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THE IMPORTANCE OF THE INSTITUTIONAL FRAMEWORK IN REGULATING CORPORATE SOCIAL RESPONSIBILITY

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Abstract

Process of globalization conditions the business to acknowledge a factor that go beyond the boundaries of classical economic theory. Effective management of the company entails building of mutual rational relationships and constructive communication with all the stakeholders in business processes. Analysis of the activities of modern companies entails the acknowledgement of their positive and negative impacts on the society and natural environment. Corporate social responsibility (CSR) is becoming an increasingly important research phenomenon, but also an institution, which serves as an indicator of civilization and sustainable development.

The aim of this paper is to demonstrate the importance of the institutional frameworks in regulating the CSR, to analyze some key aspects and issues related to the observed phenomenon and define its contemporary position. It starts from the hypothesis that a) CSR gradually changes, but its position is on the line between rhetorical illusion, voluntary possibility of implementation and the need for forced (institutional) commitment, and b) that institutional pluralism is a precondition for overcoming of the institutional vacuum and monist quasi-institutionalization of neo-liberal type. The conclusion is that it is necessary to institutionally define the achievement of balance between the economical, environmental and social imperatives.

Keywords: *Corporate Social Responsibility (CSR), Sustainable Development, Corporate Governance, Institutions, Institutional Framework.*

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1. INTRODUCTION

The subject of our analysis in this paper is the issue of corporate governance (c. g.) in the context of its CSR. The activities of creation and development of institutional support of mentioned phenomenon can not be seen only as a reaction to the major conflicts of interest, affairs and corruption scandals spawned by corporate governance in market economy countries. On the contrary, through the prism of sustainable development it must be constantly worked on overcoming the gap between the legislation and its application in daily practice.

Acceptable approach to CSR involves the integration of three basic concepts: the concept of profit, which assumes that the primary responsibility of management and managers is business and profit maximization, stakeholder concept, which advocates that the management should take care of the impacts of the activities of the company to its stakeholders and recognize their interests in decision-making and social power / social responsibility concept, which assumes that the company and the business must have a certain social responsibility for the possession of power.

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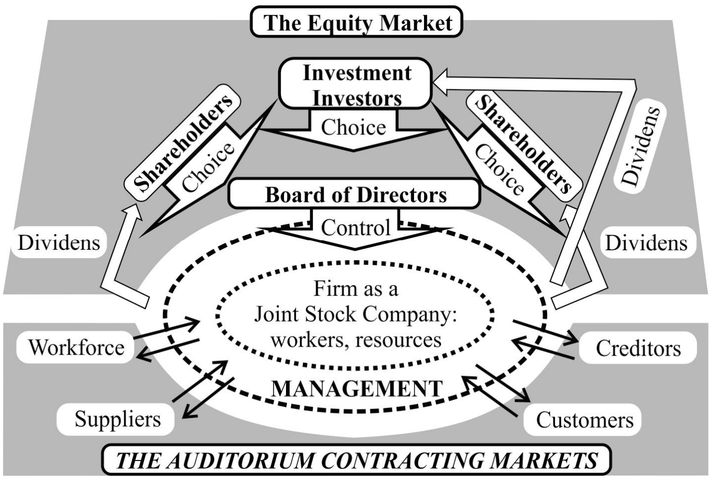
2. LITERATURE REVIEW

Institutional aspects are emphasized in the beginning of the introduction of corporate governance and the formation of the modern corporation. In fact, from the moment of which the owners were no longer be personally responsible for the obligations or for any other obligation that a company can create (limited legal responsibility), i.e. occurrence of the separation of the ownership function from the function of administering the firm's resources. Above phenomenon are identified by A. Berle and G. Means (1932) as one of the most important in economic history. In this way, the modern corporation is formed as an intermediate institutional management mechanism, which has a duty to diversify risk and reduce the cost of capital, although it creates a natural conflict between those who bear the risk (shareholders) and those who run it (managers).

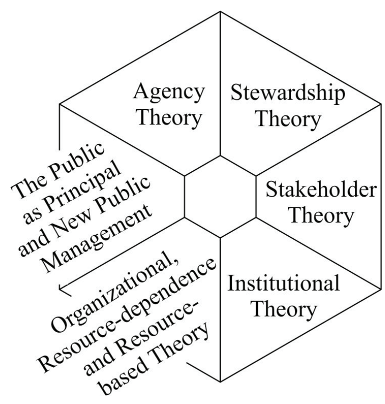
Figure 1: The structure of corrected of the Berle and Means modern corporation



Source: M. Drašković, and A. A. Lojpur, 2013.

Analysis of various theoretical models (ownership theory, stakeholder theory, agency theory, stewardship theory, institutional theory, and others) of modern corporation and corporate governance clearly indicates the dominant role of institutional factors in their formation and development.

Figure 2: Corporate Governance: Important Theories

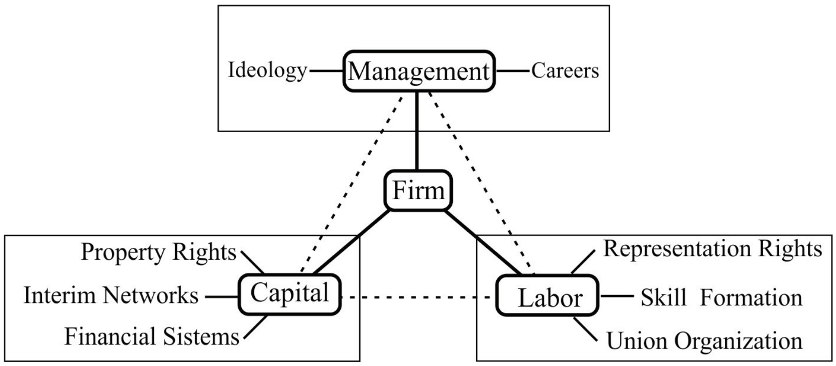


Source: Ibid.

For institutionalists, corporate governance concerns *„the structure of rights and responsibilities among the parties with a stake in the firm*" (Aoki, 2000, p. 11). From the viewpoint of comparative institutional analysis employing game theory, corporate governance is seen as *„self-enforcing mechanisms that govern (such) strategic interactions among the players*" and is defined as *„a set of self-enforceable rules (formal or informal) that regulates the contingent action choices of the stakeholders (investors, workers, and managers) in the corporate organization domain*" (Aoki 2001, p. 281).

An approach Aguilera and Jackson (2003) which emerged from institutional theory is „actor-centered institutionalism", which explains firm-level corporate governance practices in terms of institutional factors that shape how actors' interests are defined and represented. They describe corporate governance and the institutional domains shaping it as having three dimensions - management, capital and labor (Figure 3).

Figure 3: Institutional Domains Shaping Corporate Governance



Source: Aguilera & Jackson, 2003.

The stronger movement for socially responsible corporate governance has started in the late 20th and early 21st century which includes the protection of the interests of all institutional actors and all institutional levels of corporate governance.

In the introductory part of the *Principles of Corporate Governance* (OECD, 2004, p 9), the emphasis is put on the importance of the legal, institutional and regulatory framework for corporate governance: *„It provides guidance and suggestions for stock markets, investors, corporations and other stakeholders in the process of developing good c. g.*" ... The pluralistic economic institutional framework it is impossible to make corporate management become the *„synergy between macroeconomic and structural policies in achieving basic objectives of development policy ... and a key element in improving economic efficiency and growth as well as increasing of confidence of investors ... and the level of trust necessary for proper functioning of the market economy*".

New Institutional Economics (NIE) it is a multilevel concept, which means that institutions can be defined at the level of macro-conditions, markets, at the firms. NIE is concerned with the choice of a governance structure of economic actors under a given institutional environment, as well as with the effects that various institutional environments have on economic performance and development, and the change of these environments over time (Draskovic, and Stjepcevic, 2012, p. 28).

The NIE of studying organizations has been informed by themes of control and coordination that fall within the domain of corporate governance, which broad definition is exploring the implicit and explicit relationships between the corporation and its constituents. The NIE of North and Williamson have offered frameworks regarding the role of institutions in c. g. that are rooted in a rational actor model of the corporation. North argues that a national system of c. g. may be seen as an institutional matrix that provides both the roles to the players and the goals to be pursued by the corporation. Williamson acknowledges the embeddedness of c. g. arrangements in larger, society-wide systems of institutions (according to: Fiss, 2008, pp. 389-390).

Institutions, whether formal and/or informal, create a governance structure at different levels of interaction within an economy. One important level of interaction is the corporate. Discussions about the nature of the institutional setting at the corporate level, have recently received much attention in both academic and policy making circles. According to many authors, specific institutional frameworks should be in place in order to be able to support a strong c. g. framework.

Zingales (1997, p. 3) defines c. g. as "the complex set of constraints that shape the ex-post bargaining over the quasi-rents generated in the course of a relationship". These constraints are largely determined by the institutional setting, which may influence contracting relationships between various parties (Postma, Hermes, 2002, p. 3). Dixit (2009, p. 5) considers that the economics institutions are conducive to good c. g. In opinion V. Nee (2003, p. 26) the institutional environment presents the formal regulatory rules monitored and enforced by the state that govern property rights, markets and firms. It imposes constraints on firms through market mechanisms and state regulation, thus shaping the incentives structure.

3. THE INSTITUTIONAL FRAMEWORK OF CORPORATE GOVERNANCE AND CRS

It is not disputable that the power of corporations grew out of the exploitation of social resources. In economic jargon, this means that the Pareto optimum is not being respected, as the private interest is being forced to the detriment of the public interest. The former is possible only in conditions of fiasco of social and economic institutions. The establishment of an institutional framework and its appliance is a prerequisite for CSR. Because many „morbid" disorders of corporations are evident, relating to

a) indifference to the feelings of others,
b) inability to maintain stable and enduring social relationships,
c) indifference regarding the safety of others and
d) dishonesty (repeated lies and deception of consumers, the society etc.).

Whether CSR category may be more a necessity or is it the result of consciousness and notions of responsibility and ethics, or be subject to strict institutional changes (orders)? It seems that for the salvation of the planet and of humanity, the third variant must be imperative for the sustainable development. In the part relating to the principles of CSR, in addition to general views, seven principles have been set out in detail: accountability, transparency, ethical behavior, respect for stakeholder interests, and respect for the rule of law, respect for international norms of behavior and respect for human rights. These principles are not a substitute for legal obligations arising from the *„rule of law*". They serve as „helpers" to give responsibility a moral component in addition to legal.

With this very statement, one enters the institutional zone, which generates the behavior of all participants of economic activities and their relationships. Because they are implemented within the constraints, which are conditioned by the institutional structure of society and which narrow the field of individual and corporate choices. Effective institutional environment is able to reduce the negative consequences of opportunistic behavior of corporations, because its basic element - the norm, is understood as a rule of conduct and / or an obligation, generating the penalties for non-compliance. The norm is based on the principle of obligingness and as such represents a complete opposite of the voluntary principle, which characterizes CSR.

C. g. is the set of processes, customs, policies, laws and institutions affecting the way in which a corporation is directed, administered or controlled (Tchouassi, Nosseyamba, 2011, p. 198). C. g. institutions are those that determine the playing field of internal and external stakeholders in the firm. Corporate governance can be considered as a form of institutional design. These institutions are mainly path-dependent (historically determined) and mostly determined by the institutional context. C. g. contains both internal and external control relationships. Relationships between the internal and external control mechanisms reflect the interplay between internal institutions and external forces (notably policy, legal, regulatory, and market forces).

Next to the above mentioned control relationships, which are generally more formal in character, there may be informal institutions that play a role in c. g. They may be firm specific norms and values, management ethos and codes of conduct in business, as well as more general norms and values existing in society at large, self-regulation within a certain industry, and the reputation of a firm in its relations with its competitors, suppliers and customers. C. g. institutions are aimed at supplementing formal contracts between different stakeholders.

Table 1: Internal and external corporate governance institutions

Institutions	*Internal control*	*External control*
Formal	Supervisory board; Management team; Shareholders; Workers council; Guidelines and authority relations.	Competition authorities; Laws on, *e.g.,* property rights, bankruptcy and insolvency procedures, and rules regulating enforcement; Exchange rules (stock exchange); Accounting standards, and auditing and disclosure principles; Reputational agents (financial analysts, accountants, and the like); Institutional organizations like Central Banks, OECD, World Bank, EBRD.
Informal	Firm specific norms and values; Managerial ethos; Codes of conduct	Self-regulation in a sector; Reputation (trust); Societal norms and values.

Source: Postma, Hermes, 2002, p. 5

4. TRANSITIONAL BRAKES OF CORPORATE GOVERNANCE

According to the WEF's *Global Competitiveness Index* 2011-2012, which covers 142 economies of the world, all members of the former Yugoslavia take fairly low places(from 57-100). According to selected institutional indicators, related to c.g., the situation is also unfavorable. Basically they have in common the following problems: unstable and non-transparent institutional framework, insufficient knowledge, a high degree of ownership concentration, the possibility of expropriation of small shareholders, underdeveloped capital markets, short business practice, the agency problem between the majority owners (shareholders) and minority owners (shareholders), unprofessional management and the gap between formal regulations and substantive practical application of regulations and institutional arrangements.

In most transition economies, there was no „creative destruction“ in are of economic institutions, but there was the inconsistent, non-transparent, interest-motivated quasi-monist improvisation. It has caused a lot of confusion and negative consequences. Some interest-oriented alibi-economists (alibi-reformers) rhetorically substitute institutions by quasi-institutions, replacing the thesis. Therefore, the retrograde transition processes and corporate governance deficit is blamed by *„populists and nostalgics of the previous system.*“ Searching for the causes of the crisis and the transition of corporate governance out of institutional area does not make sense. Some individuals ignore clear distinction between some real economic institutions and their quasi-substitutes (eg market and distorted market structure, competition and monopoly privileges, conditions for mass entrepreneurship and individual pseudo-entrepreneurship, mass unemployment and individual overwork, regular business and non-market wealth, freedom and captivity, and full-blooded market, corporate governance and management of informal groups, etc).

The alleged commitment of some economists- reformer of (neo) liberalism, is not in compliance with their non-market monopolistic preferences, anti-institutional arrangements and non-market acquired wealth. Transparent sheath this sort of individualism is highly interest-oriented and limited to a narrow layer of privileged individuals. Reduction of the individual basis of social development has become a permanent and negative sign on the way into the present and future crisis. Institutionalized individualism of all (and not just the privileged) means freedom of choice for all. Only it can be a basis for the healthy entrepreneurship development, corporate governance and ownership efficiency.

Practice has proved that the annuity oriented behavior, the gray economy, „good players“ and their „relationship“ simply substitute the institutional and corporate behavior. It has been the way that shareholders lose their shares and dividends instead of corporate governance. Inconsistent and destructive institutional imitation and improvisation are directly affected on equality of conditions in the acquisition of private property, competition, distribution of wealth, etc.

Specific institutional braking mechanism can be described as a quasi-institutional monism. Market regulation (generated in neo-institutional economic policy) actually does not work even close to the real capacity, but in reduced various forms of substitution and deformed structures, which are under the direct influence of informal and alternative institutions. In such a reducing macroeconomic conditions is not possible to establish a favorable environment for microeconomic effects of corporate governance. Quasi-institutional have blocked principles proclaimed monism market (competition, efficient owners, private business as a mass categories, etc.) as well as innovation processes, knowledge, economic restructuring, etc. The result is *guild capitalism* (Berglöf and E. von Thadden, 1999) in which the usual private firms are favored by political figures.

This eliminates the possibility of the formation of corporate governance. Subjective regulators ignore the institutional norms of behavior. Perverted and reduced individualism arises as a civilization and a social norm. All real institutional concepts are blocked and modified by various political decisions and by interests of the *„reform creators*.“ In this way they block corporate governance, the creation of competitive practices and competencies, economic growth and development.

Quasi-neoliberal economics has shown that ignoring corporate governance, through the creation and operation of strong linkages between firms, banks and state-party authority, to giving selectively loans on very favorable terms and to privileged companies, giving a number of projects to the same individuals, expands business based on asymmetric information, the artificial devaluation of property, inflationary credit, market monopoly and corruption.

C. g. in most countries of the former Yugoslavia began to form in parallel with the privatization process, which allowed the increase of property. All attempts to improve the business environment for the improvement of c. g. have not led to satisfactory results. They have not followed the modernization of company legislature aimed at strengthening the rights of shareholders. Why? Because in the real institutional framework, numerous forms of quasi-institutional, alternative and informal substitutes existed and functioned, which objectively significantly affected the compliance with the strict rules of the game and constrained the development of c. g. It is in observed transition countries should be based on four basic principles: fairness, transparency, management responsibility to the owners and responsibility of the company before the surroundings. However, already at the first step, the ownership transformation led to the breach of mentioned principles. Privatization does not only stand for the transfer of property rights from the state to private investors, but also a change of control and management in enterprises, protection and specification of property rights, increase of enterprise efficiency etc. Obviously, the consistent application of the principles of c. g. requires a long process, in which the legislation will be changed, as well as business practices, business standards and ethics, etiquette, etc.

The main problems of c. g. in the considered countries are: abuse of shareholders' rights, non-transparent ownership structures, direct connection between control and property, inadequate and inexperienced corporate bodies and minimizing the value of the shares of minority shareholders.

5. CONCLUSION

Specifics of particular models of c. g. and appropriate CSR are predominantly conditioned by the character of relations between the two environments - corporate (voluntary, based on market laws) and institutional (binding, based on the regulations and standards). It can be assumed that in the future all models of CSR that prefer sustainable development will be increasingly leaving the first zone and accept the rules of another environment.

Our analysis has confirmed the initial hypothesis that CSR gradually changes, but its position is still at the relation between rhetoric and willingness, it is far from institutional obligation. In order to move CSR from zone of voluntarism to the zone of obligation, it is necessary to institutionally define and achieve a balance between economic, environmental and social imperatives. If this really happens, then Toffler's „adaptive corporations” will indeed have to change and adapt, in the interest of sustainable development.

Too many institutional factors (ownership, control, institutional investors, laws, standards, instruments of economic policy, etc.) are involved in the activities of the corporations for a such important and propulsive area such as institutional conditions, which constitute the institutional environment, to be left to the principle of voluntarism. Since the escalation of environmental and economic problems is increasingly emphasizing the issue of sustainable development, it is clear that the output is to be sought in the application of mandatory limiters which are called the institutions.

A new model of economic growth and sustainable development, in addition to forcing intellectual (high-tech and innovation) and environmental (clean technology, new energy sources) components must be based on institutional pluralism as a general development framework and advanced corporate governance, which includes a networked partnership cooperation and consistent application of all its fundamental principles in business. The synergy of these components is a rational response to the challenges of the crisis.

C. g. as a way of managing the corporations has not yet been affirmed in many transition economies. In underdeveloped and / or insufficiently developed institutional environment that exists in most of the transition countries the significant development of c. g. as an important element of building the microeconomic environment is not possible. In conditions of institutional protection of business and knowledge, the protection of shareholders and investors, which should be provided by c. g., is not possible.

The basic institutional foundations of c. g. (state, market and ownership regulation) in observed transition states were unstable. They broke under the weight of numerous social – pathological changes. Fixing these foundations is a prerequisite for the development of effective c. g., and sustainable economic and social development.

The market model of corporate governance per se is exposed to different institutional and corporate influence factors. In the future, we must find an appropriate model to satisfy the terms of a conflict of interest and corporate and institutional factors, as a condition for sustainable development.

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