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# THE SOCIAL FUNCTION OF BUSINESS ETHICS

Ronald Jeurissen

**Abstract:** Business ethics serves the important social function of integrating business and society, by promoting the legitimacy of business operations, through critical reflection. Although the social function of business ethics is implicit in leading business ethics foundation theories, it has never been presented in a systematic way. This article sets out to fill this theoretical lacuna, and to explore the theoretical potentials of a functional approach to business ethics. Key concepts from Parsonian functionalistic sociology are applied to establish the social integrative function of business ethics. This produces a theoretical framework for business ethics that provides strong theoretical arguments against often-heard criticisms of business ethics. Many of these criticisms are ideological in nature, in that they systematically play down the importance of integrative functions in the business-society relationship, on the grounds of unrealistic assumptions about the performance of economic and bureaucratic institutions. However, business ethics itself can also become ideological, if it forgets that the conditions for the application of ethics to business are not always ideal as well.

Business ethics is applied ethics,” says Velasquez (1992, p. 1). In principle, all human actions can be tested against moral standards, and actions in the context of business are no exception. On the one hand, this claim seems to provide a solid foundation to business ethics, because the linear subsumptive model of ethics that is implied in it, although immanently criticized (Willigenburg 1991), captures an essential element of the logic of moral deliberation and justification, and thus connects business ethics with the core of ethical theory (Beauchamp and Childress 1989, p. 6). If business ethics exists as a meaningful set of normative theories, it must be a form of applied ethics. On the other hand, one must agree that the subsumptive model alone cannot provide all the theoretical foundation that business ethics needs. The subsumptive model may make business ethics meaningful from the perspective of ethical theory, but it does not necessarily do so from the perspective of business as well.

In order to be meaningful from a managerial perspective, business ethics must be able to clarify some “good” that it is for business. The question “what good is business ethics?” cannot be answered by the deductive method of applied ethics, because the deduction is itself at issue. A second dimension of the foundation of business ethics is needed that addresses the relationship between ethics and

business in functional terms: What purpose does ethics serve for business? What contribution does it make to the functioning of business organizations, both internally and externally?

In this article, I propose an outline for a foundation theory of business ethics that answers these questions. The basic proposition will be that business ethics has an indispensable social function. Social interaction is the point of connection where ethics is linked to business in a functional way. I will argue that ethical institutions fulfill a double function in the system of social interaction in business: an integrative function as well as a legitimizing one. Without these functions, a business firm cannot function as a social entity. Therefore, ethics is not epiphenomal to business, but goes to the core of what a business organization is all about.

In the first section, I will discuss three of the existing foundation theories of business ethics. I will show that these theories have a common basis, which lies in the belief that ethical institutions have a necessary function for the integration of the business firm with its social environment. Subsequently, I will provide a systematic theoretical framework for this common basis, in the form of a theory of the social function of business ethics (sections 2 and 3). The potential of this theory will then be tested by targeting a number of often-heard criticisms of business ethics (section 4). I will show that these criticisms rest on profound misunderstandings of the nature of social interaction in the context of business. An important practical objection against the criticisms of business ethics is that their misinterpretation of social interaction in business makes them ideological. They tend to uncritically legitimize structures, policies, and actions in the world of business. Challenging these ideologies is one of the central tasks of business ethics. This argument will result in a plea for business ethics as a “criticism of small ideologies,” that ultimately also has a bearing on business ethics itself (section 5).

Although the focus of the article is on the meso level of economic organizations (companies), its theoretical core applies to the macro level of economic institutions as well. The very ethical values and norms that serve the social integration and legitimation of a business firm are also at work on the macro level of economic institutions in general. In fact, economic ethics, which studies the ethical dimension of economic institutions at the macro level, can be seen as one of the constitutive disciplines of business ethics. But there is more to business than only economics and hence business ethics is more than applied economic ethics. In section 4 I will argue that the ethical aspects of organizing, as well as legal ethics, are also essential ingredients of business ethics.

### *1. Foundation Theories of Business Ethics*

In this section, three foundation theories of business ethics are discussed: Donaldson’s “social contract model,” the “dialogue model” of Steinmann and Löhr, and the “institutional framework model” of Homann and Blome-Drees.

Their discussion is necessarily brief, and also the selection of the three models mentioned entails a restriction. It is the intention merely to show, in an exemplary way, how fundamental approaches to business ethics time and again involve the social function of ethics.

### *The Social Contract Model*

The aim of the social contract model of business ethics (Donaldson 1982) is to develop a theory of the legitimacy of the business firm. As created artifacts, business firms need a justification of their existence and activities. "We choose to create corporations and we might choose either not to create them or to create different entities. Corporations are thus like political states in their need for justification" (p. 37). Donaldson sees the relationship between the business organization and society as a social exchange that can be modeled in the form of an implicit "social contract," analogous to the social contract in political philosophy. The firm receives a number of privileges from society, mainly related to the legally institutionalized corporate personality. In exchange, society is granted a number of specific benefits of corporate production. Society agrees with this exchange because, and as long as, the social benefits exceed the social costs. Only on that condition is society prepared to acknowledge the firm's right to exist (Donaldson 1982, pp. 41–45). The social benefits of the firm are mainly in the field of efficiency through labor division, task specialization and economy of scale. Related to this, business firms offer additional social benefits, such as an increased capacity for using complex technologies and a stabilization of production and services. However, these social benefits of the firm are balanced by a variety of social costs of organized production, such as damage to the environment and exhaustion of natural resources, organized irresponsibility in anonymous organizations, alienation of workers, and abuse of political power by companies (Donaldson 1982, pp. 49–52). In order to maintain its right to exist, the firm must minimize these costs.

Donaldson's social contract model is not just a tool for establishing ethical performance criteria for business firms that business ethics can use in its subsumptive method. First and foremost, it is a theory about why the application of ethical criteria to business makes sense at all. The upshot of the social contract model is that legitimacy is a prerequisite for business in its relation to society. Without legitimacy, rational people in a society would decide against the existence of productive organizations. It is through legitimacy that the business firm is integrated with society. From the perspective of the social contract, legitimacy is established on the grounds of ethical criteria. A simple reference to the productive contribution of firms to society is not sufficient to justify it from a moral perspective. "To achieve a complete moral picture of a corporation's existence, we must consider not just its capacity to produce wealth, but rather the full range of its effects upon society: its tendency to pollute or to harm workers, or, alternatively, its tendencies to help employees by providing jobs and benefits

for society” (Donaldson 1982, p. 38). Business ethics is the institution that deals with the full range of morally relevant social effects of production that determine the degree of integration of business in society. We may conclude that the primary *raison d’être* of business ethics in the social contract model is a functional one: business ethics serves the necessary function of social integration of business, by means of promoting its legitimacy.

### *The Dialogue Model*

According to the German business ethicists Horst Steinmann and Albert Löhr, business ethics deals with the question: “What can and must be done on the corporate level to establish and continuously maintain the legitimacy of corporate actions?” (Steinmann and Löhr 1996, p. 26). Their suggestion is to qualify corporate actions as legitimate and therefore ethical to the extent that questions about why management is entitled to take those specific actions can be answered sufficiently by “good reasons,” which means to get to an overall consensus by forceless insight. The good reasons approach refers to a formal and procedural notion of corporate ethics that the authors consider appropriate to ethical questions in our post-traditional societies. Traditional values as such, without any further legitimization, are no longer able to fulfil integrative functions in a modern, pluralistic society. The proper social medium of ethics in a post-traditional society are dialogical procedures for attaining social consensus, in situations of conflicting interests or contrary insights. The central notion of the dialogical approach to ethics is “peace in society,” where “peace” refers to a general free consensus among all parties concerned. Peace in society can be promoted by developing proper institutions at all levels of society, which by their very construction promote conflict resolution through arguing and consensus (Steinmann and Löhr 1996, p. 39).

From this social-philosophical starting point, the normative core of business ethics can be defined as the moral responsibility of management for contributing to peace in society. It must be realized, however, that the ethical principle of peace is a regulative idea, which on the practical level has to be implemented in a given historical context. There are empirical conditions for ethical demands one has to take into account with respect to a “non-utopian” concept of business ethics. A realistic notion of business ethics has to take into account that it must be implemented in the context of a capitalistic market economy, involving competition, individual freedom of choice, and profit maximization as its central elements. Within this realistic framework, the authors suggest a double role of management in competitive market economies, namely:

1. on the one hand, management should be held responsible for the survival of the corporation in the market economy, where in the end profit is the indicator of whether this economic role has been fulfilled successfully; and

2. on the other hand, management should also be held responsible for contributing to peace in society by designing and implementing adequate corporate strategies, which are in fact the concrete means to gain profits. (Steinmann and Löhr 1996, p. 42).

Thus, business ethics can be understood as a self-imposed restriction of management on the profit motive. It reduces the set of strategic means that are available for a moral management to maximize profits. In this sense, ethics “dominates” the options to act with the profit motive, which is not to say that it ignores it. The profit principle is a legitimate economic institution, but not unconditionally so and only within the boundaries of the ethical goal of peace. The double function of the corporation must therefore read as follows: “Maximize your profits as far as this is in accordance with peace in society” (Steinmann and Löhr 1996, p. 46). Management’s responsibility for peace involves, among other things, a responsibility for reducing external effects of production. Externalities should be treated on the corporate level by decentralized initiatives within the market, right there where they arise as specific conflicts with stakeholders (Steinmann and Löhr 1996, pp. 45–46).

The Steinmann and Löhr account of business ethics is functional, in that it takes the integration of business in society as its key problem. The dialogue model of business is proposed as a means to help management avoid, or resolve, conflicts with their stakeholders, so that the legitimacy of their strategic choices is enhanced and the integration of the business firm with its social environment is promoted.

### *The Institutional Framework Model*

The institutional framework model of the German business ethicists Homann and Blome-Drees is an atypical example of a foundation theory of business ethics. Homann and Blome-Drees try, as closely as possible, to join with the neoclassical way of economic thinking, whereas most business ethicists prefer to see business ethics as an effort to overcome the “closed-mindedness” of the economic paradigm. In a far-reaching acknowledgement of micro-economic and game theoretical insights, Homann and Blome-Drees conclude that business ethics should strongly take into account the systematic restrictions of the possibilities for morally motivated actions in situations of economic competition. Nonetheless, they feel one need not despair of the way in which modern market economies are able to realize the fundamental principle of all morality, namely the “solidarity of all people” (Homann and Blome-Drees 1992, p. 15). Solidarity is institutionally anchored in the system of rules on which the market economy is founded: the economic rules of the price mechanism, in combination with a set of flanking legal rules. Together, these rules constitute the institutional framework that the moral standard of universal solidarity imposes on economic action. Morally legitimate outcomes of economic action are not, however, automatically guaranteed by the institutional frameworks of the market and the law. In order for that to be the case the frameworks have to be related to moral principles.

This is primarily the task of the government. But given the political influence of firms, the entire business community, too, has an important political-ethical task here.

Homann and Blome-Drees locate the foundation of business ethics in the discrepancy between the legality and the moral legitimacy of entrepreneurial operations. In this respect, they distinguish two business ethical strategies, both of which are based on the principle of voluntary moral self-binding. In the "competition strategy" the individual firm reacts to a lack of legitimacy of its actions either by developing new products and production methods in which moral and economic objectives are once again made to harmonize, or by turning to good account its self-binding to the social ethos through the company image, in accordance with the motto, "do good, and talk about it." In the "political ordering strategy," business firms together, in a joint self-binding, accept their common political responsibility to close the gap between legality and moral legitimacy, for instance by means of an industry code or a covenant (Homann and Blome-Drees 1992, pp. 136–140).

Homann and Blome-Drees acknowledge the functionalistic character of their business ethics theory: "Quite clearly, ethics is put at the service of profit here, and is thus functionalized."<sup>1</sup> This economic functionalization of ethics is, however, complemented and legitimized by an inverted ethical functionalization of economics: "For us, this functionalization of morality for the profit motive of firms is (only) morally legitimate, because the political order perspective, that is dominant in our approach, inversely functionalizes the profit motive of firms for the achievement of the goal of the solidarity of all people."<sup>2</sup> In Homann and Blome-Drees's conception, the foundation of business ethics lies in the mutual functionality of moral and economic motives for action.

A detailed discussion on the adequacy of the three business ethics foundation theories would lead too far afield here.<sup>3</sup> The intention is merely to show a common characteristic in a number of otherwise quite different views of business ethics. What do business ethicists do when they try to provide a theoretical basis for business ethics? All three models are procedural in nature. From a social perspective, the ethical procedures proposed by the different authors all point in the same direction: business ethics fulfils an important social function; it contributes to the process of integration of the firm in the society that surrounds it, by promoting its legitimacy. The integrative function of ethics can subsequently be described on the basis of several models, each of which has its own accents: as acting in accordance with the social contract of business, as dialogue, or as an institutional ordering strategy, among other things.

The search for the social function of business ethics is determined by a structural feature of modern society, which is characterized by a far-reaching differentiation of social subsystems and the inevitable problems of integration that result from it. In this situation, the relationship between business and society has become a problem that, according to business ethics, has a moral side to it. But why should the social integration of business and society (also) be seen

as a moral issue? Why could not the coordination mechanism of the market, or a system of legal rules and procedures, fulfill this function? These questions lead us, at a higher level of abstraction, to the problem of the general social function of ethics in modern society. Following on the emphasis on functionality in this question, I will try to find an answer in the functionalistic tradition in sociology, in particular in the work of Talcott Parsons.

## *2. The Social System: Differentiation and Integration*

Parsons defines sociology as the study of social systems. Social systems consist of the interactions of human individuals, who together form a collective unity, on the basis of certain membership criteria and an internal differentiation of statuses and functions (Parsons 1971, pp. 4–8). The French national soccer team, a city, or a business firm are all social systems.

According to Parsons, each social system is confronted with four problems, which result from the objective to maintain the system in a changing environment. These four problems give rise to four different forms of social interaction, which can be regarded as subsystems of the social system (Parsons 1961; Parsons 1971, pp. 8–12; Parsons and Smelser 1956, pp. 18–21, 46–51).

The first problem relates to the collective image that the members themselves have of the interaction system: the interpretation of the identity of the group and of the values that are of importance in the interaction. Consensus on this issue is reflected in an institutionalization of value patterns. Here we come across the social function of cultural reproduction, in which a social system develops, consolidates, and adapts its identity in relation with an unstable environment. This subsystem can be referred to as the sociocultural subsystem.<sup>4</sup> An important function of value patterns is to provide frameworks of legitimization for action. Legitimacy can be defined as a generalized perception or assumption that an action is desirable, correct, or suitable within a socially developed system of standards and values, convictions, and definitions (Suchman 1995, p. 574).

The second problem for a social system concerns the social integration of its members. A social system cannot exist without making certain demands of the social actions of its members. The system must generally be able to “count on” its members’ performances to contribute adequately to societal functioning. For that purpose, obligations in terms of loyalty and solidarity must be formulated. Solutions must also be found for the potential conflicts of interest in the interaction. Following Weber, Parsons talks about the institutionalization of a “legitimate order.” This social function is fulfilled by the integrative subsystem. In modern societies, the law is at the institutional center of this type of social interaction.

Thirdly, there is a problem that is related to the steering and management of the social system in the direction of collective goals. In order to achieve the objectives of the collective, resources need to be organized and mobilized. This social function is performed by the political subsystem. In modern societies, this political function is fulfilled by bureaucratic organizations.

The resources that are used by the political system must, however, also be created. This is the fourth problem of the social system: the material reproduction and the solution of the scarcity problem, in relation to the system's physical environment. Parsons refers to the interaction with regard to this problem as "adaptation," and the system specialized in this kind of interaction he calls the economic subsystem.

The legitimization of the normative order in society eventually lies in the sociocultural subsystem: "The social community is dependent on a superordinated cultural orientation system which is, above all, the primary source of legitimization for its normative order" (Parsons 1971, p. 16). According to Parsons, the relationship between the sociocultural and the integrative subsystem is brought about through the institutionalization of value patterns. These value patterns belong to both spheres. Through a process of specification into subvalues, the general value patterns from the sociocultural system are operationalized, as it were, in the standards of the integrative system (Parsons 1971, p. 13).

Parsons takes the extent to which the differentiation of the four subsystems has been completed in a society as a socio-evolutionary measure for its degree of modernization. The increased complexity of a differentiated society is functional for its evolutionary adaptive capacity, but it will also lead to new problems of integration. How can the new multiplicity of structures of interaction be transformed into some form of unity? This problem can be solved by including the newly formed social units and structures in the patterns of values and norms from the sociocultural and integrative subsystems. As a result, these values and norms will undergo a process of generalization. When the network of socially structured situations becomes more differentiated and more complex, the value patterns must be lifted to a higher level of universality if they still mean to serve as the foundation of the complex whole (Parsons 1966, p. 22). For example, the development of modern insurance systems on the basis of voluntary participation requires a form of solidarity that is much more general than the original more limited solidarity among relatives.

Within Parsons' conceptual model, we can locate ethics at the tangent plane of the sociocultural and the integrative subsystems. Ethics is a dimension of social action in which legitimacy and solidarity mutually determine each other. One can say that ethics legitimizes social action from the perspective of principles and norms of solidarity. In a modern society, ethics has a double social function: on the one hand the sociocultural function of providing legitimacy (and thus status) to universal solidarity-prompted acting; on the other hand the integrative function of the normative binding of legitimizing processes to criteria of universal solidarity. Using a term of Parsons, one might say that ethics forms an "interpenetration zone" between the sociocultural and the integrative subsystems.

### *3. The Business Firm as a Social System*

When we apply the analytical concept of the social system to the concrete collectivity of a business firm, we will have to be aware of a form of fallacy of misplaced concreteness: the reification of social subsystems. Social subsystems exist only as analytical constructs to indicate specific types of social interaction; they may not be equated with concrete social groups and collectives. We speak of reification when a social system is being looked upon solely from the perspective of one of the four analytically distinguishable subsystems and when it is—wrongly—assumed that one can adequately describe the whole from this limited perspective. Parsons does not tire of warning against the reification of social subsystems, in particular the reification of the economy. The economy is not a collective; it does not correspond with “the business community,” or something like that. Parsons sees collectives as a special type of social system that is characterized by the capacity for action in concert. A business firm is an example of such a collective. The concerted action of a collective requires adaptive, political, and integrative as well as sociocultural functions. For that reason, a business organization is always multi-functional, whereas the economy, as a subsystem of social interaction, is unifunctional (Parsons and Smelser 1956, p. 14).

A business firm is a social system that constitutes one of the many units within the overall social system of society. The firm is an open social system, which means that the firm in its four subsystems maintains relationships with the corresponding subsystems of the social environment. Through the market and the money medium, the economic subsystem has an interactive relationship with the economic subsystem of society; through the judicially framed medium of legitimate power its political subsystem is related to the political subsystem of society; through communicative processes of collective identity building and normative regulation of interests, the sociocultural and the integrative subsystems of the firm, respectively, are interactively related to the same subsystems of society (figure 1, next page).

Ethics concerns the legitimacy-through-solidarity of social action and thereby performs an integrative function in society. In this manner, ethics also functions within the social system of the firm. Given the open systems character of the firm, the integrative function of business ethics concerns both the internal integration and the external integration of the firm. Bringing about the internal and external social integration of the business firm is the social function of business ethics. It does this by furthering the legitimacy of business operations. In its recourse to moral standards, business ethics is applied ethics and the subsumptive method is at the core of its methodology. However, this normative approach to business ethics is embedded in a socio-philosophical reflection on the proper place and function of business ethics, in relation to the other social subsystems

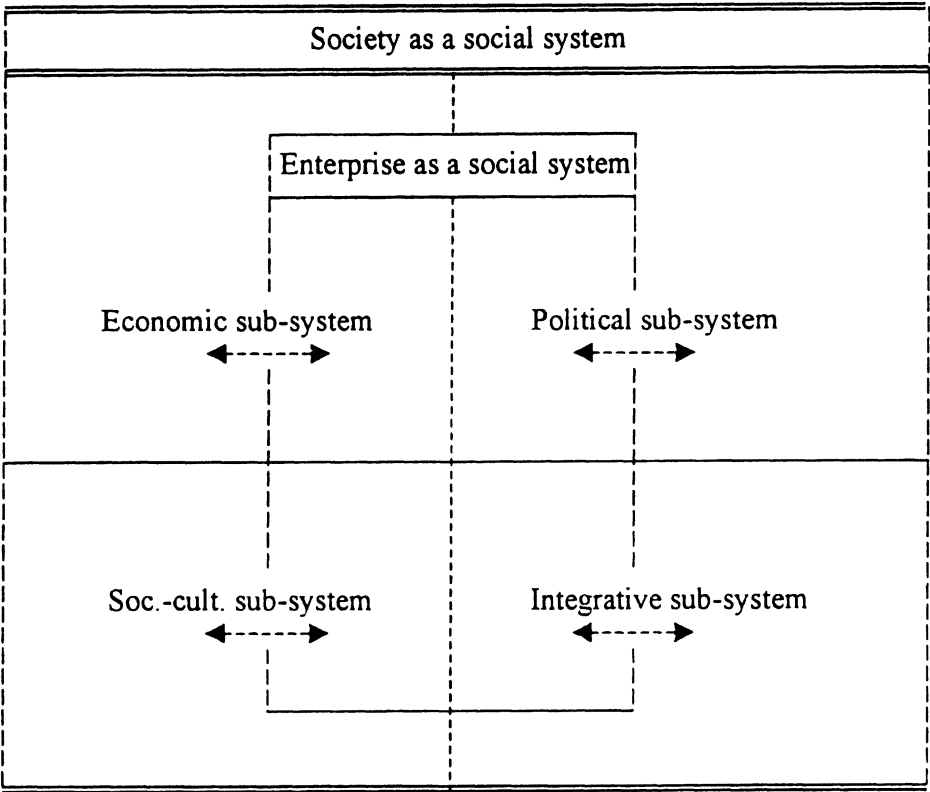


Figure 1

of the firm. As a systematic reflection on the function of ethics in the social system of the firm, business ethics is a form of social philosophy.

4. Criticisms of Business Ethics

The social function of business ethics sheds a new light on some of the criticisms that have been brought forward against the project of business ethics, and it provides some arguments of why they do not hold. The criticism presents itself in many different forms, and largely comes down to a negation of the social function of business ethics. The institution of moral integration does not play a role in the business firm. The necessary integrative functions are adequately dealt with by the economic and the political (bureaucratic) subsystems of the firm. This criticism concerns empirical claims with regard to the integrative nonfunctionality of business ethics on the one hand, and normative claims with regard to its integrative dysfunctionality on the other. The criticisms come from both economic theory and organization theory, and they can be captured briefly as follows:

*Economic non-functionality of business ethics*

Within the context of a market economy, eventually, business decisions are always based on considerations regarding profit and competitive advantage. Under the pressure of competition and prisoner's dilemma situations, people in organizations will primarily act in conformity with the mechanisms of the market and not in conformity with their own ethical judgments (Baumol 1991; Brickley, Smith, and Zimmerman 1994).

*Economic dysfunctionality of business ethics*

By virtue of its structure and its way of institutionalization, the market transforms the self-interested motives of the transacting parties into an optimal contribution to the general welfare. Moral self-guidance of parties in the market that exceeds the basic institutionalized behavioral constraints of the market (no lying, no forcing) interferes with the workings of the system, and therefore leads to suboptimal efficiency that, according to the moral theory of utilitarianism, is a form of moral suboptimality as well. Social integration of the economy through the market mechanism works at its best without any ethical "agendas" of the participants (Friedman 1970, Rudd 1981).

*Bureaucratic nonfunctionality of business ethics*

Within the hierarchical organization of a business firm, moral arguments can, eventually, always be brushed aside in an appeal to rules, procedures, or the hierarchical chain of command. In hierarchical organizational contexts, people will eventually act in conformity with procedures and job descriptions, and not in conformity with their own ethical judgments (Habermas 1987, pp. 309–311).

*Bureaucratic dysfunctionality of business ethics*

The classic criticism in this respect is the argument of the "loyalty to the superior" (Velasquez 1992, pp. 44–45; Duska 1992). Employees in bureaucratic organizations are expected not to act according to their subjective moral convictions, but exclusively in conformity with the organizational standards and rules. Moral responsibility for the behavior of the organization lies solely with the management, and not with the many "cogs" in the machine. When employees within the hierarchy act according to their own individual moral standards, the efficient and predictable operation of the bureaucracy is disturbed. Responsibility within an organization should not be anything but procedural and hierarchic in nature, and least of all should it be based on individual moral autonomy.

From the perspective of the social function of business ethics, these criticisms can be traced back to two misconceptions regarding processes of social differentiation and integration in modern society, namely the reification and idealization of social subsystems. In what follows, my arguments against the reification and idealization of the economic subsystem are all taken from economic ethics (Buchanan 1985, Sen 1987, Lewis and Wårneryd 1984, Hausman

and McPherson 1996). The line of reasoning implicitly shows how economic ethics serves as a foundation of business ethics. But as already said in the introduction, there is more to business ethics than economic ethics. Additional theoretical insights from the fields of organizational theory and legal ethics need to be taken into account as well.

### *Reification of Economy and Bureaucracy*

The criticisms concerning the economic and bureaucratic nonfunctionality of ethics within the firm are both based on a theoretically inadmissible reification of social subsystems. The firm as a whole is identified with one of its subsystems and it is subsequently assumed that all the interactions taking place can be described entirely and exclusively in terms of only this subsystem, neglecting the functional contributions of the others. The proposition that decisions in a firm are “eventually” always made on economic grounds and not on moral reasons is in fact a negation of the function of the sociocultural and integrative subsystem within the business organization.

Empirically, the sociocultural and integrative subsystems apparently determine to a large extent how people in a firm think and act. In recent business literature, cultural factors are deemed to be of great importance. The collective self-image of the organization, the whole of convictions among the members of the organization about “the way we work here,” influences the way in which decisions are made within the firm (Schein 1985, Hofstede 1991, Sinclair 1993). In his classic study on the relation between the economic and bureaucratic subsystems, Williamson also describes the workings of the sociocultural and the integrative subsystems, to which he refers with the somewhat enigmatic term “atmosphere.”

modes of organization or practices which would have superior productivity consequences if implemented within, and thus would be adopted by, a group of expected pecuniary gain maximizers, may be modified or rejected by groups with different values.

preferences for atmosphere may induce individuals to forego material gains for nonpecuniary satisfactions if the modes or practices are regarded as oppressive or otherwise repugnant. (Williamson 1975, p. 39)

The bureaucracy-theoretical elimination of ethics within the firm can also be disposed of as a form of reification, in this case of the bureaucratic subsystem. An organization does not coincide with its formal organizational structure. A striking example of bureaucratic reification can be found with Habermas. On the one hand, he agrees that the sociocultural and integrative spheres are constitutive to formal organizations. “If all processes of genuinely reaching understanding were banished from the interior of organizations, formally regulated social relations could not be sustained, nor could organizational goals be realized.” On the other hand, however, Habermas still thinks that eventually communicative agreement is not decisive in formal organizations. In bureaucratic

settings, the normative presuppositions of communication are subjected to a formal proviso. "Members of organizations act communicatively only with reservation. They know they can have recourse to formal regulations, not only in exceptional but in routine cases; there is no necessity for achieving consensus by communicative means" (Habermas 1987, pp. 310–311).

This line of argument is a paradigm case of reification. The statement is true only under the condition that an organization coincides with its bureaucratic subsystem. One of the achievements of recent organization theory is exactly that important processes which management wants to carry through within organizations often cannot be realized through bureaucratic authority. When the managers decides that the members of the organization should show more "entrepreneurship" in order to make the organization more flexible and more creative, it can well create the necessary conditions, but it can never enforce the required change of mentality. Such a process of cultural change requires leadership, which is preeminently a matter of communication, and which can even require a "servant" attitude, instead of control (Ciulla 1995).

### *Idealization of Economy and Bureaucracy*

It is stated that purely economic and bureaucratic action within the firm leads to morally better results than action based on moral reasons. The legitimacy of action coordination by the economic and bureaucratic subsystems is guaranteed by their constitutive basic institutions. These have been designed in such a way that essential cultural values and moral standards steer the subsystems automatically. Particularly, this concerns the moral principles of freedom, justice, and efficiency. With Luhmann (1969), we can speak here of "procedural legitimacy" ("Legitimation durch Verfahren"): the procedural rules of the market and of bureaucracy suffice as legitimizing decision-making criteria. Interference with the workings of these rules for the sake of moral desiderata disturbs their effectiveness, and for that reason is dysfunctional.

The propositions regarding the dysfunctionality of business ethics are based on idealized conceptions of the workings of economy and bureaucracy. Under a number of drastic theoretical restrictions, it can indeed be made plausible that economic and bureaucratic institutions will produce only morally legitimate outcomes, that cannot be improved by moral action. Under conditions of ideality, economic and bureaucratic actions are always morally legitimate, by definition. However, the practical moral relevance of this theoretical deduction is rather limited. Empirically, these subsystems never exist in pure and perfect forms. Therefore, their idealization causes a surplus of legitimacy and an ideological pseudo-legitimization of their empirical functioning.

In the following, the idealizations of the economic and bureaucratic subsystems are described summarily, while at the same time a number of empirical conditions of non-ideality are pointed out. In relation with bureaucratic idealization, attention will also be paid to the idealization of the functioning of the law.

*Idealized Economy*

The Walrasian paradigm of neoclassical economics entails the model of the perfectly operating market: the system of exchange on the basis of perfect competition. This model describes the core of the economic subsystem of modern society, seen as an analytically abstractable aspect of the totality of human interaction. The following characteristics are commonly attributed to the perfect market (Buchanan 1985, p. 14; Samuelson and Nordhaus 1989, p. 55; North 1990, p. 19; Velasquez 1992, pp. 175–184):

1. There are many demanders and suppliers, none of which holds a substantial part of the market.
2. The goods that are traded are homogeneous.
3. Buyers and sellers can freely and immediately enter and leave the market.
4. Buyers and sellers have full information on prices, quantities, and qualities of the goods brought to the market.
5. Buyers and sellers have stable preferences and are rational wealth maximizers.
6. There are no externalities.
7. There are no transaction costs.
8. The market is not regulated externally.

One can argue that the ideal market knows three unsurpassable moral achievements: the ideal market fully respects the right to negative freedom (absence of force); the exchange that is brought about in the market achieves perfect distributive justice (Velasquez 1992, p. 180); and the utility value of the distribution that is brought about cannot be improved, in terms of the Paretian efficiency criterion (Gauthier 1986, pp. 83–112). Of course, the moral quality of the distribution through the market is dependent on the moral quality of the initial division of goods. This might well be inputs, and the market is not aimed at repairing it (Sen 1985; Barry 1989, p. 254). However, this is not an ethical argument against the market mechanism as such.

It is a commonplace that conditions of ideality are never met completely in empirical markets (North 1990, p. 24; Enderle 1991). When one qualifies conditions of ideality, or gives up on them completely, the procedural legitimacy of the market will diminish accordingly. A few important imperfections of empirical markets are:

- a. Monopolies, oligopolies, and trusts lead to positions of power on the supply side, causing prices to be higher than the equilibrium under full competition. This damages the justness of exchange in empirical markets.
- b. Empirical transaction areas within markets do show barriers for entry and exit. These barriers affect the freedom of buyers and sellers, and

thus the justness of the exchange and the utility of market results. For instance, suppliers in a labor market (employees) are not entirely free to leave this market when they find the balance price of labor (their wages) too low.

- c. Usually, buyers do not have full information on products, so that their choice is not a pure expression of their preferences. This diminishes the utility of allocations through the market.
- d. Equilibrium prices do not always express the full production costs. Very often there are external costs that are not expressed in the market prices of goods and services, such as environmental costs. This also diminishes the utility of market allocations.

In spite of all these empirical restrictions of the market mechanism, the ideality of the market is often simply taken for granted in the actual legitimization of economic decisions, in business schools, behind managers' desks, in public debates, or in parliament. Apparently, there is an unreasoned "belief" in the market; one may speak of a "market ideology" (cf. North 1990, p. 23). Because of that, market arguments often produce pseudo-legitimacy in the economy. The wrong things are justified, and others discarded, from false arguments. Efforts to sideline business ethics with market arguments are part of this web of ideological pseudo-legitimizations that is being spun around the empirical economy. For business ethics, meanwhile, the motto holds that "morality arises from market failure" (Gauthier 1986, p. 84).

### *Idealized Bureaucracy*

The bureaucratic subsystem also has its ideal model. It is the concept of the formal organization, which goes back to Weber's theory of bureaucracy. Stinchcombe (1967, p. 155) defines the formal organization as "Any social arrangement in which the activities of some people are systematically planned by other people (who, therefore, have authority over them) in order to achieve some special purpose." From this definition, a number of ideal characteristics of the bureaucratic subsystem can be derived.

1. The formal organization is a "social arrangement." Here, an important condition of ideality is analogous to a condition of the perfect market: there is free entry and free exit. A formal organization is formed by people who have freely bound themselves to it, by means of a free contract.
2. The formal organization structures the activities of its members in the direction of the organizational goals. This is done in a systematic and rational manner. Goal-rationality involves the selection of effective and efficient means for certain goals. The goal-rational character of an organization lies mainly in the structure of the organization, in the totality of the rules and procedures that are intended to efficiently and effectively direct the activities of the members of the organization toward the achievement of its goals.

3. As a logical consequence of their formal basis, formal organizations are hierarchical. Weber considered hierarchy an important condition of ideality of the formal bureaucracy. The hierarchical structure guarantees that tasks are performed verifiably, orderly, and consistently. Because of that, problems of legitimacy within the organization can always be localized clearly, and can be reported to the top of the organization, who can then be held accountable.

Empirical organizations deviate from the ideal model of the bureaucracy in several ways. Therefore, they do not automatically achieve procedural legitimacy. The most important empirical deviation from the ideal model concerns restrictions of the freedom of membership. In a real situation, the members of an organization do not have full freedom to leave the organization when there are matters they disagree with. Their labor often has a high level of asset specificity and cannot be used for alternative purposes without a significant reduction of its value (Douma and Schreuder 1992, p. 108). These costs create a lack of freedom and this, again, creates power on the side of management, which can be abused.

An organization operating in concrete social reality has to deal with questions about the legitimacy of its objectives. However, the goal-rationality that controls the organization offers no framework within which these can be answered. This requires of the organization that it attune itself through communication to the patterns of values and norms from the sociocultural and integrative subsystems of society.

The ideal model of the hierarchy forbids the members of the organization to act "on their own accord." Ideally, the organization's acting responsibly is guaranteed by the hierarchical top. In reality, however, the management is not infallible. Quite often, management decisions are the cause of irresponsible actions on the part of the organization. In such cases, it is important that people lower in the hierarchy are willing to take their responsibility, and are actually empowered to do so. Under empirical conditions, an internal ethical discussion does not make an organization worse; it makes it better.

### *Idealized Law*

The problems of legitimacy that arise from the tensions between the ideal models of the economic and bureaucratic subsystems and their empirical realizations can at first be addressed through the law. One could argue that even when problems of legitimacy do occur in market exchanges and organizational procedures, these should not be dealt with by a direct recourse to ethical deliberation. Rather, it should be done via a system of legal procedures by which the actions of attitudinally and motivationally pluralistic actors can be coordinated effectively. In his later works, Parsons increasingly emphasized the importance of the procedural legitimacy of law (Sciulli and Gerstein 1985, p. 306). In Habermas's recent thought one can see a radicalization of this turn to the law.

According to Habermas (1996), the differentiation of the economic and bureaucratic subsystems has been so radical that a direct link between them and

the communicatively structured “lifeworld” no longer exists.<sup>5</sup> Fortunately, the integrative gap can be bridged by the law. Habermas assigns a “transformer function” to law, which establishes a link between the communicative interaction in the lifeworld and the strategic interaction in the subsystems of economy and bureaucracy. Under democratic conditions, law in itself integrates the goal-rationality of functional subsystems with the moral sources of legitimization in the lifeworld. The input of law are the political-ethical discussions from the public opinion which, following a number of filtering steps in the democratic decision procedures, are turned into the output of sanctioned legal regulations. With regard to the subsystems that have become disconnected from the lifeworld, the output of law subsequently functions as a set of restrictions. Law transforms morality into legality.

According to Habermas, the law is the only link that connects the two main spheres of society. Normative contents from the lifeworld can penetrate the other part of society only when expressed in the “language” of the law. Without the transformation in the code of law, normative contents would “fall on deaf ears” in the rationalized spheres of action (Habermas 1996, p. 56). For business ethics, of course, this view of the social function of law has an important implication. It is not ethics but the law that effectuates the integrative linkage between business and society.

This legalistic vision of the non-functionality of business ethics holds when the law deals with problems of legitimacy in an ideal manner. The model of the law as a transformer offers the possibility to formulate in a simple manner, and without pretending to be complete, a number of essential ideality conditions of the law.

1. Law transforms all moral inputs from the lifeworld that are candidates for the legal form.
2. There is no output that contradicts the moral input; there are no illegitimate legal rules.
3. There is no short-circuit in the system. In particular, this means that organizational entities that are controlled by law do not themselves have a link with the input of the law.

It can quickly be shown that the functioning of the law in the empiricism fulfills none of these conditions. First of all, concrete problems of legitimacy regularly remain untreated for at least some time. There is a time lag between the origination of a problem of legitimacy and the introduction of a matching legal rule (Stone 1975, p. 94). Developments in information technology and in biomedical technology offer numerous examples. Border-crossing activities sometimes bring organizations under the jurisdiction of legal systems that show considerable moral lacunae. Stone points at the problem of the ‘legislative paralysis’ with regard to complex problems in society, to which sometimes business activities, too, seem to contribute (Stone 1975, 98).

Sometimes the output of law is not based on moral input, or only inadequately. The former South African apartheid system is what comes to mind first. But also in democratic societies the fact that activities are carried out in conformity with the law does not always provide sufficient legitimacy in the eyes of the public. This became evident in Shell's PR problems with regard to the Brent Spar oil platform. Shell's plan to sink the Spar was in agreement with British law, but was strongly criticized in public opinion, notably in Germany and The Netherlands. In the Brent Spar affair, Shell became the victim of an emerging discrepancy between cultural values and the output of the law.

The condition that organizations subject to the law may have no influence on its input is not fulfilled by the empiricism either. In classical republican thinking, it is put that politics should only be a matter of citizens, for only they represent the "res publica." Formal organizations are outside the domain of legitimate political actors. In an article on the environmental responsibility of business, Norman Bowie states that the political responsibility of business should consist solely of its compliance with environmental laws, on the condition that firms refrain from all and any attempts to influence environmental legislation (Bowie 1990). Only then will it be possible for society to transform its environmental values and standards into legal rules in a pure manner. This condition does not, however, express a strong sense of reality. Organizations have a "natural" need for political influence. Because each organization has but a limited adaptive capacity, organizations have a strategic need to influence their environment, including the legislative environment. Hence, the condition that there be no "short circuits" in the legal transformation system is not met.

### *5. Business Ethics as a "Criticism of Small Ideologies"*

The reifications and idealizations of functionally specialized subsystems produce an abstract surplus of legitimacy, which cannot be fulfilled by the real relations in the world of economy and bureaucracy. Because of that, these reifications and idealizations become ideological. Seeing through and criticizing these ideologies is an important task of business ethics.

In a neutral sense, ideologies can be defined as "relatively coherent sets of beliefs that bind people together and that help explain their worlds in terms of cause-and-effect relations" (Beyer 1981, p. 166). Ideologies help managers to reduce uncertainty by providing standardized interpretations of the environment, and they help them to solve the inconsistency between norms of rationality and the norm of rapid action (McKinley, Mone, and Barker 1998, pp. 201–202). Ideologies thus enable managers to economize on information costs. As cutoffs for rationality, however, ideologies are also prone to critical philosophical and ethical scrutiny. In a critical sense, the notion of ideology refers to the presence of some form of legitimizing appearance in a collective interpretation system. Ideologies are frames of interpretation with which any valuation can be given the appearance of absolute validity and any theory can be given the appearance of

irrefutability (Topitsch 1961, p. 41). Ideologies immunize themselves against criticism by means of an inconspicuous yet systematic curtailment of communication. In this respect, Habermas speaks of the "instrumentalization" of the lifeworld (Habermas 1987, pp. 186–187; cf. 1976, p. 113).

This curtailment of communication by ideology can be compared with what Foucault (1971) has called the "order of the discourse." Ideologies have the character of a discourse; that is, they are networks of spoken and written words that are continuously being checked and regulated. An important form of discursive regulation is exclusion: some topics are forbidden, others must be brought up time and again, to pound them home, as it were. Requirements with regard to a correct formulation and specific criteria of "reasonableness," too, regulate the discourse (IJsseling 1975). Rhetoric, including the use of analogies and metaphors, also plays a part in the manner in which the discourse establishes its order. Analogies and metaphors are extremely suitable instruments for the social construction of meaning, by making some interpretations more attractive and by toning down others. Well-known metaphors of business are those of games, sports, and war (Duska 1990). The perlocutionary effect of these metaphors is mostly that they symbolize and legitimize the unlinking of the mediatized subsystems from the lifeworld (Mumby 1993).

With regard to the reifications and idealizations of social subsystems, business ethics should fulfil an ideology-critical role. In this respect, one should not interpret ideology first and foremost as the "great stories" that legitimize a total cultural, economic, and political constellation, such as communism or liberalism. Much rather, we are dealing with a plurality of ideologies at the micro-level of concrete decisions and the meso-level of organization cultures. One might speak of "small ideologies." As a criticism of small ideologies, business ethics has the task to safeguard the openness of thinking about questions of legitimacy in the context of business, and to criticize uncritical reification and idealization in this respect. Thus, it shares in the mission of critical reason, as Hans Albert saw it, "of so reducing the irrationality of life in society that the results and methods of critical thinking can be made fruitful for the formation of social consciousness and of public opinion: the task, in short, of enlightenment" (Albert 1985, p. 112).

Business ethics should also apply its ideology-critical function to itself. Business ethics, too, can indulge in reifications and idealizations. Reification occurs in business ethics when the sociocultural and the integrative subsystems are passed off as the entire reality of the firm. This leads to an uncritical "ethicization" of the firm. An example is Mulligan's proposition that "business people ought to work to create and market the specific goods and services which are morally worthy and to avoid those which are unworthy, even if such action is not legally required and even if such action does not consistently serve the firm's profitability" (Mulligan 1993, p. 66). Here, it seems as if the firm is lifted above the economy; as if economic conditions like competition have no bearing on the ethical argument at all.

In business ethics, idealization is created by ignoring the empirical non-ideality conditions of moral theories. One relates the actions in organizations to a “pure” moral theory, although the conditions under which these actions can be morally pure have not been met. In particular, this leads to a moral conception of the dysfunctionality of the economic subsystem and to a dualistic theory about the relation between economics and ethics, in which pure economic rationality is opposed to a-economic moral responsibility (Ulrich 1987, p. 124). Idealization of moral theory in business ethics may lead to ideology in the negative sense of the word: a pseudo-illegitimacy is produced. Business ethics must also criticize this ideology, which it tends to produce itself.

### Notes

<sup>1</sup>“Moral wird hier ganz offensichtlich in den Dienst der Gewinnerzielung der Unternehmen gestellt und damit funktionalisiert.” (Homann and Blome-Drees 1992, p. 142. Translation RJ)

<sup>2</sup>“Für uns had diese Funktionalisierung der Moral für die Gewinnerzielung der Unternehmen (nur) deswegen eine ethische Rechtfertigung, weil aus der dominierenden ordnungspolitischen Perspektive unseres Ansatzes die Gewinnerzielung der Unternehmen umgekehrt für die Erreichung des moralischen Ziels der Solidarität aller Menschen funktionalisiert wird.” (Homann and Blome-Drees 1992, p. 142. Translation RJ)

<sup>3</sup>For Donaldson’s social contract model, see Kultgen 1987; Hodapp 1990; Mulligan 1990; Donaldson 1987; Donaldson 1989, pp. 44–64; Conry 1995. For the dialogue model of Steinmann and Löhr, see Homann and Blome-Drees 1992, pp. 174–179; Blasche, Köhler, and Rohs 1994. For Homann and Blome-Drees’s institutional model, see Blasche, Köhler, and Rohs 1994.

<sup>4</sup>Parsons himself speaks of the “Pattern Maintenance” system (1961, p. 38): the system directed at maintaining value patterns. In earlier texts he speaks of the “Latent Pattern-Maintenance and Tension-Management Subsystem,” also referred to as the “Cultural-Motivational System” (Parsons and Smelser 1956, p. 53). I prefer the synonym “sociocultural subsystem” suggested by Münch (1984, p. 35).

<sup>5</sup>Habermas’s concept of the lifeworld (“Lebenswelt”) is similar to Parson’s sociocultural and integrative subsystems combined. However, the approach of Habermas is action-theoretical, focusing on the specific communicative nature of interaction in the lifeworld, whereas Parsons has a systems-theoretical approach, focusing on the social functions of subsystem (cf. Habermas 1987, pp. 241–242).

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