The Possibilities of Positive Use of Residual Control and Income Rights of Stakeholders in the Corporation

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Abstract

This paper presents the development of stakeholder approach towards the study of modern corporation. Based on the understanding of the corporation as an institutionally autonomous form and of material production in the current economy, as well as based on the traditional stakeholder approach and on the theory of corporate social responsibility, a hypothesis about the need of existence of residual rights of control or income for all corporative actors was formulated. In support of the hypothesis a few case studies are presented.

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1. Introduction

Almost two decades after the introduction of market principles of economic management in Russia and joint stock corporation as a special form of organization of material production, it is clear that the result is far from "projected" in legislation, and from the abstract model of the "effective corporation". The first is due to initially unrealistic benchmark of U.S. corporation operating in different institutional settings and being a product of evolution in its quite specific circumstances. It is obvious that the existing corporation in Russia today is of a different kind, in spite of the rule of law and formal existence of institutions necessary for American model (the stock market, the institution of bankruptcy). In the second case we can talk about the absence of an adequate theoretical framework that would allow to "construct" the desired image of the corporation. Traditional theories of
the corporation considering the issues of corporate governance and capitalization are particularly reflecting the level of symptoms rather than causes. And so far the agreement about the basis on which to build a modern corporation (or more widely an organized material production in general) has not been reached in the world of science.

Corporation acts as an institutionally autonomous form of organization of material production (Pletnev, 2010). Such understanding of a corporation allows to focus on the essential aspects of economic relations arising in it. At the same time, the modern corporation is a complex subject structure. It is formed by two "zones" of internal and external actors. Internal agents are the "inner circle": employees, managers and owners, and external are society, government, investors, suppliers, customers and competitors (Fig. 1). Corporation is multisubject, and recognition of it is an important step towards the establishment of a workable theory of the corporation, which will take into account the divergent interests of the subjects.

Fig. 1. Subjects of the corporation

The study of a multisubject corporation in modern economics is "executed" in the form of two competing approaches: stakeholder theory and the theory of corporate social responsibility. The first approach is reflected in numerous works (Freeman, 1984, Freeman, Wicks and Parmar, 2004, Donaldson and Preston, 1995, Asher, Mahoney and Mahoney, 2005, Post, Preston and Sachs, 2002a, 2002b, Health and Norman, 2004, Morteza Ghayour and Doaei, 2012, Tambovtsev, 2008). The main achievements of the members of this theory are reduced to the justification of the need to consider divergent interests of the corporation entities in the study of its behavior (R. Freeman), the justification of the presence in the corporation (i.e., its owners) of long-term benefits from following the interests of its stakeholders (T. Donaldson and L. Preston), hypothesizing about the need to consider the interest of stakeholders as compensation for behavioral opportunism, asset specificity and high uncertainty (K. Usher, J.M. Mahoney and J.T. Mahoney). In the development of this approach J. Post, L. Preston and S. Sachs offered to consider a system of relations of corporation with its stakeholders as an important particular asset, one of its key resources that can generate income.
An alternative approach is the theory of corporate social responsibility, as represented by the work of many scholars (Bowen, 1953, McGuire,1963, Sethi, 1975, Frederick, 1978, 1986, Вуд, 2009, Epstein, 1987, Благов, 2011). The focus of this approach is on the representatives of the corporation as a kind of "integrity", as an active, living organism, a part of society that has both rights and responsibilities before it.

Thus, different versions of the theory of corporate social responsibility show the presence of a broad front of discussions on how the corporation and the community interact, the diversity of views and the lack of consensus on what should the optimum level and the optimal form of corporate social responsibility be. However, the disadvantage of this approach is unmotivated "multiplication of entities", in which it is very difficult to distinguish the true, positive knowledge of the ways of expressing the "left" populist mindsets.

Comparing stakeholder theory and the theory of corporate social responsibility we can say that in the first case there is a development of the individualist paradigm, while in the second it is a holistic approach to the corporation. However, both in its assumptions and in the main findings the two theories show rare solidarity: the corporation must be regarded as a multisubject "object" as a "multi-purpose" system in which the individual goals of the subjects are transformed and line up in a certain co-directional "front". Such a cognitive frame is perspective for research of corporation, and can be the basis for a kind of convergence of stakeholder approach and the theory of corporate social responsibility.

One of the most important research problems in the further study of the corporation and rooting it in scientific knowledge of the cognitive framework should be to find the specific tools to operationalize it, make it more comfortable in applied research. And for solution of this task one can use an approach based on the allocation of residual control rights and income (proposed by K. Usher, J.M. Mahoney and J.T. Mahoney), modified with the changes in the objective function of the subjects and the recognition of the non-uniqueness of the individual interest among the motives of human action.

2. Residual rights of control and income of corporate entities

In any corporation along with the formal system of allocation of rights to benefits and management specific rules for the distribution of income and residual rights of control operate. Each type of entity seeks to acquire and preserve these residual rights, for what it is involved in the formation of its institutional environment, nourishes it, identifies new and improves existing ones, thereby affecting its stability, activity and efficacy.

Under the residual rights of income it is proposed to understand the recognized by corporate entities forms of appropriation of the added value of the corporation, not recorded in the formal contract between them, and sometimes directly contradicting them. In fact, the residual rights of income can be seen as a stable "delta" between clearly defined outcomes of contract interaction of entities and actual results. Residual control rights are the informal right to assignment of the functions of management of the corporation by a certain entity in excess to those specified in the contracts. Using the terminology of the agent approach, we can say that the residual rights of control are the ability of the subject to actually "be" the principal to the extent greater than it is provided for a system of existing contracts. Residual control rights and income are a successful description of the form of "force" that binds the heterogeneous entities, directing their activities towards a common goal – the corporation goal.

Also important is the following consequence of the fact that we recognize the existence of the corporation residual control rights and income in all entities: a unique "general" income and residual rights of control appear. In connection with these rights the entities constantly have a conflict among themselves which solution is the basis of the corporation. Metaphorically speaking, the competition for a "piece of cake" leads to the fact that efforts are made to increase this same cake, and everyone gets what counted (Fig. 1). Thus, the presence of so-called 'grey' areas in the distribution of rights in a corporation becomes, in the long term, the factor of entities welfare growth.
However, a significant proportion of the residual rights in the corporation could destabilize the structure, when the conflict of entities comes to the fore, and its solution in of the personal benefit becomes an aim in itself, to the detriment of the corporation goal. The basic idea, which follows from the author's understanding of the residual rights, is that in the system of allocation of rights between the entities of the corporation there must be a kind of "gap", which also will serve as a force of attraction between the entities.

Let us consider the ways of implementation of different types of residual rights of entities in the Russian corporation. Let us start with the internal entities. The owner outputs profits and assets into controlled by himself personally companies (residual income right) and interferes with the operational management of the corporation (the residual right of control). For the Russian corporations combination of the owner and the manager in a "physical" entity is characteristic, which determines the multiplier effect in assigning by him of the residual income and control rights, including the complete alienation of any kind of rights of other entities through the elimination of production complexes and the withdrawal of the capital abroad. The manager implements excess management expenses and extracts insider rents from the corporation (residual income right), he can implement discretionary behavior that does not match owners’ goals (residual right of control). The employee can show behavioral opportunism in its various forms - shirking, negligence - thereby indirectly implementing the residual income right and influencing the behavior of the corporation through trade union activities (residual right of control). In addition, the employee may indirectly "control" the various processes in the corporation, using their informational advantage by passing "up" the information he needs. Also, there is a positive consequence of the possibility of residual rights of control for the employee. It is a question of power delegation, expansion of area of responsibility of the performer, and more - about the possibility of creative work in a corporation. The increasing complexity of forms of work, their non-routine nature of the modern corporation determines the need for loosening of control in favor of trust and delegation.

Let us define the characteristics of the rights of external entities. The government can use the corporation for political purposes, including international (residual right of control). In addition, with the use of legislation imperfections (including tax), the government may implement residual income right. The society expects (and often gets) a corporation financing social projects (residual income right), and complying with environmental and "sanitary" demands in excess of the required minimum (for example, non-use of GMOs in food production), exercising their right of residual control. Regular supplier acquires the right to prepay (residual income right) and the right to review the terms of the transaction during its execution (the residual right of control). A loyal customer has the right to discounts and bonuses (residual income right) and the right to an individual approach (residual right control right).
of control). The investor (for example, a credit institution) has the right to use the maximum of its services, to loyalty of the corporation to the investor (the residual right of income). Competitor expects the corporation to refuse from price competition (residual income right) and the right to an implicit collusion, a kind of "non-aggression pact" (residual right of control).

As a result, the corporation is formed in the economy as a system that "meets expectations" when its activity not only facilitates the distribution of revenue from manufactured product, but also forms an institutional environment that "supports" the corporation, regardless of its behavior "in the moment". Thus, the corporation becomes stable, rooted in the economic system and able to transform the expected income and control rights into real ones (Table 1).

The presented table can be considered as a way to explain the stability of the corporation in which each entity is "interested" because it received (or expects to receive) more than it "should" in formal contract. In the modern corporation, each corporation entity is "connected" to it by a system of its real or potential benefits of the use of residual rights.

Table 1

| Corporation entities in the context of used ways of realization of residual rights | Entity | Main rights | Way of realization of residual right of: | Income | Control |
|---|---|---|---|---|---|
| Owner | Ownership, governance, income, capital, inheritance, perpetuity | Profit and assets withdrawal | Interference in the operational management |
| Manager | Governance, income «Consumption in the workplace», excess management expenses, insider rent | Discretionary behavior that does not correspond to the goals of shareholders |
| Employee | Use (of corporation assets), income Opportunism, shirking | Activities of trade unions, freedom of operational decision-making |
| Government | Penalty charge, income Tax additional charges | Use for political purposes, including "International" |
| Society | Prohibition of harmful use Financing of social projects by corporation | Adherence to ethical and environmental standards in excess of the minimum, the boycott of corporation production in the case of public interest violation |
| Customer | Use (of corporation production) Discounts and bonuses right | An individual approach right |
| Supplier | Income Deferred payment right | The right to revise the terms of delivery in the process of the transaction performance |
| Investor | Penalty charge Loyalty | |
| Competitor | Prohibition of harmful use Rejection of price competition | The coordinated behavior right |
3. Cases of distribution of residual rights in corporations

Not to be unfounded, we present several case studies that confirm the legitimacy of the proposed approach. Firstly, the residual rights of income and control of the public corporation owner are easy to observe in the process of sale of large blocks of shares when the transaction price is higher than the market price. In this case we speak of a "control premium" (Rodionov, Perevalova, 2011), but, in fact, it is a question of assessing the residual rights that the controlling shareholder has more than that of the minority. According to the experts (Zhiglo, Ustimenko, Stekolschikova) in Russia for the blocks of shares from 25% the premium amount was rarely less than 30% of the market price, and in some cases was more than 100%.

The second case – an ordinary construction company "X", in which the head of the supply department (managing entity) has residual rights of control (choice of supplier, amount and timing of delivery) and income in the form of "kickbacks" from suppliers. And those rights he successfully implements, since he has the advantage of information both over CEO and the owners. However, for the corporation such "opportunistic" behavior of the supply agent may be advantageous in that case if the latter is concerned in the long term stability of the corporation, in its stable operation. If so, then the supplier will provide an uninterrupted supply of materials of required quality, minimize storage costs, as it will "disguise" the private benefits they receive. That is what has been happening in the company "X" for about 3 years. But then the director, under the pressure of facts filed valid claims to the supplier on all counts. The supplier quit by going to the competitors at the same position. As a result, the total logistic costs have increased: the supply disruptions and quality problems started, the counterparties have changed, and the contract price became higher. And today, the director has reasonable doubt that, in time, the new supplier would also be actively using his residual rights. The obvious question is how feasible was to fight with those rights, if as a result the costs of the corporation only increased and the initial problem was unsolved.

The third case is the development of modern "brandonomics" (Frolov), which is based on the total persuasion of consumers as the corporation entities in that they get more value than pay for it (although in reality it is far from it). For example, the products under the brands of the company «Coca-cola» are sold at a premium of 80% relatively to "generic" analogues. In the process of selling a product secondary relationship of the corporation and consumers yield associated with participation in contests, raffles, promotions, receiving gifts, etc. In fact, there is a formation of residual income rights of the consumer at the expense of the consumer. And the realization of these rights, on the one hand, "binds" the consumer to the corporation, and on the other – allows the corporations to benefit from the increased consumption of their products.

4. Conclusion

Thus, the residual rights of income and control, their theoretical understanding and empirical evaluation is an important area for further research in the mainstream of stakeholder approach. Empowering each entity the right to have residual rights of income and control is an important theoretical and methodological step that will enrich the modern theory of the corporation and may have a wide range of applications in empirical studies of real companies.

However, even at the initial examination of this problem it is obvious that there are difficulties that may be encountered. Thus, as much as measurable and calculable these residual rights are, as accurate is their assessment and as it will be correctly interpreted by actors. It is quite a probable scenario where the owner, seeing the real distribution rights, simply reduces the "formal" law (in the form of wages) for the amount of the residual rights of the worker. How ready is the business environment to admit that the corporation is multisubject and its entities are equal? The future of the proposed approach largely depends on the answer to this question.

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