSR in Iran also confirmed that the participation of business in social projects, so-called CSR, has been in Iran's culture and religious values for a long time through concepts such as Waqf and Khoms.[675] They also maintained that the CSR infrastructure in Iran is religion and is very different from the West. They enumerated the following reasons for their answers: CSR is necessary for the survival of the company, CSR is basic human rights and already exists in Iranian laws such as the Tax Law and Labour Law, CSR is sustainable development and a great way of advertisement for the company.

[674] Waqf is an inalienable religious endowment in Islamic law, typically denoting a building or plot of land for Muslim religious or charitable purposes.
[675] According to Shia Islamic legal terminology, it means one-fifth of certain items which a person acquires as wealth, and which must be paid as an Islamic tax.

In the second step, most of the interviewees (23 out of 28) believed that the existence of social structures, such as unions, are effective in having successful CSR policies. They underlined that unions have a specialist role in each profession. Unions defend and represent that profession in the government. They need to be innovative in guiding and suggesting new laws and regulations to the government. But they all emphasized that this is not happening currently in Iran. They enumerated the following reasons for their answers: Unions are corrupt, act in their own self interest, have lost their function and are the government's followers. Moreover, Iran has a very weak group work and collective action culture, while managers refuse to accept union guidance for fear of losing their authority.

Most of the interviewees (22 out of 28) believed that Iran's legal system is not adaptable to changing economic conditions. However, many of the interviewees highlighted that Iran's society will accept a new culture if it feels the imported culture is superior to Iran's culture. They enumerated the following reasons for their answers: lack of flexibility in civil law countries, society's expectation that the parliament should make all the changes, cultural issues – lack of knowledge, traditional society, high cost of legal change, copying the laws from other countries without studying Iran's society and also lack of trust in the government.

Key proposition 1.1, 1.2. and 1.3: The Connection between Legal Rules and CSR Principles

- **The connection between corporate legal rules and CSR principles is largely a reflexive one;**
- **The so-called "law-matters" thesis needs to be assessed by reference to what has been referred to as "functional equivalents" to law in transitional economies such as Iran;**
- **The act of borrowing is usually simple, whereas buildingup a theory of borrowing on the other hand is more complex.**

Introduction

Previously, the effects of local socio-economic-legal conditions, cultural values and institutional arrangements on the process of transplanting CSR into another legal system were analysed. In this section, the connection between corporate legal rules and CSR principles, the applicibility of "law-matters" thesis and the complications of the act of borrowing from other countries will be discussed.

Roe argued that factors other than corporate law need to be taken into consideration since "corporate law is not just the 'the-law-on-the-books' alone, but as 'law-on-the-books' plus the quality of the regulators and judges, the efficiency, accuracy and honesty of the regulators and the judiciary, the capacity of the stock exchanges to manage the most egregious diversions, and so on".[676]

[676] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 167

Similarly, a series of studies by Katharina Pistor and others showed the deficiencies of transplanted laws in their new legal environment. They concluded that legal institutions in transplant countries were less developed compared with those in the origin countries due to a lack of complementarities, [677] and transplant countries were less innovative than the origin countries.[678] Pistor has further argued that law should be developed by society and made "part of the institutional fabric of society".[679] Legal institutions here means the institutions that create, support and enforce laws. It therefore covers a whole range of institutions – courts, legislative bodies, law-making and drafting agencies, enforcement agencies, law schools and bar associations. This does not mean that legal transplants are impossible and will be rejected immediately. It means that they need to take into account the specific cultural values and needs of a particular society and evolve; therefore, they cannot function in the same way or produce the same results.

Pistor and others believed that three variables are important in measuring the effectiveness of a legal system: adherence to the rule of law, effectiveness of corporate law and ability of a legal system to enforce laws to protect private property rights and enforce contracts.[680]

Furthermore, Visser maintains that legal responsibilities in developing countries involve ensuring good relationships with government officials.[681]

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[677] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' Katharina Pistor, 'Innovation in Corporate Law ' 7
[678] Katharina Pistor, 'The Evolution of Corporate Law: A Cross-Country Comparison ' 791
[679] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 90 & 93
[680] Katharina Pistor, 'Law and Finance in Transition Economies' 9
[681] Visser 491

In order to assess these key propositions, first, the interviewees' opinion was sought on the impact of corporate law on economic growth in Iran and the extent to which economic growth is facilitated by adherence to the rule of law (which comes first?). Second, the interviewees were asked about their opinion about the extent to which they believe Iranian courts and regulators rely upon corporations to regulate their own affair (e.g. self-regulation as opposed to government regulation), the extent to which they believe corporate law principles are applied within courts and the effectiveness of Iran's corporate regulators in enforcing corporate law. Third, the interviewees were asked how effective they believe Iran's corporate law is in dealing with self-dealing by corporate officials. Fourth, the interviewees were asked to describe the level of compliance upon the part of Iranian companies with legal and regulatory rules (e.g. re-disclosure). They were also asked what they believe is available as formal and informal institutions to make up for weak corporate law.

The Impact of Corporate Law on Economic Growth

In the first step, the interviewees' opinion was sought on the impact of corporate law on economic growth in Iran and the extent to which economic growth is facilitated by adherence to the rule of law (which comes first?).

All of the interviewees believed that ideally good corporate law is effective in economic development but not in Iran's case since Iran's current corporate law is an impediment to economic development.

The interviewees enumerated the following reasons for their answers:

1. *Iran's Commercial Law that includes corporate law is old, weak, inefficient and problematic. It was enacted in 1933 and the corporate law part of it was last updated in 1969. It needs to be updated according to business practice.*

2. *Iran's current Commercial Law can solve no problem. Therefore, business practice is not based on law. It is based on friendship and trust, which is the very reason for companies' conflicts and separation leading to companies' short lifespans in Iran.*

Similarly, Pistor argued stagnation may actually show the irrelevance of formal legal systems, which might be an indication of the effectiveness and efficiency of informal governance mechanisms which render the formal law irrelevant, or there is little or no demand for that particular set of rules; therefore their governments might decide not to invest in the institutions necessary to implement new legal change, or the economic condition of the transplant country is sufficiently different from that of the origin country, or the State may direct economic activities through administrative rules and regulations, leaving too little room for private actors to make differences in the market. Whatever the reasons, legal stagnation signals rejection or only partial reception of legal transplants.[682]

It has also been argued that whatever the benefits of free market economies may be, it is impossible to impose them on countries where "informal trust relations between business partners are organized differently or where dominant social groups grasp

[682] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 108

power in large firms when they are rapidly privatized under pressure."[683] In such a situation since the formal and informal rules of the game are contradictory, this imposed Westernization will bring about more negative rather than positive results.[684]

3. *Laws in Iran have many exceptions. A good law, first, should not exclude anybody from it. Second, it should also have broad definition. In Iran every little thing has a law; therefore, everything is against the law. That is why people break the law and do not feel guilty about it. People have become used to breaking the law. Third, breaking laws should have legal sanctions. In Iran, people get away easily with breaking the law.*

4. *Commercial Law needs to be in favour of business and remove the burden of proof from business. Commercial Law came into existence to replace the traditional Civil Liability Law but at the moment in Iran, in order to get businessmen's rights, lawyers would stand a better chance of winning if they litigate through Civil Liability Law.*

5. *There is no disclosure from either corporations or the government. Disclosure produces social pressure and changes the cycle. The reason for this lack of disclosure and clarity is that Iran's society lives in obscurity and likes it. Iranians are even proud of their obscure life style.*

6. *Many of Iran laws are taken from other countries without taking into account Iranian society's needs and social and cultural background. Also, laws should be*

[683] M. De Jong and Suzan Stoter, 'Institutional Transplantation and the Rule of Law: How this Interdisciplinary Method Can Enhance the Legitimacy of International Organisations' 2 Erasmus Law Review 313
[684] Ibid 314

interdependent, not in conflict with one another, and in accordance with Iran's development programme.

The laws in Iran are copies. They have not been customized to Iran's conditions. For example, Iran's Industrial Cities Law and Environmental law are too developed for Iran. therefore abiding by them and enforcing them is impossible.

This is in line with contemporary comparative law scholars' point of view that law is culture-specific, and cannot be transferred from one society to another and have exactly the same effect. The transplanted law will change as it interacts with local laws and conditions.[685] Otto Kahn-Freund maintained that it cannot be assumed that all laws are transplantable.[686]

7. *Abiding by the law is more important than enacting laws. Changing the law-on-the-books has no effect on economic development. Iranians have a huge problem with abiding by law and law enforcement. There are several reasons for this: first, Iran's society needs social development and cultural change. Second, Iranians do not trust the government and are disappointed by the way it enforces the law, so they escape the law. Third, the public has no knowledge about law. Culturally, Iranians deal with the law only when they are in trouble.*

This is in accordance with Roe's argument claiming that the rules-on-the-books could be very much the same in two nations but the quality of enforcement (because of a corrupt, incompetent or inefficient judiciary or regulatory system) might make

[685] Watson, 'Comparative Law and Legal Change' 313
[686] Kahn-Freund 14

corporate governance systems differ greatly. A flawed corporate law might work well in a system where contractual understanding and business practices counteract.[687] In other words, low-quality law might in some nations be a symptom of weak preparation for big corporations but not its baseline cause.[688]

The effectiveness of legal institutions and the process of law-making have been empirically proven to be a much better predictor of financial market development than the content of legal rules. Even in transitional economies the effectiveness of legal institutions proved to be a strong predictor of financial market development.[689]

Similarly Pistor and others show that the absence of effective legal institutions or "legality" is the most important constraint on development of financial market. They argue that "legality has overall much higher explanatory power for the level of equity and credit market development than the quality of the-law-on-the-books".[690]

Pistor and others argue that "the strength of a legal system is not encapsulated in particular legal provisions found in statutory law but in the extent to which it promotes innovation and change without creating a control vacuum".[691]

Law can create or destroy formal arrangements so law is not irrelevant, but it is a second-order phenomenon. Other institutions primarily control the economic conditions of a country including business conditions, incentives, professionalism,

[687] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 164
[688] Ibid 164
[689] Katharina Pistor, 'Law and Finance in Transition Economies' 32
[690] Ibid 14
[691] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 97

capital structure, product and managerial labour market competition.[692] These institutions are the primary control, with the law just assisting or impeding.

Furthermore, Kingsley argued that designing the right legal system is a fundamental challenge when attempting to promote economic growth in a developing country. "Law will not solve all the ills of the developing world – it will not provide food for the hungry or electricity for those without power – it will, however, allow developing countries to have a legal infrastructure to assist their development in order to attain these very important social rights".[693]

The interviewees also believed that law determines the framework of a country's economy. If this framework gives security to investors, they invest more, leading to economic development.

Soskice[694] also argued that bad and inefficient corporate law indirectly brings about economic losses in several forms: first, the prospect of managerial expropriation makes investors demand a higher *ex ante* return as a security on their investment and they choose corporations which potentially are able to generate this additional return that practically means an increase in capital cost, which might lead to loss of some investment opportunities. And second, inefficient corporate rules may induce greater agency costs since shareholders feel the need to protect themselves by monitoring managers by themselves; something which can truly be expected from an efficient corporate law.

[692] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 163
[693] Kingsley 498
[694] Soskice 301

Visser[695] has also categorized "investment incentives" as one of the major external drivers of CSR in developing countries, arguing that the greater is the social welfare in a country, the more multinational investments they attract.

The interviewees conceived that Commercial Law in Iran had the purpose of economic development when it was enacted but it did not fulfil its purpose. They also believed that the purpose of creation of publicly held companies was to collect people's small investments in order to invest in big projects. But it did not happen for the following reasons:

1. *Iran's society does not have a group work culture.*

2. *There is no security in Iran's economy. When a corporation becomes successful, the government will either misuse it or take over it.*

Homa Katouzian[696] argued that the reason that the ruler has absolute power in Iran is that the ruler has been considered God's representative on Earth and is in no way answerable to anyone, and has had absolute power over the life and property of all his people. He further explains: "When the ruler as the personification of the State is completely independent from the society, there may be no rights independently from him." This means nobody has any rights unless it is bestowed by the ruler, which can be taken away by the ruler at any time. "It was a privilege rather than a right which the State (i.e. the ruler, or local governors backed by him) could take away from him at will." It leads to a situation where there will not be any legal code or procedure that

[695] Visser 480-488
[696] Homa Katouzian, 'The Short-Term Society: A Study is the Problems of Long-Term Political and Economic Development in Iran' 40 Middle Eastern Studies 1

may limit the power of the State, or be invoked against its transgressions. This is the simple reason why there was not and there could not be private property in Iran in any sense that exists in the history of Europe.[697]

3. *Iran has had three decades of pure governmental economy. There has not been incentive for big private companies to take form. Even now, Iran is not still ready for them.*

Katouzian contended that the short-termism of Iranian society is "both a cause and an effect of lack of structure in Iranian history. This lack of structure, in turn, was a consequence of the arbitrary State, which represented personal arbitrary rule, and the arbitrary society, which tended towards chaos whenever the weakness of the State loosened its grip over it".[698]

Most of the interviewees (16 out of 28) were of the conviction that economic growth comes before adherence to the rule of law. Some (7 out of 28) believed that economic growth comes after adherence to the rule of law. And some (5 out of 28) believed that economic growth and adherence to the rule of law move in parallel and are interdependence.

Different studies[699] have suggested that getting the "right" law on the books will boost financial market development. However, there are reasons to caution against such

[697] Ibid 13-14
[698] Ibid 27
[699]'Empirical research based on a sample of 49 countries, most of them OECD member states, suggests that the level of shareholder protection is positively correlated with the development of stock markets, as measured by standard indicators, such as market capitalization and turnover ratio (La Porta and others 1997, 1998). Another empirical study (Johnson and others 2000) concludes that East Asian

simplistic conclusions. The results of these studies could not be replicated in transitional economies since massive legal change, especially in corporate law, has had remarkably little impact on the development of financial markets.[700] Moreover, the law on the books has not always been the cause for economic growth. It has been argued that countries with strong shareholder protection (mainly common law countries) have had better economic growth but there is no straightforward evidence showing that these countries necessarily had better laws on the books when they developed their corporate law. Indeed, they improved the law in response to challenges posed by the growth of the corporate and financial sectors. [701]

It has been difficult to prove empirically that law and legal institutions have contributed to economic growth and legal development.[702] Case studies on individual countries or regions are numerous but, due to the lack of reliable data, a broader empirical research on the development of law and legal institutions is rare.[703]

In recent years, the assumption that legal harmonization will lead to legal institutional improvement has been questioned by several authors. It has been argued that these attempts tend to ignore the main elements of successful economic development which are the constant change, innovation and adaptation of institutions and organizations in a competitive environment. Instead of improving domestic legal systems,

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economies with more effective corporate laws were able to weather the 1997/98 fmancial crisis better than those in which shareholders were afforded fewer protections by the law on the books and the effectiveness of legal institutions, as measured by perception data'. In Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 89-90

[700] Katharina Pistor, 'Law and Finance in Transition Economies' 32

[701] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 90

[702] Pistor, K, and, Wellons, P, 1999, '*The Role of Law and Legal Institutions in Asian Economic Development, 1960-1995*', New York: Oxford University Press.

[703] Knack and, Keefer 1994; Mauro 1995, In Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 92-93

standardization or harmonization may actually undermine the development of effective legal systems. Pistor has argued that: "for developing effective legal systems, the contents of the supplied laws is of only secondary importance to the process of law development and the compatibility of the new laws with pre-existing conditions, including existing legislation and legal institutions".[704]

There are two reason reasons that account for the importance of compatibility. These two reasons are embedded in features of legal systems: (I) the interdependence of legal rules and concepts that comprise a legal system, meaning that legal rules cannot be fully understood and enforced without reference to other legal terms and concepts. This means that without developing necessary complementarities for implementing the new rules, they might actually distort the domestic legal system. (II) Law is a cognitive institution, meaning that for it to be effective and actually change behaviour, the application and enforcement of rules must be fully understood and embraced not only by law enforcers, but also is determined by the perception of those using the law.[705]

One of the interviewees, while emphasizing that business practice and customs should be in place before laws, believed that it is not possible in Iran. He pointed at the lack of proper government supervision in Iran: if the market is suddenly freed to regulate itself, it will result in total chaos and great losses.

Another interviewee who believed adherence to the rule of law brings about economic growth, challenged the World Bank's argument that claimed no matter what the law

[704]Pistor Abstract
[705] Ibid

is, if a country is at peace, investment and employment will increase. He argued that peace comes from having proper law and proper enforcement of the law; therefore, adherence to the rule of law comes before economic growth.

Visser also accounts for "improved ethical responsibilities, incorporating good governance", to be granted "the highest CSR priority in developing countries and… that governance reform holds the key to improvements in all the other dimensions, including economic development, rule of law and voluntary action".[706]

In contrast, Pistor argues that "the fact that the transplantation of similar if not identical laws within decades after their enactment in the Western origin countries did not produce similar results questions the importance of formal law on the books for economic development. However, there may be more to effective law-making than getting the rules on the books right. Without a demand for law, which could be spurred by socio-economic development, the law will live a book-life, but will be ignored in practice".[707]

Self-regulation as opposed to government regulation

In the second step, the interviewees were asked their opinion about the extent to which they believe Iranian courts and regulators rely upon corporations to regulate their own affairs (e.g. self-regulation as opposed to government regulation), the extent to which they believe corporate law principles are applied within courts and the effectiveness of Iran's corporate regulators in enforcing corporate law.

[706] Wayne Visser
[707] Katharina Pistor, 'The Evolution of Corporate Law: A Cross-Country Comparison ' 9

Salim holds that there are other criteria which affect the efficiency of corporate governance regulation in developing countries, including culture and value systems, the quality of legal institutions, access to courts and the amount of State intervention in businesses. These issues cannot be resolved merely by reforming the law-on-the-books or by importing laws from other legal systems. Reforms should pay attention to the uniqueness of the local setting.[708]

Most of the interviewees (23 out of 28) believed that the extent to which courts and regulators rely upon corporations to regulate their own affairs is very low. They emphasized that laws are impediments to doing business in Iran and if companies abide by the law they cannot do business.

From this point of view of the interviewees one can conclude that Iran has a "mandatory legal system". Pistor maintained that a "mandatory legal system" is a system in which legislatures function as lawmakers, while judges' responsibility is just to implement these pre-made rules and they have little law-making function. By limiting the ability of private agents to experiment with new legal forms and restricting the court's ability to review them, a legal system adversely affects statutory legal change, which serves to implement abrupt radical legal change and consequently it limits the source of legal innovation.[709] The more mandatory a legal system, the less legal innovation will take place and vice versa, and the greater is the need for the institutional innovation.[710]

The interviewees enumerated several reasons for their answers:

[708] Salim 1
[709] Katharina Pistor, 'Innovation in Corporate Law ' 11
[710] Ibid 6-12

1. *Laws bring about many limitations that makes doing business impossible, especially Social Security, Labour Law and Insurance. At the same time, these limitations are not balanced with social benefits that laws give back to a society.*

2. *Laws need to be up-to-date and reformed to match Iran's current needs especially after the privatization according to Article 44 of the Constitutional Law and the removal of subsidies. Iran's laws are copies of the most developed international laws, which makes them impossible to abide by since they do not match the business realities in Iran. Therefore, what is in practice in Iran is not the written law but rather the unwritten law.*

   Similarly Kingsleyargued that law reforms imposed upon developing nations have traditionally failed to meet the indigenous commercial and social needs because the reforms have focused on the needs of the colonizer or international community, rather than on facilitating the development of domestic communities, commerce and markets.[711]

3. *Laws in Iran are not stable, not interdependent and do not move towards a common goal of economic development. They are also full of contradictions.*

4. *The government's direct involvement in business activities in Iran and its competition with private companies have turned the government into the business practice*

[711] Kingsley 498

determiner, which has made it even more impossible for companies to regulate their own affairs.

In State-owned capitalism countries such as Iran, commercial decisions are usually taken by political actors who have limited or no experience in commercial matters. Bremmer argues that "their decisions make markets less competitive and therefore less productive". He further argues that since these corporations have political support and competitive advantages (State subsidies), they threaten their private sector rivals.[712]

This result is a reflection of a fundamental problem in developing countries in transition from central planning to the market. Pistor argues that "this transition requires at its core the transformation of the role of the State from direct co-ordinator of economic activity to an important arbiter". But the lack of adherence to the rule of law in developing countries indicates that this transformation remained flawed and partial in favour of the State in these countries.[713]

5. *The cost of abiding by the law is very high.*

6. *Iran has a huge problem with implementation of the law. The government officials are either very late to react, or after their own personal interests through bribery. Officials do not understand the spirit of the law, which is economic development and entrepreneurship. They are not balanced in implementing the law. They are either too strict or too easy and after their own personal interest.*

[712] Bremmer 6
[713] Katharina Pistor, 'Law and Finance in Transition Economies' 14

Motivation is highly relevant to this analysis. Motivation must be considered both from the law reformers initially responsible for the transplant, and the legal actors[714] with the potential to use and implement it.

The interviewees who believed the extent to which courts and regulators rely upon corporations to regulate their affairs is good were managing directors of big previously governmental companies that were recently privatized (the so-called "half private-half governmental companies"). But they also emphasized that the laws need to be up-to-date and reformed according to Iran's current needs.

They maintained that companies are free to regulate their own affairs except in two cases: first, in matters of public policy and national security and second, in the matter of endangering shareholders' benefits. They also believed the fact that courts refuse to dismiss director's decision-making is an indicator of the freedom of companies in regulating their own affairs.

The Effectiveness of Iran's Legal System in Dealing with Self-dealing

In the third step, the interviewees were asked how effective they believe Iran's corporate law is in dealing with self-dealing by corporate officials.

The interviewees believed that Iran's corporate law mechanisms are quite effective in dealing with illegal self-dealing by corporate officials.

[714] Courts, attorneys, government officials

Self-dealing has been dealt with in Articles 129-133 of Commercial Law. Managers cannot do any commercial activities that are in competition with or the same as the company's activities. Also, Article 200 stipulates that managers cannot get a loan from the company unless the company is a bank. If a manager breaches these laws, they are held liable. *The interviewees believed that these articles have been enforced properly.*

The interviewees emphasized that the common public perception that managers always misuse the company is not true. This perception comes from the fact that, after the revolution, the government advertised quite successfully against capitalism, underlying that whoever has money is a bad, immoral person. But now the Iranian government has changed policies and is looking for investors after privatization but the effects of those advertisements are still there and people's mindset about wealthy people has not changed yet.

The Level of Compliance on the Part of Iranian Companies with Legal and Regulatory Rules

In the fourth step, the interviewees were asked to describe the level of compliance on the part of Iranian companies with legal and regulatory rules (e.g. re disclosure). They were also asked what they believe is available as formal and informal institutions to make up for weak corporate law.

All of the interviewees believed that the level compliance on the part of Iranian companies with legal and regulatory rules especially disclosure, tax, insurance and social security is very low.

Four of the interviewees who were managing directors of big, previously governmental companies that have been recently privatized (the so-called "half private-half governmental companies") believed that the level of compliance in the governmental companies that are listed in the Stock Exchange is good while in private companies it is low. One of the interviewees who was a lawyer for a couple of big corporations further explained that there are two reasons for compliance on the part of these companies: first, they can get a loan from a bank as that requires showing the bank that they have credit by paying social security and tax. Other companies that are not listed, no matter how big they are, will not be able to get a loan from the bank. Second, these companies are governmental; they are spending the government's money and they do not care if the company is not making any profit. It is governmental organizational structure that automatically pays tax and social security.

The interviewees enumerated the following reason for their answers:

1. *Iran's society does not trust the government. The government does not disclose anything itself; everything is hidden. At the same time, Iranians live their life in obscurity and they like it. Therefore the same goes with companies and the government. Culturally, Iranians have always been very secretive about their financial affairs.*

2. *Unions do not play their proper role in Iran; therefore, industries and professions have problems in communicating their issues to the government.*

3. *It is a cultural problem. In Iran the cultural level is low, therefore abiding by the law is low.*

4. *Iranians have a lack of legal knowledge. They do not deal with the law unless they are in trouble.*

5. *Laws in Iran are an impediment to doing business. They are not based on business realities. If companies abide by the law, they cannot do business. One of the problematic laws is the Labour Law. This law is strongly in favour of labour. It makes doing business very hard, therefore it leads to less investment, that decreases employment and that leads to a decrease in salary since the current labour needs to sell his expertise cheap to stay in his job. Law is not the borderline anymore. The borderline is goodness or badness in the culture.*

The International Labour Organization called Iranian Labour Law "comprehensive," since it covers all facets of labour relations, including hiring of local and foreign staff. This law also provides a broad and inclusive definition of the individuals it covers, with written, oral, temporary and indefinite employment contracts all recognized. Considered employee-friendly, the Labour Law makes it extremely difficult to lay off staff. Employing personnel on consecutive six-month contracts (a practice that is used to avoid paying benefits) is illegal, as is dismissing staff without proof of a serious

offense. Labour disputes are settled by a special labour council, which usually rules in favour of the employee.[715]

Pistor and others' findings also suggested that in developing countries the proportion of firms who do not trust the legal system to enforce their rights is quite high. For example, in Kyrgyzstan, Moldova, Russia and Ukraine, three-quarters of all corporations do not trust the legal system to protect their rights.[716]

6. *Disclosure has always been to the detriment of companies and businesses. That is why Iranians are wary of disclosure.*

7. *There are no strict legal sanctions in the case of false disclosure.*

8. *Iran's society does not see the effects of paying tax. Nothing changes.*

The interviewees maintained that while a large part of bad law just stays bad and companies just avoid the law and are in a constant fight with the government in order to make up for bad law, the following formal and informal institutions are in place:

1. *Companies bribe the tax officials. Most tax officials in Iran are companies' financial consultants too.*

2. *The government is easy on companies unless it is a matter of national security. Sometimes the government is strict and exerts pressure, therefore companies abide by*

[715] Rouznameh Rasmi, 'Labour Law' (*International Labour Organization*, 1990)
[716] Katharina Pistor, 'Law and Finance in Transition Economies' 9

law but still they do so in a very incomplete way and with the least possible compliance.

3. *Sometimes courts meddle in a corporation's affairs and force companies who are not economically beneficial to go bankrupt.*

4. *Some of these bad laws are made up for by friendship and trust. Many business relations in Iran are based on the unwritten law of friendship and trust. That is the very reason for companies' conflicts and separation, leading to the short lifespan of many big companies in Iran.*

This indicates another role of law through the informal law. Informal law might appear as a set of normative ideas, patterns of behaviour and action that are not based on a sharp distinction between law and morality. In other words, they are not enacted by the State and their validity does not rely on State sanctions but rather moral or practical sanctions.[717]

Moreover, as the size of transactions, and consequently markets, grow the informal governance mechanisms become less effective.[718] That is, if formal rules are not in place to govern the market, informal mechanisms surface, which in order to be effective reduce the size of the transactions and consequently the markets. Applying this proposition to corporations would mean that the more formal law in place to increase shareholder and stakeholder protection, the more prosperous the economy will get.

[717] Buhmann 191
[718] Charny142

Here the importance of the notion of "network" shows itself. An economic interpretation of "legal culture" leads us to the notion of "network".[719] Networks reduce transaction costs between market actors. The more actors accept them, the more valuable they become, which might cause monopolization by the actors within that network, leading to rent-seeking. A driving force behind the network characteristic of legal culture is that there are significant scales of economic benefits for those using a specific network. The added value that the network actors draw is from the fact that large numbers of other agents also use that network.

At the same time, Roe maintained that existing legal rules also might have an efficiency advantage because institutions and structures might have already developed certain solutions to address needs and problem arising under these rules. In such a case replacing the existing rules might make the existing institutional and professional infrastructure obsolete or ill-fitting. Replacing these rules would require new investments and adaptation to the new rules by different actors.[720]

Conclusion

In the first step, all of the interviewees believed that ideally good corporate law is effective in economic development but not in Iran's case since Iran's current corporate law is an impediment to economic development. They enumerated the following reasons for their answers: Iran's Commercial Law is old, inefficient, not in favour of business, cannot solve any problems and has too many exceptions. At the same time, business in Iran is based on friendship and trust, not law. Moreover the

[719] Ogus, 'The Economic Basis of Legal Culture: Networks and Monopolization' 423
[720] Hart 96

main problem in Iran is abiding by the law since breaking the law has become a habit. There is no disclosure and laws are copied from other countries.

The interviewees also believed that law determines the framework of a country's economy. If this framework gives security to investors, they invest more, leading to economic development.

The interviewees conceived that the Commercial Law in Iran had the purpose of economic development when it was enacted but it did not fulfil its purpose. They also believed that the purpose of the creation of publicly held companies was to collect people's small investments in order to invest in big projects. But it did not happen for the following reasons: weak group work culture, no security in the economy and a governmental economy culture.

Most of the interviewees (16 out of 28) were of the conviction that economic growth comes before adherence to the rule of law. Some (7 out of 28) believed that economic growth comes after adherence to the rule of law. And some (5 out of 28) believed that economic growth and adherence to the rule of law move in parallel and are interdependent.

In the second step, most of the interviewees (23 out of 28) believed that the extent to which courts and regulators rely on corporations to regulate their own affairs is very low. They emphasized that laws are impediments to doing business in Iran and if companies abide by the law they cannot do business. They enumerated the following reasons for their answers: laws bring many limitations, which makes doing business

impossible, laws need to be updated and reformed, laws are not stable and do not move towards a common goal, the government's direct involvement in business has made it the business practice determiner, costs of abiding by law are high and there are many problems with implementing the law.

In the third step, the interviewees believed that Iran's corporate law mechanisms are quite effective in dealing with illegal self-dealing by corporate officials.

All of the interviewees believed that the level of compliance upon the part of Iranian companies with legal and regulatory rules especially disclosure, tax, insurance and social security is very low. They enumerated the following reasons for their answers: no trust in the government, no role for unions, low cultural level, lack of legal knowledge, laws are impediments to doing business, no disclosure and no strict legal sanctions for false disclosure.

The interviewees maintained that while a large part of bad law just stays bad and companies just avoid the law and are in constant fights with the government, in order to make up for bad law, the following formal and informal institutions are in place: bribing the tax officials, the government turns a blind eye on non-compliance, courts, friendship and trust.

Key proposition 2: The Effect of Internal Norms on CSR Values within Corporations

The impact of CSR values upon corporations in transitional economies, such as Iran, is likely to be shaped by the internal norms in these corporations.

Introduction

In the previous section, the connection between corporate legal rules and CSR principles, "law-matters" thesis and the complications of the act of borrowing were discussed. In this section, the effects of internal norms on shaping CSR values within corporations will be discussed.

In order to asses if the impact of CSR values upon corporations in transitional economies, such as Iran, is likely to be shaped by the internal norms in these corporations, it was of critical importance to see how CSR policies are implemented at lower levels in Iranian companies.

In order to do this, intially the interviewees' opinion was sought as to the extent to which they believe different stakeholder groups are likely to impact upon the decision-making process of Iranian companies and if support from multiple stakeholders is important for the success of their company in Iran. Furthermore, the interviewee's opinion was sought as to who they believe are the most influential stakeholders in their company.

Second, the interviewees were asked if and in what way positive public perception is important for the success of their company in Iran.

Third, the interviewees were asked how they believed CSR values within corporations are shaped by the internal norm in these corporations. The interviewees' opinion was also sought as to the extent to which managers/directors of large Iranian companies are accountable to different stakeholder groups (e.g. employees, shareholders, consumers, etc).

Fourth, the interviewees were asked if they think more employee participation would further promote CSR policies in Iranian companies.

Fifth, the interviewees were asked to explain if they see the company as an economic player or as a socio-political player.

Sixth, the interviewees were asked why they think companies decide to get involved with CSR and how, if at all, companies benefit from CSR.

Finally, the interviewees were asked if they believe corporations have extra responsibility for social development beyond the development that arises incidentally from their responsibility to their shareholders to generate profit.

The Effect of Stakeholders on the Decision-making Process

In order to asses this key proposition, in the first step, the interviewees' opinion was sought as to the extent to which they believe different stakeholder groups are likely to

impact upon the decision-making process of Iranian companies and if support from multiple stakeholders is important for the success of their company in Iran. Furthermore, the interviewee's opinion was sought as to who they believe are the most influential stakeholders in their company.

These questions were asked to see how stakeholder value theory is seen in the Iranian business mindset. Stakeholder value theory aims at broader accountability for corporations. It maintains that no group that has contributed to corporate success should remain unrecognized. The advocates of this theory argue that shareholders are but one of the many stakeholders and contend that employees and other constituencies' interests should be considered in the corporate decision-making process.[721] Kiarie argues that the success of a corporation depends on stakeholders as much or even more than it does on shareholders.[722]

In contrast, Jensen doubts the practicality of stakeholder value theory since the advocates of this theory do not specify how managers should handle the competing interests of different stakeholder groups. He further argues that managers are left with a theory "that makes it impossible to make purposeful decisions" and keep score of managers' decisions. This will make managers "unaccountable for their actions".[723]

The interviewees gave very mixed answers to the issue of stakeholders' influence upon corporation decision-making. However, many of them (25 out of 28) believed that in general stakeholders have either very limited or no impact at all upon the decision-making process in Iranian companies due to the governmental economy,

[721] Dean 66
[722] Kiarie 5
[723] Jensen in Abstract

lack of competition and cultural underdevelopment. However, they gave a ranking of what stakeholder group they thought is the most important one:

1. *Public opinion (11 out of 20)*
2. *Consumers (10 out of 20)*
3. *The attitude of the managing director and board of directors (7 out of 20)*

They gave the following reasons for their answers:

1. *Public opinion: if public opinion is negative about a company, it is a negative advertisement that threatens the company's reputation.*

Colbert et al.'s approach also focused on exploiting CSR activities in order to build a reputation and legitimacy. They advocated alignment with political-social norms and expectations while addressing elements in the political-cultural context in order to be known as a responsible brand in the operating domain.[724]

2. *Consumers: Unless someone makes a huge noise and threatens a company's reputation, companies do not care about consumers. At the same time, if consumers want to complain, the process is time-consuming and costs a lot. There are couple of organizations in Iran that are established for consumer protection such as "Producer and Consumer Protection Organization", "Consumer and Producer Co-operative" and courts. But in practice the complaints go nowhere.*

[724] Elizabeth C. Kurucz 94

Consumers in Iran have no power due to lack of competition and choices in the market.

At the same time, evidence also suggests that at present many consumers are not particularly concerned about a corporation's environmental track record.[725] It is true that certain customer segments, such as members of socially responsible groups or older people, have been found to be willing to pay premium prices for products from high-CSR corporations, but these purchasing decisions cannot be generalized to the whole population of consumers.[726]

3. *The attitude of the managing director and board of directors.*

4. *Shareholders: in big companies, the government is the controlling shareholder and the rest of the shareholders have no idea what is happening in the company because of the dispersed ownership system. Additionally, shareholders have no say in choosing the managers. On paper they vote, but in practice the managers have been already chosen behind closed doors.*

The governmental economy and small amount of shareholders means that companies are not rooted in society. One of the interviewees mentioned having many shareholders (as a form of the pressure of public opinion) has been used as a form of strategy to prevent governmental misuses and take-overs.

[725] Gunthe 68
[726] Orlitzky, 'Corporate Social Performance and Financial Performance: A research Synthesis' 122

5. *Employees: There is the Labour Law for employee protection but it is easy to avoid it. At the same time, employee participation in a company's decision-making process will impair the company's affairs since it is not in Iran's culture and employees forget their place. Moreover, due to a governmental economy, Iran has a governmental organizational system in big companies. In other words, employees are just obedient to managers and only want their salary. They do not care who the boss is or the fact that the company is not making money since it is the government's money. Additionally, employees want to keep their job due to the current high unemployment rate.*

According to the head of the Organization for Investment, Economic and Technical Assistance of Iran (OIETAI), Iran ranked 142 among 181 countries in terms of working conditions in 2008. Iran stands at number 96 in terms of business start-up, 165 in obtaining permits, 147 in employment, 147 in asset registration, 84 in obtaining credit, 164 in legal support for investments, 104 in tax payments, 142 in overseas trade, 56 in contract feasibility and 107 in bankruptcy.[727] Iran ranked 62nd in the World Economic Forum's 2011 analysis of the global competitiveness of 142 countries.[728] Between 1992 and 2008 firms from more than 50 countries invested in Iran, with Asia and Europe being the largest participants.[729]

[727] 'Working Conditions to Improve' (*Iran Daily*, 9 November 2008) <www.nitc.co.ir/iran-daily/1387/3265/html/economy.htm>
[728] 'Iran Ranks 69th out of 139 in Global Competitiveness' (*Global Competitiveness Report, World Economic Forum*, 2010) <http://payvand.com/blog/blog/2010/09/13/iran-ranks-69th-out-of-139-in-global-competitiveness-world-economic-forum/> and 'Iran's Competitiveness Rank Up 7 Places: WEF ' (*Tehran Times,*, 9 August 2011) <http://www.payvand.com/news/11/sep/1074.html>
[729] '$34b Foreign Investment in 16Years' (*Iran Daily*, 7 December 2008) <http://www.nitc.co.ir/iran-daily/1387/3289/html/economy.htm>

The Effect of Positive Public Perception on the Success of Iranian Companies

In the second step, the interviewees were asked if and in what way positive public perception is important for the success of their company in Iran.

Soule has argued that social movements often target corporations rather than governments as a more direct means to achieve social ends, from economic equality and civil rights to product safety and accountability for negligence. [730]

The interviewees fell into two groups of negative and positive answers with a slight inclination towards a positive answer. The point that needs to be taken into consideration is that most of the interviewees giving a positive answer were managing directors of big, previously governmental companies (the so-called "half private-half governmental companies") and they did not provide sufficient grounds for their positive answer.

Some of the interviewees (15 out of 28) assumed that positive public perception among the company's target group is important for a company's success.

Similarly, Cordeiro[731] emphasized that positive public perception and support from multiple stakeholders is necessary for MNCs to be successful in emerging economies.[732]

[730] Sarah A. Soule, *Contention and Corporate Social Responsibility* (Cambridge University Press 2009) 54
[731] Cordeiro 1
[732] Reed 238

The interviewees supported their positive answer (positive public perception is important for the success of the company) with the following reasons:

1. *Negative public perception wastes a company's energy to fight it off.*

2. *There are different public perceptions. In Tehran, the society is more educated but in the rest of Iran, the public likes charity work a lot and is hugely affected by television and advertisements.*

3. *The government pays more attention to public perception due to its fear that public pressure or negative reaction could lead to political instability.*

4. *Positive public perception attracts more customers for the company and the company will sell more.*

   Similarly Soule argues that social movements generate change in business practices by introducing new cognitive frames with which organizational actors must contend as they seek to legitimate new products and expand their operations. Social movements also have the capacity to bring about new institutional orders in a variety of settings beyond capitalist enterprises.[733]

5. *Good quality products/services and keeping up that good quality gives families a sense of security about that product/service, leading to more production.*

[733] Soule 186

The other half of the interviewees (13 out of 28), while assuming that positive public perception would be important for the success of the company, believed it did not apply in Iran's current situation.

They enumerated the following reasons for their negative answers:

1. *Public opinion becomes important in Iran whenever the public puts pressure on the government or the government's reputation is in danger.*

2. *Government officials always trick the public and put on an act claiming that public opinion is important to them. The public knows it and does not trust the government.*

3. *Iran has a governmental economy. There is no competition and the public does not have choices. At the same time, companies do not have a role in this market. It is the government's policies that determine everything.*

4. *Iran is in a bad economic condition. People do not have enough money to increase their choice of product purchases.*

5. *Iran's society does not have the social coherence to stand against companies' actions. A collective action and group work culture does not exist in Iran either.*

This is against Soule's opinion of the importance of social contention in CSR. Soule argues that activist campaigns do encourage greater CSR, and that social movement

campaigns often target both states and companies simultaneously in order to effect change through multiple means. Corporations seem to benefit by being the subject of protest, as Soule states clearly: ‘‘while they may not acquiesce to all claims made on them by activists, they do change. Thus, we can think of social movements and anti-corporate activists as important engines driving corporate innovation’’.[734]

6. *Companies do not worry about public perception since the importance of "brand" does not usually exist in Iran. Companies do not last long. If something goes wrong that endangers the company's reputation, it simply changes its name and starts all over again. In rare cases where "brand" is important, the public does not pay attention to quality or performance. It only cares about the name.*

7. *Iran is in a transitional period; that is, Iran is still not developed enough for CSR concepts and does not have the necessary conditions and infrastructure either. Managers still do not have enough knowledge and expertise. The public likes CSR but it does not see it as a company's duty. And the public certainly does not know that it has the right and power to want companies to behave in a socially responsible way. The public does not pay attention unless a company's action leads to a huge criminal matter.*

Katouzian also argues that Iranian society has not reached the stage of development corresponding to that of post-Renaissance Europe. Between the two Iranian revolutions (The Constitutionalism Revolution and Islamic Revolution) in the twentieth century, Iran did produce new institutions, organisations, goods and services

[734] Ibid 144

simply because of arbitrary and unsystematic copying from Europe. This was mostly achieved through the 1960s and 1970s because of large and increasing oil revenues. "But the relationship between the State and society remained essentially the same, such that in the second revolution (1977-78) the propertied classes either supported it or remained neutral, much as they had done in the first one (1905-1909)".[735]

8. *Consumer Protection Law went into parliament in 2002. It came out in 2009. It took seven years for the parliament to realize the necessity of consumer protection. This example shows that Iran is still not ready to take into account public perception.*

The Accountability of Directors to Stakeholders in Iranian Companies

In the third step, the interviewees were asked how they believe CSR values within corporations are shaped by the internal norms in these corporations. The interviewees' opinion was also sought as to the extent to which managers/directors of large Iranian companies are accountable to different stakeholder groups (e.g. employees, shareholders, consumers, etc).

This discussion refers to the two different corporate responsibility policies: explicit and implicit. Firstly, *explicit* CSR refers to the corporate policies which reflect the company's own discretion and initiative for certain societal interests. In contrast, *implicit* CSR has been referred to as the corporations' policies as a reflection of wider policy arrangements embedded in the *formal and informal institutional environment*. Implicit CSR normally occurs in the form of values, codified norms and rules which

[735] Katouzian 26

result in mandatory and customary requirements defining the proper obligations of corporate actors.[736]

All of the interviewees, while assuming that external conditions, such as, pressure from the government or public are more effective than internal elements, believed that CSR values within corporations are shaped by the attitudes of the managing director and board of directors. They all emphasized that the most important driver of CSR would be the managing director's attitude. They argued that managing directors in Iran are governmental, powerful, experienced and have a huge say in how a company is run. One of the interviewees further explained that CSR falls into the category of organizational culture and culture in an Iranian company comes from the top (managers) down (to employees). Managers need to build the right culture and educate their employees in order to institutionalize CSR in their company.

Jones also argued that the empirical evidence shows CSR and Corporate Financial Performance (CFP) are most likely correlated in the sense that CSR helps improve managerial knowledge and skills, and therefore enhances corporate reputation. By balancing a large number of stakeholder interests, a corporation may increase various stakeholder groups' confidence that the corporation will be understanding and non-adversarial in resolving future stakeholder conflicts.[737] CSR and CFP may influence one another in a way that good managers are capable of taking positive strategic action in both economic and social domains. Astute managers are able to identify and implement specific CSR activities through which their organization's reputation can

[736] Moon, '"Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility'2-10
[737] Jones, 'Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics' 404

be enhanced in social or environmental domains. They also ensure that slack resources are invested wisely to promote these opportunities.[738]

Most of the interviewees (25 out of 28) believed that managers/directors of large Iranian companies' accountability to different stakeholders is weak in Iran.

This is in line with "agency theory," which maintains that the principal's problem is to motivate the agent to do what he or she was asked to do leading to higher as agency costs. This issue arises due to the fact that the agent because the agent (managers) has more information about the company than the principal (shareholders). Agency theorists generally assume that managers will pursue their own interests whenever possible, rather than those of the principal.[739]

One of the major attacks on agency theory is the "team production" theory.[740] According to this theory the mere focus on agency costs should shift to a focus on "protecting specific investments," meaning that public corporations today need more than one individual or group to invest.[741] In this way the managers' goal would be protecting "the wealth-creating potential of the entire corporate team".[742]

The team production theory has been strongly criticized by the advocates of shareholder wealth maximization theory who argue that under the team production theory it is impossible to mediate between different claims on the corporation.

[738] Orlitzky, 'Corporate Social Performance and Financial Performance: A research Synthesis' 123
[739] Salazar 144
[740] Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* 101
[741] Stout, 'Specific Investment: Explaining Anomalies in Corporate Law '
[742] Stout, 'A Team Production Theory of Corporate Law' 296

Bebchuk supports the team production model of the board as a vehicle for protecting stakeholders' interests, but criticizes the model on the grounds that it leaves stakeholders with too little power and directors "accountable to no one."[743]

The interviewees enumerated the following reasons for believing that managers/directors of large Iranian companies' accountability to different stakeholders is weak in Iran:

1. *In big companies, managers are governmental. They do not directly deal with stakeholders and do not care unless the stakeholder is powerful too. It is the government's money, not theirs, since they are not shareholders of the company. Moreover, managers do not have job security and all their energy goes into keeping their position and drawing personal benefits instead of into the company's economic and social development.*

2. *Managers are scared since they are not required by the law to implement CSR activities. CSR activities need to be either stipulated in the company's Articles of Association or have the permission of Annual General Assembly. Another reason for this fear is the fact that there have been some cases that managers took CSR initiatives and were held responsible for them due to political reasons. In other words, if a manager's good political status turns a bit bad, these initiatives will be used against them, therefore managers try to be very careful and get permission from the top. This procedure can be very long, during which managers either lose incentive or forget about the whole thing.*

[743] Bebchuk 57

This issue shows the problems that arise from not having a particular definition for CSR. These problems are more evident in practice rather than on paper. In practice managers need to have a proper definition to know what is expected from them, what are the limits of CSR and the issues for which CSR exists to be able to form strategies to respond to those issues.[744]

This highlights one of the positive points of stakeholder theory in that it fills in the conceptual gap and obscurity of current CSR theories by addressing concrete interests and practices and demonstrating specific responsibilities towards specific groups of people affected by business activity. Therefore, it is not a mere ethical theory disconnected from business management, but a managerial theory related to business success.[745]

On the contrary, some of the proponents of shareholder value theory this theory in a more efficient way so it creates the best environment for the creation of wealth. If making profit is the primary objective of the corporation, it incentivises the businesses to create the goods and services demanded by consumers. At the same time, requiring managers to deal with social concerns or stakeholders will distract them from their main task and pushes them to take decisions on an issue out of the scope of their knowledge or experience. Directors as entrepreneurs are experienced in business matters, not in balancing social interests.[746]

In the same fashion, Jensen famously stated that it is impossible for managers to seek to maximize more than one meaningful objective. This objective is long-term value

[744] Andrew Crane 4
[745] Mele 66. In Ibid.
[746] Deakin 11-12

maximization or value-seeking. Jensen then connects this principle to stakeholder theory through what he calls "enlightened stakeholder theory". Jensen states: "(E)nlightened stakeholder theory adds the simple specification that the objective function of the firm is to maximize total long-term firm value".[747] While enlightened stakeholder theory appears to utilize the structure of stakeholder theory, "but accepts the maximization of long-term value of the firm as a criterion for making the requisite trade-off among its stakeholders".[748] Henderson,[749] while generally accepting CSR initiatives, argued that the pursuit of objectives other than shareholder profit maximization might reduce the society's general welfare due to multiple objectives.

3. *Because of Iran's bad economic conditions, managers are very busy trying to meet the company's primary economic goal of making profit and keep the company running from one day to another. They simply do not have time for CSR and do not prioritize it.*

4. *Managers in Iran cannot be held accountable due to the unstable economic conditions leading to sudden decreases/increases in profit. They cannot have long-term planning either. Some managers do try to ipmlement CSR but it is due to personal reasons, such as benefits, lobbying and religious beliefs, or it is an order from the top. It is not classic CSR like in the West and obviously it is not programmed.*

5. *There is no competition in the market and consumers do not have choices; therefore, managers do not fear or feel threatened by negative public perception.*

[747] Jensen 4
[748] Ibid in Abstract
[749] Henderson quoted in Ararat 2

6. *Since Iran's society does not ask for CSR and does not see CSR as a company's duty, the same goes for companies and their managers. The managers are part of this society and their mindset and behaviour matches their society's mindset and behaviour.*

A small number of the interviewees who happened to be the managing director of previously governmental companies (the so-called "half private-half governmental companies") did not measure managing director's behaviour and did not comment on this issue. They just said that the attitude of the managing director is the most important factor in promoting CSR policies in the company.

The Effect of More Employee Participation in Promotion of CSR Policies in Iranian Companies

In the fourth step, the interviewees were asked if they think more employee participation would further promote CSR policies in Iranian companies.

Most of the interviewees (18 out of 28) believed that more employee participation not only does not further promote CSR policies in an Iranian company but it might hurt the company.

The interviewees enumerated the following reasons for their negative answers:

1. *Iran is in bad economic shape. Therefore, if employees are given more power and responsibility, they will seek their primary economic needs instead of promoting CSR policies.*

2. *Iranians have a short-term mindset. Employees are considered as short-term assets of the company and in return employees consider the company a short-term place to be in, therefore they do not think about the future of the company. One of the interviewees who was the lawyer for some big corporations believed that in Iran neither managers nor employees have any effect in promoting CSR for two reasons: first, managers are appointed by the government; they did not go through different levels of hierarchy and did not work their way up. Second, neither managers nor employees are shareholders of the company. That is the reason they do not feel that the company and its profits belong to them; it belongs to the government.*

   Considering the two reasons above and the short-term mindset, the culture of "sustainable employment" will never improve in Iran. This culture allows managers and employees to stop spending all their energy on keeping their positions and to start thinking about the long-term economic and social development of the company.

Katouzian in his article about short-termism in Iranian society wrote: "lack of long-term continuity, by definition, resulted in significant change from one short period to the next, such that history became a series of connected short runs. In this sense, therefore, change was more frequent – usually also more drastic."[750]

[750] Katouzian 2

He further supports his argument by the most visible example of the short-term nature of Iranian society. Iranians have a habit of declaring a building sound in foundation and structure as a "pick-axe building" (sakhteman-e kolangi). The only reason for this behaviour is simply that their architecture and/or interior design is not according to the latest fashion or whims. Therefore, rather than building a new house on a new site, thus adding to the stock of existing physical capital, the owner destroys the existing house and builds a new one on its site. This shows that Iran is a society where many of its socio-political aspects are constantly in danger of receiving the "pick-axe" treatment because of a short-term mindset.[751]

3. *There are some cultural issues in giving power and responsibility to employees. First, in Iran employees have never participated in policy-making due to governmental organizational behaviour in which there is a huge distance between managers and employees. There has always been a top-down organization in Iran. Second, in Iranian culture responsibility equals interventions. Employees will soon forget their position as employee and see themselves as manager. For example, in Housing Co-operatives and Producer-Consumer Co-operatives, employees are chosen as managers. Not only has this not had an effect on the promotion of CSR, the appointed employees have also started behaving like any other Iranian managers in getting the best things for themselves.*

4. *Employees in Iran are not educated enough, and do not have enough knowledge and incentive; therefore, this extra power might result in the misuse of power or wrong reactions upon the part of employees.*

[751] Ibid

5. *An employee's duty is to do his job, not to intervene in policy-making. This is the job of managers. They are the ones responsible for governing and running the company.*

6. *Employee participation is an internal affair of the company. It does not have an external effect; therefore, it does not have an effect on an external concept such as CSR.*

Evidence also suggests that the integration of prior CSR-corporate financial performance research shows that "although the internal-skills perspective is substantiated empirically to some extent, the internal learning effects of CSR tend to be 33% smaller than the reputation effects emanating from high CSR".[752]

Some of the interviewees (8 out of 28) believed that more employee participation would promote CSR policies in Iranian companies. They emphasized that participating makes employees feel they belong to a company. This will increase their efficiency level by carrying out decisions better. They will also behave better with stakeholders. This situation will guarantee an increase in profit and the company's success.

Two of the interviewees believed that employee participation and its efficiency directly depends on the managing director and board of directors' attitude. The other interviewees also indirectly mentioned this fact while answering the question.

[752] Orlitzky, 'Corporate Social Performance and Financial Performance: A research Synthesis' 119

The Debate between Economic and Socio-political Justifications for CSR

In the fifth step, the interviewees were asked to explain if they see the company as an economic player or as a socio-political player.

This is a debate between economic and ethical justifications for CSR. It is a debate between two fundamental understandings of what a corporation is: a disconnected, simple entity with one-dimensional, stable interests, or an interconnected, complex self with multidimensional, dynamic interests, taking responsibility for a greater common good.[753]

All of the interviewees emphasized that the economic role is the primary function of a company.

Most of the interviewees (20 out of 28) believed that a company is both an economic and socio-political player, with a great emphasis on the political role.

Corporations that base their business case for CSR on this approach take on a political role including a complex mix of political and economic interests and dynamics. "The power and position of the corporation in society is the central concern; the organization accepts social duties and rights or participates in some form of social co-operation as an expected part of doing business".[754]

[753]Michaela Driver, 'Beyond the Stalemate of Economics versus Ethics: Corporate Social Responsibility and the Discourse of the Organizational Self' 66 Journal of Business Ethics 337 337
[754] Elizabeth C. Kurucz 94

The interviewees supported their opinion by the following reasons:

1. *Iran has a governmental economy. Economic and politics are interwoven in Iran. Politics directly affects companies in several ways: first, politics increases or decreases society's feelings of security. Second, sanctions are negatively affecting companies in Iran. The government policies and foreign relations have taken away many international markets from companies in Iran. Third, in all elections companies have been forced to donate money to candidates' campaigns. All big successful companies are doing their business with political connections. Fourth, companies are considered a driver and performer of the government's policies in managing the capital market to achieve its purposes and ideologies.*

According to the World Bank, the fourth round of international sanctions in 2010 has increased the cost of doing business, limited access to foreign direct investments and foreign technologies, and exacerbated international trade and financial transactions. The United Nations Security Council (UNSC) sanctions include a ban on financing and exports related to Iran's nuclear and military programmes. Additional sanctions beyond those called for by the UNSC pose constraints on some international financial transactions, particularly in the euro and the US dollar.[755]

Similarly, the IMF 2011 report on Iran stated that new international sanctions in 2010 have in practice increased the cost of doing business, limited FDI and technology transfer, and affected international trade and financial transactions.[756]

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[755] WorldBank, 'http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/IRANEXTN/0,,menuPK:312966~pagePK:141132~piPK:141107~theSitePK:312943,00.html'

[756] IMF11/241 3

Iran is one of the few major economies that has maintained positive growth in the aftermath of the 2008 global financial crisis, despite sanctions imposed by the international community as a result of the country's nuclear programme.[757]

2. *When a company gets bigger and operates internationally, it becomes a socio-political player automatically since, first, it deals with many people; and second, the survival and success of the company depends on its role as a socio-political player.*

3. *Economy and society are interwoven. If the economy goes bad, society goes bad too.*

Mele[758] also argued that business and society are two interwoven systems; therefore, since corporations exist and operate in a shared environment, they should be socially responsible like any other member of that environment. A corporation would risk its reputation if its performance were contrary to the expectations of those people who constitute the corporation's social environment.

In similar fashion, Stiglitz maintains "politics and economics are intricately interwoven: corporations have used their financial muscle to protect themselves from bearing the full social consequences of their actions".[759]

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[757] Farnaz Fassihi, 'Iran's Economy Feels Sting of Sanctions ' (*Wall Street Journal, Middle East*, 12 October 2010) <http://online.wsj.com/article_email/SB10001424052748703735804575535920875779114-lMyQjAxMTAwMDEwMTExNDEyWj.html> and 'Tehran Exchange Extends Advance' (*Financial Times*, 25 AUgust 2010) <http://www.ft.com/cms/s/99a1b6dc-b06d-11df-8c04-00144feabdc0,Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2F99a1b6dc-b06d-11df-8c04-00144feabdc0.html&_i_referer=http%3A%2F%2Fen.wikipedia.org%2Fwiki%2FEconomy_of_Iran#axzz1eXfWQBxc>

[758] Mele 52

[759] Stiglitz, *Making Globalization Work: The Next Step to Global Justice* 209

The interviewees who maintained companies are just economic players highlighted that ideally a company's socio-political involvement is a good phenomenon, but not in Iran's current situation.

They believed that, besides the fact that a company's raison d'être is economic and its purpose is profit making, Iran's economic situation does not allow companies to play a socio-political role either.

They supported their answers with the following reasons:

1. *Due to Iran's internal political situation that has made it extremely dangerous to be politically active, no company has the incentive to be a socio-political player.*

2. *Iran is in a bad economic situation, therefore; companies need to be able to take care of their primary function of generating profit first before introducing CSR.*

3. *In developing countries such as Iran in which the economy is governmental, the government is a powerful partner in business and always takes its share from the businesses' success in the form of high tax. Therefore, it is the government's duty to be the socio-political player.*

One of the interviewees believed that in Iran companies are neither economic players nor socio-political players but rather companies are played with by the government's policies. Big companies are governmental and the private companies have either no

role because of the bad economic conditions or, if they have enough investment, they try to stay away from politics because of security reasons.

The Reason and Benefits of Getting Involved in CSR for Iranian Companies

In the sixth step, the interviewees were asked why they think companies decide to get involved with CSR and how, if at all, companies benefit from CSR.

Kurucz argues that having a CSR approach within the corporation focuses on building competitive advantages through strategic management of resources in order to satisfy the legitimate demands of stakeholders. Stakeholder demands are viewed more as opportunities to be used by sharp managers for the benefit of the corporation and less as constraints on the organization.[760]

Most of the interviewees (25 out of 28) believed that making more profit is the main reason for getting involved with CSR. They argued that due to morality regression in Iran and bad economic conditions either the government needs to exert pressure and press for CSR or companies need to see an increase in profit.

The interviewees maintained that one of the effective forms of doing business is a strategic move of advertising and marketing through "making news about company's activities", and today pursuing CSR policies is one way of making news.

[760] Elizabeth C. Kurucz 94

One of the interviewees believed that advertising through CSR would have negative results for the company since in Iranian culture charity is highly valued if it is hidden. He held that the public might think that the company is misusing their emotions to gain more profit. Another interviewee disagreed with this assumption, arguing that charity work is so highly valued in Iranian culture that even if the public knows that CSR activities are just for show and making profits, it will result in positive public perception about that company.

Another reason that many interviewees (15 out of 28) gave as the main reason for getting involved in CSR is the survival of the company. They emphasized that a better reputation in society brings about positive public opinion regarding the company's activities, leading to less political and social pressure on the company. Companies can attract people's attention in order to have their support and loyalty through doing CSR activities.

It has been argued that corporations view stakeholders as part of the environment that needs to be managed, rather than as a driver for corporate strategic decisions. Paying attention to stakeholder concerns helps to reduce corporate risk by avoiding decisions that will push stakeholders to oppose the corporation's objectives. Establishing trusting relationships with key stakeholders is seen, from this perspective, as having the potential to significantly lower costs for the corporation.[761]

Moreover, running a successful corporation involves balancing multiple claims, among which conflicting stakeholders' interests in an important one. If stakeholders

[761] Ibid 88

feel insecure, they will ask for more return as a guarantee on investments or services. This situation will lead to an increase in capital-raising costs which, since most corporations cannot ensure that they make this surplus profit, will lead to less investment and less opportunities for the corporation.[762]

Evan and Freeman base the legitimacy of the stakeholder theory on two ethical principles: "Principle of Corporate Rights" and "Principle of Corporate Effects". Both principles are based on Kant's theory of Respect for Persons.[763] The "Principle of Corporate Rights" holds that "the corporation and its managers may not violate the legitimate rights of others to determine their future". The "Principle of Corporate Effects" focuses on taking responsibility for the consequences of one's actions, holding that "the corporation and its managers are responsible for the effects of their actions on others".[764]

A small number of the interviewees mentioned personal reasons, such as religious and moral values, and increasing employee efficiency as other reasons for getting involved with CSR.

Some of the interviewees underlined that CSR inevitably will bring extra costs to companies. They believed companies should take into account their long-term survival and profit, not the immediate result of CSR, which is the extra costs.

[762] Dunfee 350. In Ibid.
[763] Kant thought that humans occupy a special place in creation. Animals have value inso-far as they serve humans' purposes. Things only have the value that humans give them. Humans cannot be used as a means to an end but animals can. Humans have dignity because they are rational agents capable of making their own decisions and guiding their conduct by reason; therefore, we have the duty of beneficence, doing good, to all persons.
[764] Freeman

Do Iranian Companies have Extra Responsibility for Social Developments?

In the seventh step, the interviewees were asked if they believe that corporations have extra responsibility for social development beyond the development that arises incidentally from their responsibility to their shareholders to generate profit.

Almost half of the interviewees answered positively and the other half answered in the negative. There was a slight inclination towards the negative answer.

The ones who answered positively emphasized the fact that a company needs to be economically successful and generate profit before any plans for social development. Peter Drucker argues that profitability and responsibility are compatible and the challenge is to convert business' social responsibilities into business opportunities. He wrote: "…the proper 'social responsibility' of business is to tame the dragon, that is, to turn a social problem into economic opportunities… economic benefit, into productive capacity, into human competence, into well-paid jobs, and into wealth".[765]

Orlitzky argues that high levels of CSR may provide the slack resources necessary for a corporation to engage in corporate social responsibility; at the same time, CSR often represents an area of relatively high managerial discretion, so that the initiation and maintenance of voluntary social and environmental policies may depend on the availability of excess funds. In other words, no matter how much the executive leadership and organizational culture is supportive of CSR, the primary condition to use their discretion is profits and thus slack resources represent the necessary

[765] Drucker 62

conditions for high CSR. That is, a corporation's prior profit level, if it is low, may act as a factor inhibiting CSR activities and investments.[766]

The interviewees enumerated the following reasons for their positive answers:

1. *A company's survival depends on long-term social development programmes because of pressure from society.*

2. *A company's raison d'être is for social development, especially increasing employment.*

3. *Social development programmes increase their profit.*

The ones who gave a negative answer mostly believed that ideally corporations have extra responsibility for social development, but not in Iran. They enumerated the following reasons for their negative answers:

1. *In Iran in recent years following the revolution, society has had a huge regression in moral values. The only goal of companies today is making short-term profits, even if it means sacrificing the whole society.*

2. *Companies do not last long in Iran because the economy is not strong enough. This fact makes companies make short-term plans, and social development should be a long-term plan.*

[766] Orlitzky, 'Corporate Social Performance and Financial Performance: A research Synthesis' 122

3. *A company's raison d'être and main function in society is to generate profit. It is wrong to expect social and political behaviour from it. These are the duties of other institutions in society, such as charity organizations. However, many of the interviewees mentioned that many charity organizations do business themselves in Iran which is, as they argued, very wrong since, first, the public does not trust charity organizations anymore, and second, commercial activities are not charity organizations' function in society.*

4. *Companies would like to have social development programmes in Iran but they do not have enough facilities to do so.*

5. *Social development is more charity work rather than business. Companies need to see whether having social development projects increases their profit and success, otherwise it is a moral duty, not a commercial one.*

6. *In Iran there is no competition and no disclosure. If there is a competitive market, having social development plans would have a positive economic effect for the company.*

7. *Companies require social development projects from the government for two reasons: first, companies see their social responsibility as being towards their employees, not the whole society; neither do they have the capacity to do it. Second, according to Constitutional Law the government has the responsibility for social fairness, social well-being, employment and fair distribution of income. At the same time, the*

government is getting quite a high tax revenues from companies. The government is getting its share from businesses; therefore, many companies expect that it does its duties, including CSR, properly. Companies are not going to do the government's function for it.

Conclusion

In this section attempts were made to see if the impact of CSR values upon corporations in transitional economies, such as Iran, is likely to be shaped by the internal norms in these corporations.

In the first step, the interviewees gave very mixed answers to the issue of stakeholders' influence upon corporation decision-making. However, many of them (25 out of 28) believed that in general stakeholders have either very limited or no impact at all upon the decision-making process in Iranian companies due to a governmental economy, lack of competition and cultural underdevelopment. However, they gave a ranking of what stakeholder group they thought is the most important one: 1. Public opinion (11 out of 20), 2. Consumers (10 out of 20), 3. The attitude of the managing director and board of directors (7 out of 20).

In the second step, the interviewees were asked if, and in what way, positive public perception is important for the success of their company in Iran. The interviewees fell into two groups of negative and positive answers, with a slight inclination towards a positive answer. The point that needs to be taken into consideration is that most of the interviewees with positive answers were managing directors of big, previously

governmental companies (the so-called “half private-half governmental companies”) and they did not provide sufficient grounds for their positive answer.

Some of the interviewees (15 out of 28) assumed that the positive public perception of a company’s *target group* is important for that company’s success. They supported their positive answer with the following reasons: negative public opinion wastes companies’ energy in fighting it off, the government is scared of pressure from negative public opinion, positive public opinion will lead to more customers and more profit.

The other half of the interviewees (13 out of 28), while assuming that positive public perception would be important for the success of the company, believed that it was not important in Iran’s current situation. They enumerated the following reasons for their negative answers: public opinion is important only when it endangers the government’s reputation, there is no trust in the government’s actions, companies do not last long, a governmental economy and no competition, bad economic conditions, a weak culture of collective action and group work, Iran is in transitional period and not sufficiently developed, and managers do not have enough expertise.

All of the interviewees, while assuming that external conditions such as pressure from the government or public is more effective than internal elements, believed that CSR values within corporations are shaped by the attitudes of the managing director and board of directors. They all emphasized that the most important driver of CSR would be the managing director’s attitude. They argued that managing directors in Iran are governmental, powerful, experienced and have a huge say in how a company is run.

One of the interviewees further explained that CSR falls into the category of organizational culture, and culture in an Iranian company comes from the top (managers) down (to employees). Managers need to build the right culture and educate their employees in order to institutionalize CSR culture in the company.

In the third step, most of the interviewees (25 out of 28) believed that managers/directors of large Iranian companies' accountability to different stakeholders is weak in Iran. They gave the following reasons for their answers: managers are governmental, the money belongs to the government, not managers, managers do not have job security therefore they spend most of their energy scurrying to keep their position or drawing personal benefits, CSR is not required by law and might even in some cases be considered against the law. Bad and unstable economic conditions mean managers are busy with the everyday business of the company, there is no competition and consumers do not have choices, and the public does not have enough knowledge about CSR.

A small number of the interviewees who happened to be the managing director of previously governmental companies (the so-called "half private-half governmental companies") did not measure managing directors behaviour and did not comment on this issue. They just said that the attitude of the managing director is the most important factor in promoting CSR policies in the company.

In the fourth step, most of the interviewees (18 out of 28) believed that more employee participation not only fails to further promote CSR policies in an Iranian company but it might hurt the company. They enumerated the following reasons for

their negative answers: a short-term mindset combined with bad economic conditions make employees think only about their own benefits, employees are not used to having power; cultural issues, the lack of knowledge and skills leading to mismanagement and misuse of power, dealing with CSR is the managers' job and CSR is an external affair of the company, while employee participation is the internal affair of the company.

Some of the interviewees (8 out of 28) believed that more employee participation would promote CSR policies in Iranian companies. They emphasized that participation makes employees feel they belong to a company. This will increase their efficiency level by carrying out decisions better. They will also behave better with stakeholders. This situation will guarantee an increase in profits and the company's success.

In the fifth step, all of the interviewees emphasized that the economic role is the primary function of a company. Most of the interviewees (20 out of 28) believed that a company is both an economic and socio-political player, with a great emphasis on the political role. They supported their answers with the following reasons: a governmental economy, survival and success, and economy and society are interwoven.

The interviewees who maintained that companies are just economic players highlighted that ideally a company's socio-political involvement is a good phenomenon, but not in Iran's current situation. They believed that, besides the fact

that a company's *raison d'être* is economic and its purpose is profit-making, Iran's economic situation does not allow companies to play a socio-political role either.

In the sixth step, most of the interviewees (25 out of 28) believed that making more profit is the main reason for getting involved with CSR. They argued that due to moral regression in Iran and bad economic conditions either the government needs to exert pressure and force for CSR to happen, or companies need to see an increase in profits.

The interviewees maintained that one of the effective forms of doing business is a strategic move of advertising and marketing through "making news about the company's activities," and today doing CSR is one way of making news.

Another reason that many interviewees (15 out of 28) gave as the main reason for getting involved in CSR is the survival of the company. They emphasized that a better reputation in society brings about positive public opinion regarding the company's activities, leading to less political and social pressure on the company. Companies can attract people's attention in order to have their support and loyalty through untertaking CSR related activities.

In the seventh step, the interviewees were asked if they believe corporations have extra responsibility for social development beyond the development that arises incidentally from their responsibility to their shareholders to generate profit.

Almost half of the interviewees answered positively and the other half answered in the negative. There was a slight inclination towards a negative answer.

The ones who answered positively emphasized the fact that a company needs to be economically successful and generate profit before making any plans for social development. The ones who gave a negative answer mostly believed that ideally corporations have extra responsibility for social development, but not in Iran.

Key proposition 3: The Importance of Political Determinants of CSR

The political determinants of CSR are fundamental to explaining its impact; these will vary from developed to transitional economies:

1. **The State has a major influence in developing countries, such as Iran, upon the adoption of CSR in many companies;**
2. **Transitional economies, such as Iran, present major obstacles to the adoption of a dispersed ownership model of the corporation.**
3. **The relationship between the legal rule to be transplanted and the socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.**

Introduction

In the previous section, the effects of internal norms on shaping CSR values within corporations were discussed. In this section, the State influence over the adpotion of CSR policies in developing countries will be discussed.

Power and participation are two key issues that require further exploration in the CSR and development debate. CSR is an arena of political contestation "both in the 'macro' sense of defining relations between the market and the State, and between different actors and social groups, and in relation to participation in decision-making".[767] Who has the power to make decisions, what power structures are implicit

[767] UNRISD, 2003, '*Conference news: corporate social responsibility and development: towards a new agenda',* Geneva: UNRISD, P, 21.

in CSR, and who has a voice in the debate are all questions that we need to consider.[768]

The significant effect of politics on ownership structure is shown in the fact that "it can determine who owns corporations, how big it can grow, what it can produce profitably, how it raises capital, who has the capital to invest, how managers or employees see themselves and one another, and how authority is distributed inside the firm".[769] As Stiglitz puts it: "politics and economics are intricately interwoven: corporations have used their financial muscle to protect themselves from bearing the full social consequences of their actions".[770]

Moreover, legal rules are often the product of political processes combining public features and the interest of powerful economic-political groups. To the extent that interest groups play a role, each interest group will push for rules that favour it.[771] Control over corporate resources provides political power; therefore, the set of rules that might be easier to pass are those that would not directly lower those groups' interests,[772] but instead simply allow transactional changes.[773]

Additionally, bringing change often requires the co-operation of those parties who control the corporation. And the fact that a change would be efficient would not

[768] Marina Prieto-Carron 984
[769] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 1
[770] Stiglitz, *Making Globalization Work: The Next Step to Global Justice* 209
[771] Hart 97
[772] Rent-seeking occurs when an individual, organization or firm seeks to earn income by capturing economic rent through manipulation or exploitation of the economic environment, rather than by earning profits through economic transactions and the production of added wealth.
[773] Hart 104

ensure that controlling parties would always want it to occur. The controlling parties might prevent an efficient change if it reduces their private benefits.[774]

Wilks argues that it is impossible to understand the "structural dependence" between the state and the corporation without studying the corporation in its mould as a political actor.[775]

In order to analyze the State influence in developing countries such as Iran upon the adoption of CSR in many companies, attempts were made to see if the political determinants of CSR are fundamental to explaining its impact, whether transitional economies, such as Iran, present major obstacles to the adoption of a dispersed ownership model of the corporation, and whether the relationship between the legal rule to be transplanted and the socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.

In order to assess this key proposition, in the first step, the interviewees' opinion was sought to see if CSR policies contradict any social/political values in Iran in a way that they would induce a backlash. They were also asked what local conditions have caused difficulties in transplanting commercial laws in Iran.

In the second step the interviewees were asked to give their opinion about the role of the State (the government), if any, in promoting CSR policies. They were also asked what source, if any, the government has used to promote CSR policies and what has the State done to encourage CSR policies. The interviewees' opinion was also sought

[774] Ibid 80
[775] Wilks 56

as to how they believe the private sector/their company benefit from CSR partnerships with the government and if they think that promoting CSR policies will increase the level of co-operation between the public and private sectors in Iran.

In the third step, the interviewees were asked to give their opinion about the factors they believe promote the adoption of CSR values in Iran.

The Effect of Local Conditions and Social/Political Values in Introducing CSR in Iran

The interviewees' opinion was sought to see if CSR policies contradicted any social/political values in Iran in a way that would induce a backlash. They were also asked what local conditions have caused difficulties in transplanting commercial laws in Iran.

Otto Kahn-Freund holds that distinctive "environmental" conditions in each country, particularly the political environment in the form of constitutional structure and interest group coalitions, make successful transplants rare.[776] Kahn-Freund argues that "anyone contemplating the use of foreign legislation for law-making in his country must ask himself: how far does this rule or institution owe its existence or its continued existence to a distribution of power in the foreign country which we do not share? How far would it be accepted and how far rejected by the organized groups[777]

[776] Kahn-Freund 7: By politics, Kahn-Freund means constitutional structure of government as well as interest group pressures.
[777] By 'organized groups', he means not only groups representing economic interests: big business, agriculture, trade unions, consumer organisations, but equally of organized cultural interests, religious, charitable, etc. All these share in the political power, and the extent of their influence and the way it is exercised varies from country to country.

which, in the political sense, are part of our constitution?"[778] And consequently the strongest "organic" element in the law today is "its close link with the infinite variations of the organization of power in culturally, socially, economically very similar countries".[779]

For example, from the very beginning of introducing economic reforms in developing countries, serious attempts have been made to strengthen creditor and shareholder rights. But Pistor el al.'s studies, which compared the scope of change in developing countries using their various shareholder rights indices, showed "that legal change did not focus exclusively on the strengthening of minority shareholder rights".[780] Their studies also demonstrated that "while management has been a clear target of the reform efforts, suggesting that the classic corporate governance paradigm has influenced reforms, anti-block holder rights, as well as the supervision of stock markets were also improved substantially".[781] They also found little evidence that countries followed a particular governance model in designing a legal change package. "Rather an all-round improvement of shareholder and creditor rights has taken place".[782]

Another example is associated with implementing the Anglo-American model of corporate governance in developing countries, among which the most prominent is the agency theory that shapes the baseline of the Anglo-American corporate governance system. The nature of agency problem in this system means aligning directors' interests with shareholders' interests, whereas this problem in developing

[778] Kahn-Freund 12
[779] Ibid 12
[780] Katharina Pistor, 'Law and Finance in Transition Economies' 4
[781] Ibid 4
[782] Ibid 4

countries has been historically between majority and minority shareholders where one of the families is the controlling shareholder, ignoring the interests of the small shareholders.[783]

Moreover, many analysts argue that corporations' various economic performance or policies derive more or less directly from differences in the formal organization of the political economy.[784] The organization of a nation's political economy is inextricably bound up with its history in two respects: on the one hand, it is created by statutory-legal implementation means and their operating procedures; on the other, repeated historical experiences build up a set of common expectations that leads actors in certain directions in order to co-ordinate effectively with each other.[785]

The important question here is whether a market-oriented approach to corporate governance is feasible for developing countries looking to develop equity markets. For many authors, the answer to this question has been negative for since the market-oriented approach assumes the existence of markets with a non-legal market institutions infrastructure to protect shareholders instead of formal laws. The existence of non-legal complementarities represents little need for strong laws. However, developing countries do not yet have the mature market institutions that make a market-based model of governance with weak legal protections for protecting shareholders possible. Indeed, the whole endeavour is to create markets.[786]

[783] Rafael La Porta, 'Corporate Ownership Around the World' 27
[784] Buhmann 12
[785] Ibid 13
[786] Kiarie 1911-1913

Most of the interviewees (20 out of 28), while highlighting that CSR and doing charity work have roots in Iranian culture and religious views, believed that implementing CSR policies in Iran would induces a backlash for the following reasons:

1. *Iran is in bad economic shape. Private companies will consider CSR as extra cost and a new burden. Companies need to be justified about the economic benefits of CSR and the profit they can derive from it in the long-term. In other words, if CSR has a negative effect on profit-making, companies will stand against it.*

   According to the World Bank, economic growth in Iran increased by 3.5% in 2009/10 while prudent macroeconomic policies reduced inflation to about 10% and ensured a fiscal surplus. The initial impact of the removal of the substantial energy and food subsidies in December 2010 did not suppress Iran's economic performance despite stricter economic sanctions. Nevertheless, growth is projected to decline to 2.5% and inflation to increase to above 20% due to the impact of the substantial increase in energy prices. However, maintaining tight monetary and fiscal policies is expected to bring inflation back to 12% in 2012/13. The medium-term outlook for economic growth is positive (around 4.5%) but crucially depends on sound macroeconomic management and the capacity of the corporate sector to adjust to higher energy costs.[787]

2. *Iranian society and Iranian companies need to be educated about CSR, which needs to be justified and explained to them. If they do not know about it, they will resist it. A culture needs to be developed taking into account Iranian society's needs and*

[787] WorldBank, 'http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/IRANEXTN/0,,menuPK:312966~pagePK:141132~piPK:141107~theSitePK:312943,00.html'

characteristics. Moreover, Iranians like copying and following; therefore, if some big companies become pioneers in Iran, other companies will follow those standards.

An example of this education is that companies in Iran should learn to fear that if they do not try to find solutions to community problems, the government might increase its role, leading to new obligations and greater intervention in the labour market. "Many companies prefer to be one step ahead of government legislation or intervention, to anticipate social pressures themselves and hence be able to develop their own policies in response to them".[788]

As for education in Iran, according to the World Bank, Iran's social indicators are relatively high by regional standards. Most human development indicators have improved noticeably based on the government's efforts to increase access to education and health. Virtually all children of the relevant age group were enrolled into primary schools in 2008, while enrolment into secondary schools increased from 66% in 1995 to 80% in 2008. As a result, youth literacy rates increased from 86% to 94% over the same period, rising significantly for girls. Consequently, Iran is well placed to achieve the MDG target with regard to eliminating gender disparities. Currently, the number of Iranian women enrolled in university (at undergraduate level) is twice as high as the number of men. Similarly, Iranian women are playing an increasingly important role in the economy, though their market participation and employment rates remain limited.[789]

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[788] Vogel 308

[789] WorldBank, 'http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/IRANEXTN/0,,menuPK:312966~pagePK:141132~piPK:141107~theSitePK:312943,00.html'

3. *If CSR produces any negative political effect through the way it is being implemented or through the purposes followed by institutions that are implementing it, it will induce a strong political backlash. One of the interviewees mentioned that Iran's government does not differentiate between ownership and sovereignty. It believes ownership brings about sovereignty; therefore, if there is a rich socially influential owner (company), the government will stand against it and delete it.*

Roe also maintains that international agencies are often considered as a way of placing mechanical rules and basic institutional infrastructure for promoting international corporations in a nation; but these initiatives might induce a strong political backlash if that nation's underlying politics is not in line with those of international agencies. These differences will eventually lead to political instability and, over time, less productivity and less efficiency; hence, in order to implement changes, international agencies should focus on what can be changed; not to examine the political bedrock if changing it, at least in short run, is impossible.[790]

4. *Because of the governmental economy and lack of competitive market, the main functions of CSR are impaired in Iran. For example, CSR tries to push private companies to accept responsibility towards society and public authorities or CSR pushes companies to satisfy customers more. These functions are applicable in a competitive market that has big private companies.*

[790] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 1

Ogus also argued that competition between national legal orders is the chief engine for change.[791] Lawmakers, especially in small jurisdictions, are aware of a country's need of investment by multinational corporations and domestic industries which usually threaten to migrate and operate under another jurisdiction if the national legal system imposes higher costs on them than those incurred by their competitors operating in different jurisdictions. This pressure resulting from competition between different legal suppliers can heavily influence politicians and subsequently motivate lawmakers; however, competition might not always prevail if having more competitive laws endangers key players' potential benefits.[792]

Additionally, another obstacle to competition in developing countries is that they do not tend to liberalize their laws. Indeed, in many developing countries the body in charge of securities market regulation is not an independent agency, but rather under the direct control of the Ministry of Finance, or an equivalent governmental organization. That is: "rather than using securities regulation as a complementary control device for shareholders and investors, it was frequently used as an instrument of direct State control".[793]

The IMF reported that, despite the fact that banking remains the backbone of the financial system, Iran's equity markets have become viable, though still small, channels of finance for the real economy. Market capitalization has doubled in dollar terms between 2006 and 2010, as a result of more listings, significant IPOs under the government's privatization plans, as well as sharp increases in prices in 2009-10. Iran has two venues for listing and trading shares: the Tehran Stock Exchange (TSE) and

[791] Ogus, 'The Economic Basis of Legal Culture: Networks and Monopolization' 420
[792] Ogus, 'A Strategic Interpretation of Legal Transplants' 4-5
[793] Katharina Pistor, 'The Evolution of Corporate Law: A Cross-Country Comparison ' 53

an OTC (Over The Counter) exchange for small and medium-sized enterprises. The two venues list some 500 companies. The TSE hosts a main board for the more liquid shares and stronger companies, and a secondary board for less liquid shares. The OTC exchange lists companies with less of a track record. The 5th FYDP provides that companies which have issued shares under public placements must be listed on the OTC exchange, regardless of their performance. As a result, another 1,500 companies will be listed by 2012 and therefore comply with minimum requirements of transparency and governance.[794]

5. *Iranian society does not trust the government; therefore, anything that comes from the government will induce resistance and backlash.*

6. *If a company pays attention to CSR more than is common practice, it will raise the bar and interfere with the societal arrangements; therefore, the government and society will stand against it.*

Some have argued that when a foreign law is transplanted it will either lead to integration or repulsion. Teubner argued that the transplanted institutions "work as a fundamental irritation which triggers a whole series of new and unexpected events".[795] He further stated that "legal irritants" cannot be domesticated; they are not transformed from something alien into something familiar, not adapted to a new cultural context, rather they will unleash an evolutionary dynamic in which the

[794] IMF11/242, 'slamic Republic of Iran: Selected Issues Paper' Country Report No. 11/242 10
[795]Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences ' 12

external rule's meaning will be reconstructed and the internal context will undergo fundamental change."[796]

7. *CSR should not contradict Iranian culture and religious values. It cannot be implemented in Iran according to Western values.*

8. *Despite the fact that CSR exists in Iran's culture and religious beliefs, putting them into practice will be very hard. Iranian society is traditional and superstitious. Changing behaviour will be a very long and hard process.*

Mattei holds that differences in different legal systems do not imply inefficiencies.[797] Different legal systems may develop different solutions to the same problem that is consistent with their legal tradition, which may be as efficient as the agreed legal theory by the competitive market. It is not a rule of "one size fits all".

William Bratton and Joseph McCahery in their influential work on comparative corporate governance assert that each national corporate governance system is a significant system in itself.[798] No empirical research demonstrates a clear necessity or requirement for convergence of corporate governance laws.[799] Therefore, there is a place for developing individual national models of corporate governance and no need for developing nations to simply cut and paste Western laws into their law books. [800]

[796] Ibid 12
[797] Mattei, 'Efficiency and Equal Protection in The New European Contract Law: Mandatory, Default and Enforcement Rules' 6
[798] McCahery213, 219
[799] Ibid 222
[800] Kingsley 499

Some of the interviewees (8 out of 20) believed that if the society and companies are educated and have knowledge about CSR, it would not induce a social/political backlash. They maintained that Iranians are prepared and have the necessary grounds already existing in Iranian culture and religion for CSR values. They emphasized that CSR values need to be in conformity with Iranian politics, religion and culture.

The Role of the Iranian State in Promoting CSR Policies

In the second step, the interviewees were asked to give their opinion about the role of the State (the government), if any, in promoting CSR policies. They were also asked what source, if any, the government has used to promote CSR policies and what has the State done to encourage CSR policies. The interviewees' opinion was also sought as to how they believe the private sector/your company benefit from CSR partnerships with the government and if they think that promoting CSR policies will increase the level of co-operation between the public and private sectors in Iran.

The World Bank has stated that Iran's economy is transforming towards a market-based economy. The Iranian State still plays a key role in the economy, owning large public and quasi-public enterprises which partly dominate the manufacturing and commercial sectors. Over 60% of the manufacturing sector's output is produced by State-owned enterprises; the financial sector is also dominated by public banks despite the entrance of four private banks in the early 2000s. Moreover, Iran's 2010 Doing Business ranking is in the bottom tier of the MENA region. However, the authorities have adopted a comprehensive strategy as reflected in their 20-year Vision

document and the 5th Five-Year Development Plan to ensure the implementation of market-based reforms.[801]

Similarly, the IMF in its 2011 report on Iran maintains that the Iranian authorities view the transformation to a market-based economy as a means to enhance efficiency and increase its growth potential. Iran has a relatively well-diversified economy with a sizeable industrial base, but large-scale subsidies and inefficiencies have limited Iran's ability to further develop its non-oil economy. Iran's total factor productivity growth has been low and its energy-intensiveness increased in recent years. Despite some recent improvements, Iran only ranked 129 out of 183 in the ease of doing business criteria in 2010. FDI (Foreign Direct Investment) flows have also remained very low by comparison to a group of comparator countries,[802] largely due to international sanctions but also on account of a difficult business environment.[803]

The IMF also suggested that the following policies be taken by Iranian authorities: (i) to maintain short-term macroeconomic stability to support the reform process; (ii) transition further to a free market-based economy to foster growth and support job creation; and, (iii) strengthen the financial sector.[804]

According to the World Bank, Iran's government has launched a major reform of its indirect subsidy system, which, if successful would markedly improve the efficiency of expenditures and economic activities. The overall subsidies were estimated to cost

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[801] WorldBank, 'http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/IRANEXTN/0,,menuPK:312966~pagePK:141132~piPK:141107~theSitePK:312943,00.html' ibid

[802] Brazil, China, Egypt, India, Russia, Saudi Arabia, Turkey.

[803] IMF11/241 12

[804] Ibid

27% of GDP in 2007/2008 (approximately US$77.2 billion). The government has opted for a direct cash transfer programme while substantially increasing the prices of petroleum products, water, electricity, bread and a number of other products. Preliminary estimates suggest that the government's comprehensive cash transfer programme accompanying the ongoing subsidy reform has reduced poverty and regional income disparities significantly.[805]

Most of the interviewees (19 out of 28) believed that the government has never used any resources and had a very weak performance in promoting and encouraging CSR policies.

This is in line with the CIA World Factbook's opinion about Iran's government's economic performance. Iran's economy is marked by an inefficient State sector, reliance on the oil sector, which provides the majority of the government's revenues, and statist policies, which create major distortions throughout the system. Private sector activity is typically limited to small-scale workshops, farming and services. Price controls, subsidies and other rigidities weigh down the economy, undermining the potential for private-sector-led growth. Significant informal market activity flourishes.[806]

The interviewees enumerated the following reasons for their answers:

[805] WorldBank, 'http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/MENAEXT/IRANEXTN/0,,menuPK:312966~pagePK:141132~piPK:141107~theSitePK:312943,00.html'

[806] CIA

1. *The government's main purpose has always been only political and economic security for itself.*

Bremmer also argues that in State capitalism economies, the motivation behind decisions is political rather than economic. He further maintains that if politics and business are closely related, domestic political instabilities that threaten the State also threaten business.[807]

Securing private property rights by the State has two opposing effects: on the one hand is controlling disorder, which means that investment must be secured, typically by the government, from expropriation; on the other hand is controlling the abuses of State intervention, implying that a government capable of protecting property against private infringement can itself become the violator. As both the Marxist and the public choice literature have identified long ago, politicians choose policies and institutions to stay in power and to get rich.[808]

2. *The government has lost people's trust. It needs to regain people's trust by being honest with the public.*

3. *The government in Iran does not think big and long-term.*

Katouzian emphasized the importance of long-term planning. He stated that all the major theories of economic development are agreed that the industrial revolution happened because of long-term accumulation of, first, commercial then industrial

[807] Bremmer 6-7
[808] Andrei Shleifer 2-6

capital. Long-term accumulation was one of the necessary conditions of modern industrial development to provide the necessary investment in the commercial sphere, leading to continuous expansion of foreign trade and innovation.[809]

Capital accumulation requires saving, which in turn requires a minimum degree of security and certainty concerning the future. In countries such as Iran, where financial and physical assets have been constantly under the threat of confiscation and expropriation, capital accumulation rarely happens.[810]

4. *The government in Iran has problems getting through its normal day-to-day affairs, let alone strategizing for a greater goal such as CSR.*

As Reed argued, even expecting most corporations to live up to a stronger understanding of a responsibility in developing countries is rather naive. Developing countries struggle with major challenges in their efforts to implement mechanisms to enforce Anglo-American corporate governance reforms and promote development: first, this model has developed some conditions, such as monitoring systems, to function effectively. How can developing countries introduce the same conditions? Second, even if they introduce these basic conditions, do they need to introduce other features to supplement the Anglo-American model in order to match with their special needs and effectively contribute to development? Third, whether the Anglo-American model is the best choice for promoting development in developing countries or whether, in the longer term, they need to consider other alternatives.[811] It is currently being argued that the key to effectiveness does not depend on whether a country

[809] Katouzian 21
[810] Ibid 25
[811] Reed 240

adopts one model or the other, but more on whether it has a well-functioning legal system which supports the appropriate and timely enforcement of contracts[812] and ties the reforms to the larger question of democratic political reforms which are being undermined by the notion of globalization.

5. *After the revolution, the government did its best to make people believe that capitalism, investment and money are bad concepts. Now after privatization, the government wants investment but people's mindset has not changed yet.*

The IMF suggested that encouraging foreign investment and accelerating the ongoing privatization process will also support the restructuring of the economy. Greater participation of foreign investors would not only bring capital but also much-needed modern technologies, management know-how and access to foreign markets. The planned privatization of SMEs (Small and Medium-Sized Enterprises) with listing on Iran's stock exchange would give these companies access to new capital, increase work incentives and reduce pressures for bailouts and quasi-fiscal activities.[813]

Despite all these shortcomings in the government's activities, all of the interviewees strongly believed that the government plays the most important role in promoting CSR policies.

This is in accordance with Pistor's opinion about the role of the State. She argues that "corporate governance is an integral part of State governance"; therefore, for the law on the books to make a difference and have more than a marginal effect "an effective

[812] Freeman 4
[813] IMF11/241 15

system of external private finance requires a credible commitment by the state that private rights will be honoured and enforced, and not undermined by State interventions".[814]

In the same fashion, Reed holds that governments in developing economies have a key role to play. Because of the relatively low costs of health and education programmes in these countries, which provide the necessary basis for long-term growth and development, a tremendous impact can be made without affecting the efforts to stimulate economic recovery.[815] Liberalization policies of the Anglo-American kind are based on developments in private corporations which, however, undermine the social programmes undertaken by the governments and are funded by tax revenues; they also are said to induce a "race to the bottom" by engaging in what has been termed "regulatory competition".[816]

Some have argued that CSR is "mutually exclusive" with the role of the State as regulator since CSR is going beyond regulation; whereas some insist that CSR is the relationship between the State and market actors.[817] In contrast, Black argues that different national and international regulation is what CSR is dealing with and it does not necessarily come from the State since it is a broader social phenomenon.[818] In other words, regulation includes law but is not limited to it. In this way, she holds that the role of the State in CSR regulation is limited by nature.

[814] Katharina Pistor, 'Law and Finance in Transition Economies' 15
[815] Reed 235
[816] That is, playing one country off against another for such benefits as low tax rates, tax holidays, subsidies, less stringent regulatory standards for labour and the environment, etc.
[817] Vogel 304
[818] Kraakman 18

One of the interviewees, who was a governmental official as well as the managing director of one of the biggest companies in the industry sector, raised the question of legitimacy that can be applied to business going too far from its role towards making public-interest decisions. He, along with two other interviewees, who were the managing directors of two of the most active companies in the Tehran Stock Exchange, believed that public interest is not part of corporations' expertise. It is not what their structure asks them to do. So it can be argued that they are going out of their range, and certainly it is not democratic. They believed that it is not important what a CEO of a corporation says and wants in this respect. No one elected them. They do not have any power to speak for people. These are the decisions that should be made by governments, not by corporations. As one economist put it in a critique of CSR: "the proper guardians of the public interest are the governments, which are accountable to all citizens".[819]

The interviewees enumerated the following as the role that the government can play in promoting CSR policies:

1. *Iran has a governmental economy in which companies and the government are on one side and consumers on the other. Consumers will never be able to manage to make companies behave in a socially responsible way. Moreover, companies' relationship with the government is not financial but rather they are part of the government's annual budget, leading to companies not caring about profit-making. This needs to change.*

[819] McBarnet 26

Roe, along with the interviewees, asserted that even radical sudden legal change will not change pre-existing legal institutions overnight. This will take time and may not even succeed fully since rent-seeking may get in the way. Those who enjoy rents in the pre-existing legal system and not in the new one will use all their lobbying power to either block the new rule-making or make it practically ineffective and ignored. Typically, this type of change occurs in response to a crisis.[820]

The IMF emphasized the importance of the financial sector's role in Iran's growth strategy. In line with the 1983 Law on Usury (Interest) Free Banking, the banking system and the CBI (Centre for Promotion of Imports) support a broader set of goals and policies of the government, which aim at enhancing economic growth and job creation with low inflation. More recently, Iran's capital markets Tehran Stock Exchange (TSE); OTC network (commodities exchange) have gained importance in the government's strategy of promoting a more market-oriented economy and mobilizing private capital for the financing of the economy. The strategy encompasses the 2010 subsidy reforms, as well as a wide-ranging privatization programme in line with Principle 44 of the Constitution that affirms the primacy of private property in Iran's economic development. Finally, the 5th FYDP that lays out Iran's development strategy for the period 2010-15 contains an important chapter on strengthening and liberalizing the financial system.[821]

2. *The government can use a reward/punishment method to promote CSR policies. It can use tax exemption and bank loans as rewards. Many of the interviewees brought up*

[820] Roe, 'Backlash '
[821] IMF11/242 3

tax exemption as the best way for the encouragement of CSR policies by the government and the best way to increase voluntary compliance with CSR rules.

Pistor has further explained the effect of a level of compliance. She argues that if the level of voluntary compliance is high, law enforcement by the State and State intervention will be limited to a few cases and can be effective. And if the level of compliance is low, the ability of the State to enforce the law and improve its effectiveness is rather limited. She further argues that "voluntary compliance requires a credible threat that defection will be sanctioned. Effective law enforcement by the State may not be the exclusive element but is certainly an important element in making this threat viable".[822]

3. *The government needs to have a supervisory and controlling role and it needs to stop meddling in business. The government needs to allow the market to grow and manage itself. Iran needs a competitive market. The government needs to gradually reduce its presence and surrender its place to private companies.*

The IMF also suggested that in order to achieve higher growth and create jobs, the authorities should adopt a comprehensive multi-pronged strategy as reflected in their 20-year Vision document and 5th Five-Year Development Plan. The strategy should aim at promoting a market-based economy by reducing the role of the government, privatizing enterprises and increasingly allowing prices to reflect market forces. To support the phasing out of subsidies, enterprises that are most energy-intensive can qualify for subsidized loans to invest in energy-efficient technologies. In addition, the

[822] Katharina Pistor, 'Law and Finance in Transition Economies' 8-9

government has set up incentive programmes to improve management and productivity.[823]

As for the design of this reform in the State's role, two camps have emerged in the debate: on the one hand, there are proponents of the "big bang" approach, who argue for a quick and all-at-once introduction of all reforms; on the other hand, there are those who stand for a "gradualist" approach and emphasize the step-by-step and sequencing of reforms. The advocates of the big-bang approach argue that reform packages complete one another and should be introduced simultaneously and in a comprehensive way; thus, introducing partial reforms would eliminate their positive effects and disorganize the economy.[824]

On the other hand, the proponents of gradualist reform have argued that gradualist reform packages have higher feasibility and may be easier to get started, and the sequencing of reforms may create constituencies for further reforms and increase the irreversibility of enacted reforms and reduce the costs of reversal in case of rejection.[825]

4. *The government can use parliament for passing new regulations about CSR or for interpreting current regulations to promote CSR policies. It can increase standards of working conditions in the Labour Law, such as increasing the minimum salary and reducing working hours.*

[823] IMF11/241 15
[824] Murphy, 'The Transition to a Market Economy: Pitfalls of Partial Reform' 905
[825] Dewatripont 1208

Aguilera maintains that the laws which governments pass to encourage CSR have significant influence in two aspects: first, the standards established by laws and mandatory regulation, while not immediately translated into action in any realistic portrait of global organizational practice, have a particularly strong influence on establishing social expectations about responsible corporate behaviour. Second, once the social expectation is created, a number of other forces, including consumer demands, institutional investor demands, community demands and NGO demands press for the standards set out in the law. Third, the laws and policies that the governments enact send a strong signal about the importance of a subject, possible future legislations and the individualistic versus collectivist nature of the country's underlying political and social philosophy.[826]

5. *The government controls radio and television. It can use this means to advertise for CSR.*

6. *The government needs to establish and strengthen civil society institutions, such as unions and NGOs.*

Evidence from these countries shows that with the "weak civil society and market institutions and sometimes over-arching governments there has only been a slow and tentative development of explicit CSR"[827] For example, in Russia the absence of long-term social capital and of habits of business responsibility are the main reasons for the slow CSR development. "But where markets, civil society and the government are relatively autonomous, mutually reinforcing and non-parasitic, explicit CSR may

[826] Aguilera 454
[827] Moon, '"Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility' 18

emerge within the range of governance solutions as evidenced in the Czech Republic and Hungary (coincidentally countries which retained some vestiges of civil society through communism)".[828]

7. *The government needs to educate people from an early age to be able to build a culture. Iran's society needs to learn how to do group work and collective action.*

8. *The government needs to determine general policies and strategies. It needs to define a framework within which companies move towards a mutual goal. Iran's economy has been governmental for a long time. Companies are still used to governmental organizational structure in many so-called "half private-half public companies". Even Iranian managers have governmental organizational behaviour. They need a model and a plan otherwise they will mess up the economy. At the same time, Iran's society is used to the government's intervention in business due to a governmental economy; therefore, they will accept CSR from it.*

Pistor maintains that in many transition economies, privatisation simply led to the explicit recognition of State control rights through the allocation of ownership titles to insiders. She argues that: "Despite changes in ownership structures, the State has in many ways retained direct influence even over privatized companies. The direct provision of financing is not the most important vehicle for exercising this influence. Rather the State has traded access to subsidies and regulatory favours for influence and in many instances allowed soft budget constraints to be perpetuated by

[828] André Habisch quoted in Moon, '"Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility' 18

widespread tax arrears. In many large companies the State retains effective control rights as the largest single shareholder or through golden share provisions."[829]

9. *In developing countries such as Iran everything starts from top to bottom.*

10. *The government needs to appoint knowledgeable and skilled managers that do not have a governmental organizational mindset and behaviour.*

Richard Eells contends that assuming political life for corporations brings about inescapable political issues. In the light of this political life, the responsibilities of corporate managers should be correctly spelled out, while new ways should be recognized to hold them accountable. But there is still the constitutional crisis that arises from political life.[830] Eugene V. Rostow has argued against corporate democracy as a solution to constitutional crisis. He holds that "shareholder democracy" is impractical and there is no solution for it even in theory. He further argues that the best way to hold corporate managers accountable is to restrict their ability to direct the corporation for the sole purpose of profit maximization for their shareholders. By this, he implies that the employees' interests should be taken care of by unions, while protecting public interests is the concern of government.[831]

11. *Iran is in bad economic shape; therefore, the government needs to incentivize employees by increasing their well-being.*

[829] Katharina Pistor, 'Law and Finance in Transition Economies' 3
[830] Gioia in Stormer 60
[831] Orlitzky, 'Corporate Social Performance and Firm Risk: A Meta-analytic Review' in Stormer 268

12. *The government can use its power and push governmental companies to allocate a certain amount of their time and profit to socially responsible projects.*

Some of the interviewees (9 out of 20), who all happened to be previous governmental managers and recent "half private-half governmental company" managers, did not properly give their opinion about whether the government has used any resources to encourage CSR policies. They simply emphasized the importance of the government's role and almost all of them directly asked for guidelines from the government. They believed that it is a company's duty to move within the framework defined by government and strongly suggested that all companies' function is to fulfil the government's purposes. All of them believed that if government did not provide them with a framework, the economy would be a huge mess.

It has been argued that governments also informally use corporations' help for implementing public policies and that this will cause excessive dependence by States on big corporations.[832]

In answer to the question of whether CSR policies would increase the level of co-operation between the public and private sectors, many interviewees did not give any answer or explanation. The ones who answered (11 interviewees) gave a strongly negative answer. They emphasized that there is a huge distance and mistrust between government and private companies. The government always tricks the public by putting on a socially responsible face but the outcome of its behaviour is never socially responsible. The government has always used force against private

[832] Rowe

corporations; there has never been any spirit of co-operation. At the same time, the government is the biggest businessman in Iran. It is the reason for many corporations' lack of success. The government competes with companies in the market and due to its power, financial status and extension, always wins. Moreover, the government's concern has never been CSR. The rare times that they pay attention to CSR, it is because its reputation and security is in danger.

The Factors that Promote Adoption of CSR Values in Iran

In the third step, the interviewees were asked to give their opinion about the factors that they believe promote the adoption of CSR values in Iran.

Paredes has suggested: "instead of an enabling corporate law, a much more mandatory corporate law regime for developing countries that basically fills the void left by the lack of market institutions in these countries".[833]

Most of the interviewees (24 out of 28) held the conviction that as long as there is a governmental and political economy in Iran, CSR will not be developed. They also agreed that the ground for developing CSR policies in Iran is not ready and would take a long time. The government is the main economic player in Iran and does not consider CSR as its responsibility. Social security, retirement conditions and minimum wages systems in Iran are weak. Priority needs to be given to correcting these systems rather than CSR, which is on a higher level.

They believed that the following factors will promote CSR policies in Iran:

[833] Deakin 407

1. *The government needs to stay away from the economy and doing business, and a liberal economy needs to be developed in Iran. As a consequence, there would be competition in the market since consumers would have more choices. Moreover, political economy is to the detriment of companies. The slightest political issue has a direct negative effect on companies. This situation is making it almost impossible to do business in Iran.*

The IMF in its 2011 report on Iran holds that the Iranian authorities' economic reform strategy, anchored in privatization, reduction of the role of government and market-based prices for energy and agricultural goods should help achieve higher growth and create jobs. In particular, the ongoing restructuring of existing enterprises through the adoption of energy-efficient technologies, and the steadfast implementation of initiatives to support the creation of new enterprises, are critical to move Iran to a higher growth path. The IMF also suggested that the development of new growth sectors will require rebalancing of the economy, and should be supported by labour market reforms, including adequate unemployment benefits. Ongoing programmes to enhance skill-matching and retrain workers should help remove labour market frictions. To avoid weakening incentives for effective corporate restructuring, subsidized financial support should not be provided to non-viable enterprises. At the same time, encouraging foreign investment and accelerating the ongoing privatization process will also bring new financing and support the restructuring of the economy.[834]

[834] IMF11/241 20

2. *The government needs to have a supervisory role. It also needs to stop subsidizing and arranging companies' affairs for them. Companies need to take decisions themselves so society will be able to expect responsibility from them. With freedom comes responsibility. Another reason for removing the government from the economy is the fact that the money keeps going from one governmental company to another; it never reaches society so private companies can participate in cash flow in society and thereby develop.*

3. *Managers need to become shareholders and have longer management tenures to be able to focus on the financial and social development of the company instead of on keeping their position. They also need to be educated about CSR in order to have the necessary knowledge and skills.*

A useful point of departure for an analysis of corporate governance in transition economies is to think about the problems of corporate control under central planning. Pistor argues that corporate structure under central planning has two particular characteristics: first, they do not need to worry about "raising external finance" since budget control is done by central planning; therefore, "the concept of financial discipline or accountability was essentially absent from the socialist firm". Second, the State is the owner of most assets. It faces the problem of monitoring the managers of corporations to act according to the targets set out by central planning. "The two problems are inter-related. If sanctions for not acting according to financial discipline such as "cutting off supplies and ultimately forcing an enterprise to close down" are not available, problems of corporate control could never be resolved."[835]

[835] Katharina Pistor, 'Law and Finance in Transition Economies' 3

This is in line with the view of the advocates of globalism, who are convinced that an unlimited and borderless global economy will lead to better common good. They argue that the primacy of market imperatives over political regulation will leave everybody better off.[836] In other words, the "invisible hand"[837] of the market will direct private corporations to do less harm and move towards the common good. They assume that corporations can be considered as the solution to the global regulation gap and public well-being.[838]

4. *The government needs to build a culture through education and advertising, a culture that develops a sense of responsibility and a long-term mind-set in society, since companies are a part of society and will imitate the behaviour of the society. A responsible society will demand responsible companies. At the same time, growth is a package that includes a collection of economy, culture, religion, social mindset and politics. These elements need to grow together for sustainable social and economic development to happen. Moreover, a financial disclosure and transparency culture needs to be developed starting from the government. In this way, the government can start regaining people's trust.*

The IMF also noted that further enhancing transparency and data collection on economic activity is essential to facilitate policy-making. National income statistics

[836] Such as: Irwin, 2002; Krauss, 1997; Norberg, 2003; in, Palazzo, 'Globalization and Corporate Social Responsibility'' 416

[837] This term is used to describe the self-regulating nature of the marketplace. It is a metaphor first coined by the economist Adam Smith in *The Theory of Moral Sentiments*. For Smith, the invisible hand was created by the conjunction of the forces of self-interest, competition, and supply and demand, which he noted as being capable of allocating resources in society. This is the founding justification for the laissez-faire economic philosophy.

[838] Ibid.

should be published with minimum delays. High-frequency data across various sectors should be collected and analyzed. The presentation of fiscal accounts on the basis of the GFSM2001 manual would be an important step in increasing transparency on fiscal operations, and should be further improved by giving a more detailed presentation of transactions of financial assets and liabilities.[839]

The IMF also reported on the Iranian government's activities to promote transparency. Companies use the regulator's electronic network to file and disclose quarterly statements within 30 days of quarter end, of which the mid-year and end-year must be audited. Companies are required to post annual audited financial reports within 60 days of year-end, and to provide quarterly earnings guidance. Material developments of a financial or corporate control nature must be immediately disclosed to the market. As concerns enforcement, the Securities and Exchange Organization (SEO) requires that all company insiders (directors and senior officers) be registered and their market trades individually traceable (audit trail) on its central depository system, which handles all post-trade requirements of Iran's capital markets. The SEO supervises the audit profession and retains its own auditors to verify that financial statements fairly represent management's current knowledge. Iran has a dedicated court with judges specialized in capital market issues to prosecute market abuse and manipulation. This framework incorporates the lessons of several scandals that marred Iranian equity markets in the 1980s.[840]

[839] IMF11/241 15-16
[840] IMF11/242 11

5. *Companies need to see an economic justification for CSR. They need to see an increase in profit or at least see the social impacts of doing CSR, while making sure at least they sustain no financial harm from doing it.*

6. *Iran needs to develop big private companies.*

   The IMF in its 2011 report on Iran also highlighted the importance of creating new enterprises to facilitate a structural change in transitional economies. Iran's government has recently launched programmes to promote entrepreneurship, including private-run consultancy and training programmes, which are important steps in facilitating the creation and development of enterprises. The success of these initiatives should be assessed by monitoring the number of newly created enterprises and jobs. Further efforts should also be made to continue streamlining licensing procedures, particularly for small services.[841]

7. *Iran needs to have a reasonable tax and social security system. Consequently, companies will stop avoiding them.*

8. *A model for CSR needs to be developed in order for companies to know what is expected from them. Companies need to know what the limits are for doing CSR to be able to keep a balance. Iran is a very emotional society. One of the reasons companies try to stay away from CSR is the danger that it might distract companies from their main function.*

[841] IMF11/241 15

9. *The public's knowledge about CSR needs to be increased. The public needs to be informed about CSR. Iran's society wants CSR but it does not have the knowledge to see it as a duty for corporations.*

A small number of the interviewees (4 out of 28), who were the managing directors of previously governmental companies (the so-called "half private-half governmental companies"), did not consider the governmental economy as a problem. They accounted for more government intervention through it providing a model and being able to use punishment/reward policies for developing CSR policies. One of the interviewees believed that the more religious values are promoted, the more CSR values would be promoted. He also emphasized that CSR will not be developed in Iran according to Western values but rather Islamic-Iranian values.

Conclusion

Although the economic aspects of the corporation have received the widest notice, the concept of the corporation as a political system is by no means unknown. Walton Hamilton argues against the Hobbesian concept of the corporation (which argues that the corporation is a lesser commonwealth), holding that in some cases the corporation is an even greater commonwealth. Merriam has observed business enterprises as private governments, concluding that in some cases this private government has controlled the public government. C. Wright Mills has also referred to corporations as political institutions. Berle also found politics in all manner of corporations, a view that he shares with Aristotle. [842]

[842] Drucker 45

In order to analyze the State's influence in developing countries such as Iran upon the adoption of CSR in many companies, attempts were made to see if the political determinants of CSR are fundamental to explaining its impact; whether transitional economies such as Iran present major obstacles to the adoption of a dispersed ownership model of the corporation; and whether the relationship between the legal rule to be transplanted and the socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.

In order to assess this key proposition, in the first step, the interviewees' opinion was sought to see if CSR policies contradict any social/political values in Iran in a way that they would induce a backlash. They were also asked what local conditions have caused difficulties in transplanting commercial laws in Iran.

Most of the interviewees (20 out of 28), while highlighting that CSR and doing charity work have roots in Iranian culture and religious views, believed that implementing CSR policies in Iran would induces a backlash for the following reasons: the need for CSR to have an economic justification in Iran, lack of CSR culture, CSR might threaten Iran's political stability, a governmental economy and lack of competition in the market, lack of trust in the government's activities and initiatives by Iran's society, and CSR might be in conflict with Iran's culture and religion since it is a Western value.

In the second step, the interviewees were asked to give their opinion about the role of the State (the government), if any, in promoting CSR policies. They were also asked what source, if any, the government has used to promote CSR policies and what the

State has done to encourage CSR policies. The interviewees' opinion was also sought as to how they believe the private sector/your company benefit from CSR partnerships with the government and if they think that promoting CSR policies will increase the level of co-operation between the public and private sectors in Iran.

Most of the interviewees (19 out of 28) believed that the government has never used any resources and had a very weak performance in promoting and encouraging CSR policies for the following reasons: Iran's government's main purpose has always been to keep its economic and political security, Iran's society does not trust the government, Iran's government does not think big and long-term, Iran's government has problems getting through its everyday and normal affairs, and the Iranian government's advertising that money and capitalism are bad concepts.

Despite all these shortcomings in the government's activities, all of the interviewees strongly believed that the government plays the most important role in promoting CSR policies. They suggested the following roles for the government: stopping meddling in business, gradually staying away from the economy, stopping subsidizing companies, using a reward/punishment method, having a supervisory and controlling role, establishing and strengthening civil society institutions, educating society to do group work and collective action, determining a model and framework for CSR policing through general policies and strategies, and appointing skilled and knowledgeable managers.

In the third step, the interviewees were asked to give their opinion about the factors they believe promote the adoption of CSR values in Iran. Most of the interviewees (24

out of 28) held the conviction that as long as there is a governmental and political economy in Iran, CSR will not be developed. They also agreed that the ground for developing CSR policies in Iran is not ready and would take a long time. The government is the main economic player in Iran and does not consider CSR as its responsibility. Social security, retirement conditions and minimum wage systems in Iran are weak. Priority needs to be given to correcting these systems rather than CSR, in which is on a higher level.

They believe that the following factors will promote CSR policies in Iran: promoting a liberal economy, the government needs to have a supervisory role, the government needs to stop subsidizing companies and arranging their affairs for them, managers need to become shareholders and hold longer management tenures, the government needs to build a CSR culture through education and advertisement, companies need to see an economic justification for CSR, Iran needs to develop big private companies and public knowledge about CSR needs to be increased.

Chapter 8: Conclusion

In Chapter 2, CSR literature review, attempts were made to show the importance of studying the political and cultural circumstances of developing countries. The relationship between politics and corporate governance rules was discussed. In order to demonstrate this, first "path dependence" theory was discussed. It was concluded that the patterns of history deeply influence the current patterns of politics. Then "convergence theory" was debated. The advocates of this theory claimed that corporate governance is on the reform agenda all over the world, moving towards the Anglo-American model of shareholding aiming at maximizing shareholder value. They argue that the success and prosperity of Common Law jurisdictions (which follow a shareholder value model) compared with other jurisdictions is an indicator of the superiority of the Anglo-American model. It was concluded that this model has many flaws and needs to be modified. The failures of this model were pointed out while proving that there is no one-size-fits-all model.

The chapter continued by analysing the globalization of capitalism. This theory claimed that capitalism is the foundation of most of the advanced economies and convergence is happening towards the shareholding model of these advanced economies. It was argued that different countries follow different successful models that work for them. Differences in models do not mean inefficiency. Also, the flaws of capitalism were discussed to further prove this point.

Moreover, the role of international institutions in bringing about these changes was discussed. It was concluded that international organizations need to pay careful

attention to the socio-political circumstances of the country they are operating in otherwise their activities will be rejected.

Finally, the role of corporate law was discussed, concluding that law can create or destroy anything, so law is not irrelevant, but it is a second-order phenomenon. It was argued that other institutions primarily control managerial mistakes. They are: business conditions, incentives, professionalism, capital structure, product and managerial labour market competition.[843] These institutions are the primary control, with the law just assisting or impeding.

In this section Key proposition 3.2 was debated. This proposition maintained that transitional economies, such as Iran, present major obstacles to the adoption of a dispersed ownership model. This section was also related to Key proposition 1.1. Attempts were made to see whether the connection between legal rules and CSR principles is a reflexive one.

Different definitions of CSR were discussed and attempts were made to show the diversity and lack of consensus on this matter. A conclusion was drawn to the effect that a good definition is the one that encompasses what is expected from corporations in terms of CSR policies. They are expected to balance their desire to maximise profits with respecting other stakeholders' interests.

Different CSR theories were discussed. It was concluded that it is not easy to say which theory is the best and a good normative theory needs to include a correct view

[843]Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* 163

of human nature, business and society, and the relationship between business and society.

Shareholder-value theory seemed to still have strong conceptual bases. Friedman's "profit-maximization" theory and the agency theory seem to have lost a bit of their attraction due to the collapse of the market and growing concensus on the need for more socially responsible corporations, but they still remain the most significant criticism of CSR initiatives.

In this section, Key proposition 2 was examined. This proposition argued that the impact of CSR values upon corporations in transitional economies such as Iran is likely to be shaped by internal norms in these corporations. Also Key proposition 3.2 was debated. This proposition maintained that transitional economies such as Iran present major obstacles to the adoption of a dispersed ownership model.

Different studies that have been conducted to show the link between corporate social performance and corporate financial performance were demonstrated. It was concluded that, in line with Friedman's "Strategic CSR" and meta-analytic evidences, CSR might be considered as an important factor for better corporate financial performance, but not as an essential, internal resource.

Furthermore, the role of globalization in CSR debates was debated. It was argued that "CSR as a rapidly developing business strategy is a response to globalization and the extension of global multinational enterprises across countries, with the implication

that State control over such enterprises is rarely fragmenting".[844] The role of States as compared to corporations in regulating the market and the problems associated with assuming political responsibility for corporations were discussed.

In Chapter 3, Legal Transplants, it was concluded that differences in different legal systems do not imply inefficiencies.[845] Different legal systems may develop different solutions to the same problem which are consistent with their legal tradition, which may be as efficient as the agreed legal theory by the competitive market. It is not a rule of "one size fits all".

In this chapter, the definition of legal transplants was discussed. Attempts were made to debate legal transplants' development and its influence in the study of legal culture and legal systems. It was concluded that variation of transplantation process based on social, legal, economic, fiscal, financial and technical circumstances prevailing in each country's "legal culture" and legal system should be taken into account. Different series of arguments including Watson's argument, LLSV's argument and Pistor et al.'s arguments were discussed. Additionally, the effect of costs that a legal system incurs through the legal transplantation process was discussed. Furthermore, the development of legal transplants in developing countries was discussed. It was suggested that legal transplantation is not an easy and short-term solution for developing countries in order to fill in the gap of less developed legal systems. "For law to play a role in economic activities and long-term economic development, it

[844] Aguilera 453
[845] Mattei, 'Efficiency and Equal Protection in The New European Contract Law: Mandatory, Default and Enforcement Rules' 6

must be incorporated, meaning that it must develop solutions to problems that exist in the home jurisdiction".[846]

In this section, Key proposition 1.3 was discussed. This proposition argued that the act of borrowing is usually simple, whereas on the other hand, building up a theory of borrowing is more complex. Additionally, Key proposition 1.2 was examined. This held that the so-called "law-matters" thesis needs to be assessed by reference to what has been referred to as "functional equivalents" to law in transitional economies such as Iran.

This chapter also discussed the first key proposition. This key proposition examined whether the process of transplanting into another legal system is likely to be affected by local socio-economic-legal conditions, cultural values and institutional arrangements. Furthermore, this chapter discussed Key proposition 3.3. This involved determining whether the relationship between the legal rule to be transplanted and the socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.

In Chapter 4, CSR in Developing Countries, it has been argued that there is an urgent and persistent need for a critical study of the potentials, challenges and limitations of CSR initiatives in developing countries. The specific issues in different developing countries should be taken into account.

[846] Katharina Pistor, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' 109

As noted in Levine, financial systems exist to mitigate information and transaction costs in order to improve the allocation of capital within the market. Different types and combinations of information, enforcement and transaction costs in conjunction with different legal, regulatory and tax systems have motivated different financial contracts, markets and intermediaries across countries and throughout history.[847]

In this chapter Key proposition 3.3 was further examined. Attempts were made to see whether transitional economies, such as Iran, present a major obstacle to the adoption of the dispersed ownership model of the corporation. Additionally, Key proposition 1.2 was further debated. This held that the so-called "law-matters" thesis needs to be assessed by reference to what has been referred to as "functional equivalents" to law in transitional economies such as Iran.

In this chapter, first, globalization and its effect on developing countries has been discussed. In this section, the different nature of CSR policies in developing countries was demonstrated and attempts were made to define a conceptual framework based on explicit and implicit CSR policies for studying comparative CSR.

Second, the Anglo-American nature of reforms and the two contributing factors to development of this model of corporate governance, including the failure of Import Substitution Industrialization (ISI) and the influence of international financial bodies, were discussed. It was concluded that this model, besides the unavailability of evidence to confirm that it results in economic development, is not the ideal model for a variety of reasons. The Anglo-American model needs a number of modifications to

[847] Deetz

adapt to the special needs of developing countries. It has been also suggested that the developing countries might need to take this into account in the future. Further, team production theory as an alternative to shareholder wealth maximization was discussed.

The theoretical stream arguing that social development is a result of economic development and counter-arguments were discussed. It was suggested that social development is not necessarily the result of economic development; on the contrary, stable economic development is a result of prior social foundations.

In Chapter 5, Iran's current social, political and legal systems were discussed, and in Chapter 6, CSR policies' current status in Iran was discussed. Iran is an Islamic country, located in the Middle East with strong Persian cultural elements and a French-Belgian-Islamic commercial legal system. Iran's special characteristics make transplantation of new concepts a very complex matter. The new concepts will be affected by local socio-legal-political conditions leading to their acceptance or rejection. Digging deeply into these elements might show that there exists an Iranian style of CSR that just needs to be strengthened and encouraged rather than changed or renewed.

Literature about CSR in Iran is very rare, even the few pieces of researche that do exist are shallow and in many cases contradictory. They do not explore CSR in an Iranian concept of CSR but rather try to explain why Iran does not have CSR in a Western style, arguing that Iran is not economically ripe for Western CSR concepts. While this argument might be partially correct when it comes to securing investments

for large corporations, not having a Western-style CSR is not in itself a bad thing.

In this chapter, first, the CSR key players in Iran were shown. Second, the main CSR activities undertaken by CSR key players in Iran were demonstrated. Third, examples of domestic and foreign company activities were presented. Fourth, the State's role in promoting CSR policies was discussed, concluding that the State has an important role. Fifth, the UN role in promoting CSR policies was debated, showing different initiatives that were taken by the UNDP in Iran to encourage sustainable development. Sixth, the Stock Exchange role in promoting CSR policies was demonstrated. In this section, a summary of the Iranian Code of Corporate Governance ratified by the Tehran Stock Exchange was presented. Seventh, the difficulties of promoting CSR policies in Iran were discussed.

In chapter 7, data was analysed in four parts: a) Key proposition 1, b) Key propositions 1.1, 1.2 and 1.3, c) Key proposition 2, d) Key proposition 3. Also, the methodology and the interview questions have been included as an index to this chapter at the end of the thesis.

In the analysis of Key proposition 1 (the effect of socio-economic-legal conditions on the process of introducing CSR into Iran's system), most of the interviewees who believed there is no demand for CSR in Iran, believed the CSR concept already exists in Iran's ancient culture and religious values such as Waqf.[848] They enumerated the following reasons for their negative answers: low cultural and economic development, lack of competition and a governmental economy, bad economic conditions, that CSR

[848] Waqf is an inalienable religious endowment in Islamic law, typically denoting a building or plot of land for Muslim religious or charitable purposes.

becomes important only when political stability is threatened, and the differences between business customs in Iran and the West.

The interviewees admitted that there are several cases of CSR in Iran but they are the personal preferences of managing directors rather than an accepted culture or an institutionalized concept. They also strongly presumed that the attitudes of managing directors constitute the most important driver for CSR in Iran.

The interviewees who believed that there is a demand for CSR in Iran also confirmed that the participation of business in social projects, so-called CSR, has been in Iran's culture and religious values for a long time through concepts such as Waqf and Khoms.[849]

Most of the interviewees (23 out of 28) believed that the existence of social structures such as unions is effective in having successful CSR policies. They underlined that unions have a specialist role in each profession. Unions defend and represent that profession within the government so they need to be innovative in guiding and suggesting new laws and regulations to the government, but they all emphasized that this is not currently happening in Iran.

Most of the interviewees (22 out of 28) believed that Iran's legal system is not flexible enough to changing economic conditions. However, many of the interviewees highlighted that Iran's society will accept a new culture if it feels the imported culture is superior to Iran's own culture.

[849] According to Shia Islamic legal terminology, it means one-fifth of certain items which a person acquires as wealth, and which must be paid as an Islamic tax.

In analysis of Key propositions 1.1, 1.2 and 1.3 (the connection between legal rules and CSR principles), initially all of the interviewees believed that ideally good corporate law is effective in economic development but not in Iran's case since Iran's current corporate law is an impediment to economic development.

The interviewees also believed that law determines the framework of a country's economy. If this framework gives security to investors they invest more, leading to economic development.

The interviewees were convinced that Commercial Law in Iran had the purpose of economic development when it was enacted, but it did not fulfil its purpose. They also believed that the purpose of the creation of publicly held companies was to collect people's small investments in order to invest in big projects but it did not happen for the following reasons: a weak 'group work' culture, no security in the economy, a governmental economy culture and not being ready for sudden reforms.

Most of the interviewees (16 out of 28) held the conviction that economic growth comes before adherence to the rule of law. Some (7 out of 28) believed that economic growth comes after adherence to the rule of law. And some (5 out of 28) believed that economic growth and adherence to the rule of law move in parallel and are interdependent.

Second, most of the interviewees (23 out of 28) believed that the extent to which courts and regulators rely upon corporations to regulate their own affairs is very low.

They emphasized that laws are impediments to doing business in Iran and if companies abide by the law they cannot do business.

Third, the interviewees believed that Iran's corporate law mechanisms are quite effective in dealing with illegal self-dealing by corporate officials.

All of the interviewees believed that the level of compliance on the part of Iranian companies with legal and regulatory rules, especially disclosure, tax, insurance and social security is very low.

The interviewees maintained that while a large part of bad law just stays bad and companies just avoid the law and are in constant fights with the government, in order to make up for bad law, the following formal and informal institutions are in place: bribing tax officials, the government turning a blind eye to non-compliance, courts, friendship and trust.

In analysis of Key proposition 2 (the effect of internal norms of corporations in shaping their CSR values), initially the interviewees gave very mixed answers to the issue of stakeholders' influence upon corporation decision-making. However, many of them (25 out of 28) believed that in general stakeholders have either very limited or no impact at all upon the decision-making process in Iranian companies due to a governmental economy, lack of competition and cultural underdevelopment. However, they gave a ranking of what stakeholder group they thought is the most important one: 1. Public opinion (11 out of 20), 2. Consumers (10 out of 20), 3. The attitudes of the managing director and board of directors (7 out of 20).

Second, the interviewees were asked if and in what way positive public perception is important for the success of their company in Iran. The interviewees fell into two groups of negative and positive answers, with a slight inclination towards a positive answer. The point that needs to be taken into consideration is that most of the interviewees with positive answers were managing directors of big, previously governmental companies (the so-called "half private-half governmental companies") and they did not provide sufficient grounds for their positive answer.

Some of the interviewees (15 out of 28) assumed that the positive public perception of a company's target group is important for the company's success.

The other half of the interviewees (13 out of 28), while assuming that positive public perception would be important for the success of the company, believed that it didn't apply in Iran's current situation.

All of the interviewees, while assuming that external conditions, such as pressure from the government or public, are more effective than internal elements, believed that CSR values within corporations are shaped by the attitudes of the managing director and board of directors. They all emphasized that the most important driver of CSR would be the managing director's attitude. They argued that managing directors in Iran are governmental, powerful, experienced and have a huge say in how a company is run. One of the interviewees further explained that CSR falls into the category of organizational culture, and culture in an Iranian company comes from the top (managers) down (to employees).

Third, most of the interviewees (25 out of 28) believed that managers/directors of large Iranian companies' accountability to different stakeholders is weak in Iran.

Fourth, most of the interviewees (18 out of 28) believed that more employee participation not only does not further promote CSR policies in Iranian companies, but it might hurt the company.

Some of the interviewees (8 out of 28) believed that more employee participation would promote CSR policies in Iranian companies. They emphasized that participation makes employees feel they belong in a company. This will increase their efficiency level by carrying out decisions better. They will also behave better with stakeholders. This situation will guarantee an increase in profits and the company's success.

Fifth, all of the interviewees emphasized that an economic role is the primary function of a company. Most of the interviewees (20 out of 28) believed that a company is both an economic and socio-political player, with a great emphasis on the political role.

The interviewees who maintained that companies are just economic players highlighted that ideally a company's socio-political involvement is a good phenomenon, but not in Iran's current situation. They believed that, besides the fact that a company's *raison d'être* is economic and its purpose is profit-making, Iran's economic situation does not allow companies to play a socio-political role either.

Sixth, most of the interviewees (25 out of 28) believed that making more profit is the main reason for getting involved with CSR. They argued that due to moral regression in Iran and the bad economic conditions either the government needs to exert pressure and force for CSR, or companies need to see an increase in profits.

Another reason that many interviewees (15 out of 28) gave as the main reason for getting involved in CSR is the survival of the company. They emphasized that a better reputation in society brings about positive public opinion about a company's activities, leading to less political and social pressure on the company. Companies can attract people's attention, have their support and loyalty through undertaking CSR activities.

In the seventh step the interviewees were asked if they believe corporations have extra responsibility for social development beyond the development that arises incidentally from their responsibility to their shareholders to generate profit.

Almost half of the interviewees answered positively and the other half answered in the negative. There was slight inclination towards a negative answer.

The ones who answered positively emphasized the fact that a company needs to be economically successful and generate profit before any plans for social development. The ones who gave a negative answer mostly believed that ideally corporations have extra responsibility for social development, but not in Iran.

In order to analyze Key proposition 3 (the importance of political determinants of CSR), the State influence in developing countries such as Iran upon the adoption of CSR in many companies, attempts were made to see whether the political determinants of CSR are fundamental to explaining its impact; whether transitional economies, such as Iran, present major obstacles to the adoption of a dispersed ownership model of the corporation; and whether the relationship between a legal rule to be transplanted and the socio-political structure of the "origin" jurisdiction will determine the rejection or acceptance of legal transplants.

In order to assess this key proposition, in the first step the interviewees' opinion was sought to see if CSR policies contradict any social/political values in Iran in a way that they would induce a backlash. They were also asked what local conditions have caused difficulties in transplanting commercial laws in Iran.

Most of the interviewees (20 out of 28), while highlighting that CSR and doing charity work have roots in Iranian culture and religious views, believed that implementing CSR policies in Iran would induce a backlash.

Then the interviewees were asked to give their opinion about the role of the State (the government), if any, in promoting CSR policies. They were also asked what source, if any, the government has used to promote CSR policies and what the State has done to encourage CSR policies. The interviewees' opinion was also sought as to how they believe the private sector/your company benefit from CSR partnerships with the government and if they think that promoting CSR policies will increase the level of co-operation between the public and private sectors in Iran.

Most of the interviewees (19 out of 28) believed that the government has never used any resources and had a very weak performance in promoting and encouraging CSR policies.

Despite all these shortcomings in the government's activities, all of the interviewees strongly believed that the government plays the most important role in promoting CSR policies.

Moreover, the interviewees were asked to give their opinion about the factors they believe promote the adoption of CSR values in Iran. Most of the interviewees (24 out of 28) were of the conviction that as long as there is a governmental and political economy in Iran, CSR will not be developed. They also agreed that the ground for developing CSR policies in Iran is not ready and would take a long time.

They believed that the following factors will promote CSR policies in Iran: promoting a liberal economy, that the government needs to have a supervisory role, the government needs to stop subsidizing companies and arranging their affairs for them, managers need to become shareholders and hold longer management tenures, government needs to build a CSR culture through education and advertising, companies need to see an economic justification for CSR, Iran needs to develop large private companies and public knowledge about CSR needs to be increased.

Recommendations for future research

One of the limitations of this research was that the interviewee sample was limited to publicly held companies listed on the Tehran Stock Exchange. These companies are semi-governmental (half governmental and half private), meaning that the organizational system of government and the governmental mindset still lingers there. The reason behind choosing this sample was that these companies are the most influential and powerful in Iran. They are the avant-gardes in the business environment. If they develop a certain policy, other companies will follow their lead. Other studies could be performed using this study's design, but using corporate leaders from only the private sector.

Another limitation was that the interviewee sample was limited to managing directors and senior managers. It would be interesting to see the results of a similar study using a sample of the Iranian population or employees. Achieving such a sample would be very challenging, but would provide exceptional benefits to the overall knowledge of corporate social responsibility.

Moreover, due to Iran's political situation and sensitivity over foreign research in the country, the interview questions were designed in a way not to address anything politically sensitive. This limited the discussions during the interviews especially if it included criticizing the government. Usually interviewees criticized the government but the interviewer refrained from asking more questions to avoid causing any alarm in the interviewees. Another research project might be conducted in a more politically relaxed environment. This would allow the discussion to follow easily, shedding more light on the path that needs to be taken to promote CSR policies.

This study demonstrated that economic development comes before the rule of law. Also the common business practices are more important than the law-on-the-book. Many interviewees stated that laws in Iran were impediments to doing business. Most of the laws are outdated and some are over developed. They also emphasized that the level of legal compliance in Iran is very low. More research is needed to determine which parts of legal system need changing, where the change should come from (whether through transplantation or internal development) and the reasons behind this low compliance level.

This thesis was the very first research on promoting CSR policies in Iran; therefore, in some parts it tends to address many issues at the same time. Other studies might be conducted addressing only one issue on a deeper level such as the stakeholder issue in promoting CSR policies in Iran or the government role in promoting CSR policies.

Other research might be able to go deeper in to the reasons behind the limited stakeholder role in developing countries, specifically in Iranian companies. And what needs to be done to increase this role, or if it is a good idea to increase their role and if this increase would impair the proper functioning of the economic system.

Another study might be able to reveal the resources that the government can use and policies it needs to develop to prepare the population to be more receptive to CSR polices and become more familiar with it. This thesis discovered that when it comes to CSR policies (basically all social concepts), it is believed that government plays the most important role in promoting the CSR policies.

A study could be performed to determine the role of education and public knowledge in promoting CSR policies in a developing country. This thesis revealed that according to the interviewees, public does not have enough knowledge about CSR or the fact that they have the right to ask corporations to behave in a socially responsible manner.

Index:

Index 1 (Chapter 6): *Summary of the Iranian Code of Corporate Governance*[850]

Chapter 1 (Descriptions) – Clause 1

This chapter offers descriptions and definitions of important terms.

Chapter 2 (Board of Directors)

This chapter describes the characteristics of the board of directors such as structure of the board, duties of the board, selection criteria and number of board members. It addresses issues such as:

- Directors' qualifications;
- Effectiveness of the board;
- Separation of duties between directors on the board and other managers;
- Separation of CEO and the Chair;
- Presence of non-executive directors;
- Meeting at least once a month;
- Formation of audit committee and delineating its responsibilities;
- Having an effective internal control system which should be evaluated annually.

Chapter 3 (Public Assembly) – Clauses 21-30

In this chapter shareholders' public assembly characteristics and responsibilities is covered. It addresses issues such as:

- Procedure for Chairperson selection;

[850] Iranian Code of Corporate Governance 2004 and further amendments 2005.

- Structure of determining compensation for members of the board of directors;
- The requirement of submitting board of directors' reports and independent auditor's report to the assembly meeting. These reports must be on public display at least 10 days before the shareholders' assembly;
- The necessity to publish financial statements that have been approved by the shareholders' assembly at most 10 days after the assembly.

Chapter 4 (Accountability and Disclosure) – Clauses 31-36

In this chapter these issues were addressed:

- Annual financial statements;
- Six-month interim financial statements;
- Stock transaction information related to the board of directors, top executive managers and their families;
- Insider-related information;
- General information related to the organizational structure, product, human resources, social responsibilities and company environment.

Chapter 5 (Frauds and Penalties)- Clauses 37-38

Index 2 (Chapter 7): Interview Questions

1. Is there a demand for CSR in Iran?
2. What do you understand to be the key feature of CSR in Iran?
   2.1. Are oil companies different?
3. To what extent are different stakeholder groups likely to impact your decision-making process?
   3.1. How are CSR policies implemented at lower levels in Iranian companies?
4. Why do companies decide to get involved in CSR?
   4.1. How do companies benefit from CSR?
5. How can the private sector/your company mutually benefit from CSR partnerships with the government?
6. What has the State/your company done to encourage CSR policies?
7. Do you see the company as an economic player or as a socio-political player?
   7.1. Which role prevails?
8. How are CSR values within corporations shaped by the internal norms in these corporations?
9. Do corporations have extra responsibility for social development beyond the development that arises from their responsibility to their shareholders to generate profit?
10. Is positive public perception important for the success of your company in Iran?
11. Is support from multiple stakeholders important for the success of your company in Iran?
    11.1. Who are the most influential stakeholders?
12. Do you think promoting CSR policies will increase the level of co-operation between the public and private sectors in Iran?

13. In your opinion, do CSR policies contradict any social/political values in Iran in a way that they would induce a backlash?
14. In your opinion, how can CSR policies begin to be prompted in Iranian companies?
15. What is the impact of corporate law on economic development in Iran?
    15.1. In your opinion, how well do Iranian courts deal with the application of corporate law principles?
    15.2. Are Iran's corporate regulators effective in enforcing corporate law?
    15.3. To what extent do Iranian courts and regulators rely upon corporations to regulate their own affairs (i.e., self-regulation as opposed to government regulation)?
    15.4. To what extent do corporations in Iran avoid complying with legal and regulatory rules (i.e., re disclosure)?
    15.5. In your opinion, how effective is Iran's corporate law in dealing with illegal self-dealing by corporate officials?
    15.6. What substitutes are available to make up for weak corporate law?
16. What local conditions have caused difficulties while transplanting laws into Iran?
17. How flexible is Iran's legal system in response to changing economic conditions?
18. In your experience, what are the principal costs of introducing CSR rules in Iran?
19. Do you think that more employee participation would enhance promoting CSR policies in Iranian companies?
20. What role has the government played in encouraging CSR policies?
21. What resources, if any, has the government used to promote CSR policies?

22. In your opinion, to what extent do successful CSR policies depend on the existence of social structures (such as unions, professional associations, etc) commonly referred to as “civil society”?

    22.1. To what extent is economic growth facilitated by an adherence to rule of law ideas (chicken or egg issues)?

23. To what extent are managers/directors of large Iranian companies accountable to different stakeholder groups (e.g. employees, shareholders, consumers, etc)?

Index 3 (Chapter 3): Methodology

Typically, CSR research uses survey; case studies are neglected. This imbalance is likely the result of prudential and ideological considerations.[851] In their review of 94 published empirical studies of ethical beliefs and behaviour in organizations, Randall and Gibson[852] found that 81% of available empirical studies relied exclusively on survey data. Similarly, Ford and Richardson[853] observe that over 95% of 46 published studies of ethical decision-making relied exclusively on questionnaires, open-ended questions, interviews or the subject's response to a hypothetical scenario or vignette posed to them.[854]

Such a heavy reliance on survey methods has been criticized as being conceptually naive in terms of weak theoretical bases, and having a lack of clear hypotheses and poor conceptualizations.[855] Surveys introduce methodological problems such as measurement difficulty, limited potential to grasp the complexities and nuances of moral issues, information validity and respondents' social desirability bias.[856] Reliance on secondary data and self-reporting does little to shed light on the complexities of cross-cultural research in CSR as well and suffers from inherent

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[851] Stephen Brigley, 'Business Ethics in Context: Researching with Case Studies' 14 Journal of Business Ethics 219 and Abagail McWilliams Andrew Crane, Dirk Matten, Jeremy Moon and Donald S. Siegel (eds), 'Are You Ethical? Please Tick Yes or No on Researching Ethics in Business Organizations' 20 Journal of Business Ethics 237

[852] D. M. Randall and A. M. Gibson, 'Methodology in Business Ethics Research: A Review and Critical Assessment' 9 Journal of Business Ethics

[853] Robert C. Ford and Woodrow D. Richardson, 'Ethical decision making: A review of the empirical literature' 13 Journal of Business Ethics 205

[854] Howard Harris, 'Content Analysis of Secondary Data: A Study of Courage in Managerial Decision Making' 34 Journal of Business Ethics 191

[855] Andrew Crane, 'Are You Ethical? Please Tick Yes or No on Researching Ethics in Business Organizations' and Gibson

[856] Donna M. Randall and Maria F. Fernandes, 'The Social Desirability Response Bias in Ethics Research' 10 Journal of Business Ethics 805 and Justin Tan, 'Institutional Structure and Firm Social Performance in Transitional Economies: Evidence of Multinational Corporations in China' 86 Journal of Business Ethics 171

desirability and selectivity biases.[857]

In contrast, exploratory case studies, utilizing multiple sources of evidence, are conducted on a foundation of naturalistic interpretation of social action rooted in the context of organizational cultures and institutional systems and allows the researchers to determine the effective meaning of ethical beliefs and responsible practice within its real-life context to build up a more holistic understanding of the research issue.[858] Furthermore, given the relatively new and unexplored nature of the phenomenon – the development of CSR policies in a developing country such as Iran – this study adopted an exploratory research strategy.[859] Qualitative research, rather than traditional quantitative empirical tools, is particularly useful for exploring implicit assumptions and examining new relationships, abstract concepts and operational definitions.[860] The objective was to conduct an analysis of corporate business environment, managers' mindset and current practices and strategies in Iran in order to see how CSR policies can be implemented there. Interviews were conducted with the managing directors of big corporations listed in the Tehran Stock Exchange. This would help to build theories on how companies see CSR in Iran's business environment and to develop strategies that would facilitate future development of CSR policies in a developing country such as Iran.

Moreover, an exploratory methodology such as this has been recognized as being

[857] Tan
[858] Robert K. Yin, *Case Study Research: Design and Methods: (Applied Social Research Methods, Volume 5): 005*, vol 5 (3rd edn, Sage Publications, Inc. 2003) and Tan
[859] Yin and Kathleen M Eisenhardt, 'Building Theories From Case Study Research' 14 The Academy of Management Review 532
[860] Richard A. Bettis, 'Strategic Management and the Straightjacket: An Editorial Essay' 2 Organization Science 315 and Karl E. Weick, 'Drop Your Tools: An Allegory for Organizational Studies' Administrative Science Quarterly 301

particularly useful for researchers interested in examining strategies in emerging economies.[861] In addition, qualitative research has provided critical insights into innovation,[862] entrepreneurship,[863] and alliances, as well as a variety of other phenomena, such as social issues' organizational change,[864] and proactive responsiveness to environmental uncertainty.[865]

Since the issues relevant to transitional markets are under-examined,[866] a qualitative approach is more able to reveal the sensitive and complex issue of implementing CSR policies in Iran.[867] Such an approach facilitates within-case analysis and cross-case comparisons, which can greatly enhance the replicability and generalizability of conclusions elicited from the cases.[868] In response to such calls, this thesis used mixed methods, including analyses of corporate documents and media reports, as well as interviews with a range of actors from the field to construct an understanding of legitimate CSR practices. Secondary data provide material when it is not possible to gather primary data, overcoming a substantial dilemma in conducting CSR studies. With its unobtrusiveness, the "eavesdropping" quality of the case study overcomes the social desirability response bias and the reluctance to respond to explicit ethical questions.[869] Moreover, secondary data, generated at the time as the events being investigated, overcome problems of recollection and make longitudinal study

[861] Lorraine Eden Robert E. Hoskisson, Chung Ming Lau and Mike Wright, 'Strategy in Emerging Economies' 43 The Academy of Management Journal 249
[862] D. Charles Galunic and Kathleen M. Eisenhardt, 'Architectural Innovation and Modular Corporate Forms' 44 The Academy of Management Journal 1229
[863] Paula Bassoff and Christine Moorman Anne S. Miner, 'Organizational Improvisation and Learning: A Field Study' 46 Administrative Science Quarterly 304
[864] Ted London and Stuart L Hart, 'Reinventing Strategies for Emerging Markets: Beyond the Transnational Model' 35 Journal of International Business Studies 350
[865] Harrie Vredenburg and Frances Westley Sanjay Sharma, 'Strategic Bridging: A Role for the Multinational Corporation in Third World Development' 30 Journal Of Applied Behavioral Science 458
[866] Cordeiro
[867] Eisenhardt, 'Building Theories From Case Study Research'
[868] Ibid and Yin
[869] Harris and Fernandes and Tan

possible.[870]

The initial literature review provided guidance for this study and helped to identify meaningful and relevant key propositions and questions for the interviews. More specifically, this included collecting data on the CSR literature, legal transplants, CSR in developing countries and the background of Iran's culture, economy and legal system. The research was conducted over a period of three years and involved triangulation between a variety of different sources of data including analysis of stock exchange reports, press, politics, annual reports and the conducting of formal and informal interviews with managers at a number of listed companies in the Tehran Stock Exchange.[871]

One point that should be taken into consideration is that Iran is a very politically sensitive country. Attempts were made to avoid touching upon sensitive political issues and not to approach politically sensitive industries such as oil/gas. However, in developing countries such as Iran politics tend to be involved in every aspect of people's lives, therefore complete avoidance of the subject proved to be impossible.

28 interviews were conducted. The interviewees included:

- Seventeen managing directors of large Iranian corporations listed on the Tehran Stock Exchange. These managing directors were not chosen randomly. They were chosen from the fifty most active corporations in the Tehran Stock Exchange and preference was given to the biggest ones, which were the so-called half-private/half-

[870] Harris
[871] Yin

governmental corporations (previously governmental corporations).

- Five well-known lawyers of major Iranian corporations listed on the TSE (all of whom had a PhD in law, were teaching at the university and had more than 15 years of experience). These people were chosen to cross-check the data collected from the interviews with the managing directors and also to further explore different aspects of developing CSR policies in Iran.

- Five higher middle managers of the biggest industrial Iranian corporation. All of them had more than 15 years of experience of working in that industry. These people were chosen to cross-check the data collected from the interviews with the managing directors and to further explore different aspects of developing CSR policies in Iran. Convincing the managing directors of these companies to give an interview proved to be impossible and politically sensitive; therefore, higher middle managers were chosen.

- One chief editor of the most famous industrial magazine in Iran. This interviewee had more than 25 years of experience in the industry press. This person was chosen for the purposes of data cross-checking and having another outlook on the matter.

All of the interviews were conducted in Persian and translated into English by the author of this thesis. After that the data was summarized and categorized according to the key propositions. Data analysis was performed according to the theories and data that were collected in the earlier chapters. It also involved triangulation among a variety of different sources of data including analysis of stock exchange reports,

press, politics, annual reports and the conducting some informal interviews with government officials.

From the 22 companies that have been interviewed:

- 3 had environmental reports.
- 8 had posted a quality certificate such as ISO on their website.
- 5 had ethical codes.
- None published annual reports, neither on their website nor on paper for public view.
- Only 1 company published financial reports on its website. However, these reports were not regular and the last one was from two years ago.
- None mentioned CSR in any of their published reports or on their website.

The structure of the board of these 22 companies included:

- 1 CEO
- 1 Chair
- 1 Deputy Chair
- 2-4 board members. It was not mentioned whether they are executive or non-executive members. From the observations of the interviewer, many board members do not participate in their company's meetings and affairs at all. Being a board member is simply a title and is given to individuals in order to use their connection and power for the benefit of the company.
- From the 22 companies, only 1 had 3 inspectors and another one had external auditors.

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