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Towards a More 'Ethically Correct' Governance for Economic Sustainability

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Abstract In this paper, we propose that economic sustainability is seen in terms of (inter-temporal and international) value creation. We claim that value appropriation (or capture), can become a constraint to economic sustainability. We propose that for sustainable value creation to be fostered, corporate governance needs to be aligned to public and supra-national governance. In order to achieve this, a hierarchically layered set of 'agencies', needs to be diagnosed and the issue of incentive alignment addressed. Enlightened self-interest, pluralism and diversity, as well as a representative supra-national organisation for world-wide economic sustainability can serve as a new, more 'ethically correct' governance for economic sustainability, but not a panacea.

Keywords Governance · Economic sustainability · Agency · Value creation and capture

Introduction

The aim of this article is to discuss the nature and foundations of a more 'ethically correct' governance for economic sustainability, namely one which is not based on the blind pursuit of narrow, short term, sectional, self-interest. We approximate economic sustainability with the sustainability of economic value creation and discuss the impact of value appropriation-capture on the sustainability of value creation. We explore the relationship between governance and economic sustainability. We suggest that corporate governance should be aligned with public and supra-national governance, in a way that addresses a number of hierarchically layered 'agencies', not merely the 'agency' between owners and managers. We propose institutional and policy configurations that help foster world-wide economic sustainability, and point to the daunting challenge of achieving it.

In terms of structure, the second section briefly revisits debates on corporate governance and 'shareholder value'. The third section analyses the nature of sustainability and value creation and capture, and the relationship between strategies for value capture and economic sustainability. The fourth section diagnoses and pays attention to a set of more complex, hierarchically layered agencies, than usually acknowledged, and the challenge of incentive alignment in their context. It then goes on to propose a new model of governance for world-wide sustainable value creation, which is more 'ethically correct' than extant ones, and discuss its limitations. The final section has concluding remarks.

Corporate Governance and (Share-Stakeholder) Value

Extant economic debates on corporate governance emphasise the need for incentive alignment between shareholders and managers, in the context of a separation of ownership from management and/or control (Jensen and Meckling 1976). Management-oriented theories, such as 'stakeholder' and 'stewardship' theories (see Clarke 2004, 2007; Klein et al. 2012), have dealt with a broader set of issues, as well as multiple stakeholders. Both sets of theories under—conceptualise the important issue of value and value-creation, which is necessary for the very definition of shareholder, or stakeholder value. We aim address this limitation below.

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The transaction costs and resource-capability-based theories of the firm (Coase 1937; Penrose 1959; Teece et al. 1997), can help explain value generation by firms, by emphasising efficiencies in transaction and production costs and revenues, respectively, but cannot explain a focus on the pursuit of *shareholder* value. The focus on shareholder value, has been justified in terms of theories such as Alchian and Demsetz (1972). The authors observed that in any team effort, where individual output is hard to measure, team members may 'shirk'. Avoiding this requires a monitor, who should also be self-monitored (so as to avoid the infinite regress problem of 'who monitors the monitor'). This can be achieved by the monitor becoming a residual claimant of profits, thereby being incentivised to eliminate inefficiencies. Owners (shareholders) are best suited for this purpose, as they have invested in firm-specific assets. Therefore shareholder value is critical. It can be prejudiced by the pursuit of other than profit, managerial objectives, such as sales revenue, discretionary expenditures and non-profit maximising growth. This makes important the need to align incentives between owner-shareholders and managers. Subsequent contributions by Grossman and Hart (1986), Hart and Moore (1990), provided support to the shareholder value maximisation idea, by showing that, under certain, rather restrictive, assumptions, maximising shareholder value equals the maximisation of the net present value (NPV) of the corporation as a whole, see Klein et al. (2012).

The separation of ownership from management has been analysed by Berle and Means (1932), who claimed that this ultimately can imply a separation of ownership from control, with control residing with professional management. Jensen and Meckling (1976) discussed the 'agency' between owners and management and the need to align their interests. Both ideas, namely that owners should be the residual claimants, and that of a separation of ownership from control, are dubious (Pitelis 2004; Klein et al. 2012). Indicatively, workers and other stakeholders also invest in firm-specific assets, while in knowledge-based activities, knowledge workers are more likely to be self-monitored.

One problem with the separation of ownership from control idea, concerns its empirical validity. This depends on questions such as what ownership percentage suffices to give control to a cohesive group, how can we identify such groups, to what extent does dispersion of ownership imply that a lower share- ownership percentage can suffice for owners' control to be achieved. Such and related considerations raised doubts on the importance and extent of management control (Scott 1986; Pitelis and Sugden 1986). Additional problems refer to constraints managers face in pursuing their aims, such as the market for corporate control (Manne 1965), the market for managerial compensation (Fama 1980), monitoring and bonding by shareholders and debt-holders, the M-form organisation (Williamson 1991), and concentrated institutional shareholdings by pension fund managers, etc. (Pitelis 1991). All these suggest that there may be sufficient reasons to believe that managers' interests will tend to be closely aligned with those of the larger shareholders, hence a focus on a corporate 'controlling group' that comprises top management and large shareholders, could better approximate the issue of who controls today's big corporation (Pitelis and Sugden 1986, Pitelis 1987). This is critical for an appreciation of the types of agencies involved and their importance, see below.

We conclude that the focus on 'agency' between 'owners' and 'managers' is narrow. In particular, the 'agency' between 'employers' and 'employees', which was critical in Alchian and Demsetz, and at the heart of Coase's (1937) transaction cost theory, has been all but forgotten. This is likely to be more important than the agency between owners and managers, given the more sharply divergent objectives between employers (high profits) and employees (high wages), that can engender intra-firm struggles (Marx 1959; Cyert and March 1963; Pitelis 2007). Given extensive discussions on the importance of human resources, and their relationship for value-creation, in economics and management (see, for example Pfeffer 1998, 2010, and Becker and Huselid 2006), this is unsatisfactory.

In addition to the above, the link between corporate governance and shareholder value is predicated on the assumption of the objective of profit maximisation by all owners-shareholders (including small shareholders through for example their pension funds, who are sometimes even unaware if and where their funds are invested), and who are assumed to be residual claimants, as well as the rather heroic assumption that this is reflected in sustainable share price and dividend growth (Pitelis 2004; Lazonick and O'Sullivan 2010).

It is therefore important to revisit the issue of 'agency' and the debate on shareholder and stakeholder's value. In a recent paper Klein et al. (2012), for example, suggest that contributions by Rajan and Zingales (1998) and Blair and Stout (1999), question the shareholder supremacy perspective and point to the possibility of a third party (the Board), functioning as a guardian of the wider corporate interest, as opposed to interests of particular groups such as the shareholders, so as to ensure continuing investments by co-specialised and complementary human resources-stakeholders. Porter and Kramer (2011) proposed that we focus on shared value, as opposed to shareholder value.

It is arguable, that a major limitation in literature concerns the lack of satisfactory theory of sustainable, inter-temporal value creation, and its relationship to value capture. We focus on these below.

Sustainability and Value

The Nature of Sustainability

In recent years sustainability has become central to the discourse and practice of organisations (Hunt 2011), and nations (Boulouta and Pitelis 2013). The recent financial, economic and institutional crisis added urgency to the issue of the nature and determinants of economic sustainability. It is now widely acknowledged that some business and regulatory practices were paying more attention to narrow self-interest, and short-run returns, without adequate regard to the sustainability of such returns and economic performance as a whole (Epstein 2008; Hart and Zingales 2010). This renders the analysis of the nature and constraints to economic sustainability topical, important and urgent.

Sustainability is usually taken to refer to the 'triple bottom line', namely environmental, social and financial/economic (Savitz and Weber 2006; Boulouta and Pitelis 2013). The most commonly used definition of sustainability is that of UNWCED (1987, p. 8), that focuses on 'sustainable development'. This is development that "meets the needs of the present without compromising the ability of future generations to meet their own needs."

There are limitations of the UN definition. By focusing on intergenerational 'needs', it begs the question whether sustainability can be attainable by merely monitoring the needs of future (not just present) generations. This surely is not the intention, raising doubts on the wisdom of referring to 'needs' in general, and across generations, in particular.[1]

In addition, sustainability need not necessarily be linked to an objective such as 'development'. Ideally the term should be defined in its own right (be generic) and then be applied to particular cases.[2]

In the above context, a more tractable definition proposed here, views 'sustainability' as the condition under which the satisfaction of a particular objective by economic agents in the short term, is not pernicious to the satisfaction of the same objective in the longer term, and/or when the satisfaction of the objective of an economic agent does not prejudice the satisfaction of the objectives of other economic agents.

An example of non-sustainable practices in terms of the aforementioned definition could involve an agribusiness corporation that pursues profits by overusing, hence spoiling, the fertility of the soil, thereby compromising its ability to keep making profits in future. In the context of wider social sustainability, the same corporation that in the short run makes profits by being a 'sweatshop', might fail to achieve its own purposes in future, if its employees move to other companies, strike, reduce their productivity, etc. Concerning economic sustainability, the focus of the company in question on 'exploitation' at the expense of 'exploration' (March 1991), for example, may lead to its eventual failure, as a result of the appearance of disruptive, more innovative competitors.

Non-sustainability becomes more complex when one focuses on the impact of one's actions on her 'peer group', namely others who share similar (or same) objectives, or activities. For example, in the aforementioned case, non-sustainability would involve the corporation in question over-exploiting the environment, in ways pernicious to its competitors and complementors in the sector (environmental non-sustainability), employing restrictive practices, which stymie competition and innovation and can damage the reputation of the sector to customers, who may shift to other sectors (economic non-sustainability), and/or exploiting employees, who can strike or revolt (social non-sustainability).[3]

It is widely accepted in strategic management (SM), that the objective of firms is to obtain sustainable competitive advantage (SCA). Conceptual perspectives, such as reduction of rivalry-'positioning' (Porter 1980), transaction costs (Williamson 1975, 1985), resource-based (Penrose 1959; Barney 1991), evolutionary (Nelson and Winter 1982), and/or (dynamic) capabilities-based (Teece et al. 1997), provide reasons and prescriptions on how SCA can be achieved. However, without exception, the 'S' (sustainable), in SCA is limited to the sustainability of the advantage vis-à-vis one's 'competitors', and without much regard to wider sustainability issues—such as environmental, social or economic—intra-nationally, let alone inter-nationally. This is not surprising, if strategy is taken to be about outperforming 'rivals'. However, unless wider

[1] If we assume that 'needs' remain the same across generations (which is rather heroic), then allowance should be made for projected increases in populations. This should involve the current generations also factoring into their needs and actions, the projected impact of anticipated population changes. This is a challenge.

[2] For example, the *Concise Oxford Dictionary* defines 'sustainable' as "able to be sustained", "sustain" as "keep (something) going over time or continuously". This is generic and useful in emphasizing inter-temporal and continuity dimensions. On the other hand, it does not serve the purpose of tractability and operationalisability—two useful properties when conducting scholarly analysis.

[3] Even more complex is the situation that allows for differing objectives by economic agents. For example an agribusiness corporation is interested in expanding its activities, in an area where the inhabitants would rather keep 'undeveloped', but more 'habitable'. In order to avoid making the issue intractable, one would need to at the very least refer to 'legal' and/or 'legitimate' objectives. This would raise the question of who is to judge this. Limiting one's focus to 'legal' only can helpful, in that in most modern economies, there exists a body of law and a legal system that aims to define and enforce property and other rights. Recent complaints against 'cleptocratic' political elites, would point to limitations here too, one, however, needs to draw the line, so as the analysis can proceed. Our line here is to focus 'legal' objectives, see Clegg and Haugaard (2009) for more.

sustainability issues are considered, the word 'sustainable' in SCA becomes suspect, or only applicable in the short term. We develop this argument below.

Returning to our focus here on economic sustainability, the critical question is sustainability of what? The 'sustainability of development' concept adopted by the UN is too broad and contested. The debate in development and growth economics, concerning the definition of development, its relationship to growth, the means of measurement, etc., is endless (see, for example Frynas 2008; Todaro and Smith 2009). Indicatively, do we refer to sustainability of development in terms of GDP per capita, or the Human Development Index (HDI), or another index, and are the above leading to the same results? Arguably not, as otherwise alternative measure would not (need to) be devised to start with. But if so, how do we measure sustainable development?

It is arguable that a more generic, history and theory-founded, and potentially operationalisable, concept is that of inter-temporal and inter-national value creation, or put differently sustainable world-wide value creation. This differs from the economic focus on Pareto efficiency, defined as a condition where one cannot be made better off without someone else becoming worse off, as a result of a change (Varian 1992). The last mentioned is intra-national focused and ignores distributional inequities. Today, these have become pervasive enough to be considered by many scholars as a major contributor to the current crisis (Argitis and Pitelis 2006; Stiglitz 2012). The focus on sustainable world-wide value creation avoids both these limitations and arguably provides a better benchmark for business ethics scholarship (Mahoney et al. 2009).[4] We elaborate on these points below in the context of a wider discussion of value creation and value capture, and their interrelationship. This is aimed to highlight how the pursuit of value capture, can sometimes prejudice the sustainability of value creation.

The Nature and Theories of Value

Value has a very long history, from Aristotle, to the founder of modern economics Adam Smith. It has recently come to the centre of analysis by strategic management (SM) scholars, who couch much of their discourse in terms of value creation and value appropriation/capture (see Ramirez 1999; Bowman and Ambrosini 2000; Amit and Zott 2001; Lepak et al. 2007; Pitelis 2009a, b; Mol and Wijnberg 2011).

The classical economic theory of Smith, Ricardo and Marx, attributed 'value' to labour power expended to produce a commodity ('labour theory of value'). On the other hand, the 'neoclassical', 'marginalist' notion of 'value' of Jevons, Menger and others considers value as the perceived 'utility' of a good or service to a potential-target user. 'Utility', in turn, is affected by 'scarcity'. Wealth can be seen as aggregate value, realised in market prices (see Dobb 1973).

Adam Smith, in his *Wealth of Nations* (1776), attributed the wealth-creating abilities of market economies to the 'visible hand' of the firm and the 'invisible hand' of the market. Looking at a 'pin factory' in Scotland, Smith observed how specialisation, the division of labour, teamwork and invention engender productivity improvements. The marvels of the 'visible hand' (the factory), were complemented by the 'invisible hand' of the market—the free interplay of demand and supply by economic agents, in pursuit of their own interest. The invisible hand helped provide information, incentives, co-ordination, and realise value through exchange. Competition would help ensure that 'natural' (what we call today competitive), prices will tend to emerge. Restrictive practices by, 'people of the same trade' would endanger this outcome, calling regulation by the state-government. Schumpeter (1942), has later emphasised the role of innovation and creative destruction as a determinant of value and wealth creation.

In the neoclassical economics tradition, on the other hand, the focus shifted from production, to exchange relationships, subjective value, and efficiency in resource allocation. The aim of economics became one of 'economising', of making rational choices between ends and scarce means which have alternative uses (Robbins 1935). Given scarcity, rationality and the need for economising, the economic aim became that of achieving an efficient allocation of scarce resources.

This focus is still dominant in economic circles, despite extensive criticisms by the likes of Schumpeter (1942), Penrose (1959), North (1981) and many others. For example, for Nicholas Kaldor's (1972), "the pattern of the use of resources at any one time can be no more than a link in the chain of an unending sequence and the *very distinction*, vital to equilibrium economics, *between resource-creation and resource*-allocation loses its validity." (pp. 1245–1246, emphasis added). Moreover, as Dobb (1973) maintained, in reality both utility and cost-based factors are relevant in explicating value creation. The importance of the aforementioned observations lies in that the sustainability of value creation can also be linked to both cost-supply and demand-based factors. This is important in helping us appreciate how, as a result, governance can play a role in economic sustainability, by impacting on such factors.

[4] Economic sustainability relates to the concept of economic resilience, see Simmie and Martin (2010), for a critical account. Resilience usually focuses on the ability to withstand shocks, usually external ones, and/or rebound. Economic sustainability instead is more interested in the endogenous to an economy factors that can help foster, or hinder, its capability to satisfy its objectives inter-temporally. In this paper we focus on economic sustainability.

In Strategic Management, the term 'value added' has already been employed as a measure of performance. For example, Kay (1995) defined 'value added' as "the difference between the (comprehensively accounted) value of a firm's output and the (comprehensively accounted) cost of the firm's inputs" (Kay 1995, p. 19). Kay regards 'value added' as "the **key** measure of corporate success" (Kay 1995, p. 19, emphasis added). An advantage of the 'value added' construct, is that it is operationalisable and measurable, and there exist data on it. This renders our focus on sustainable value creation more operational than alternatives, such as Pareto efficiency.

Despite extensive interest in value creation, value capture and sustainability, there has been very limited attention to the relationship between the type of value capture strategies and economic sustainability, as a whole. This is our focus below.

Value Capture and Firm-level Strategies

It is arguable that the attempt by firms to capture value, motivates them to create appropriable value to start with. On the other hand, value capture may, in some cases, prejudice the very sustainability of the value creation process (Mahoney et al. 2009). We elaborate on this issue and its potential ramifications below.

In mainstream microeconomics, the possibility of capturing value as 'rents' appears whenever monopolistic conditions restrict supply, hence given the demand schedule, raise prices above those just sufficient to cover average costs. (Moreover, the concepts of 'rent capture' or 'rent seeking' have wide currency in economics, of the private as well as the public sector, see Krueger (1974), and Mueller (2006) for accounts.) Under the assumption of given technology and resources-skills, the neoclassical industrial organisation (IO), approach is capable in showing how value can be captured in the form of monopoly rents, without preoccupation with value creation. Subsequent development in IO, discuss the condition under which such 'rents in equilibrium' can be achieved, see Baumol (1982), Tirole (1988). These conditions refer to the existence or otherwise of barriers to entry and exit (or mobility barriers). The absence of barriers to mobility help establish the 'zero waste' condition (Baumol 1991), present in perfectly competitive and 'contestable' markets, or the 'zero profit' one (Augier and Teece 2008). For the last mentioned, escaping this 'zero profit' condition is of essence to business strategy.

The focus of Strategic Management is not on value creation per-se, but rather on value capture (Makadok and Coff 2002). Value creation, becomes important to the extent it is necessary for a firm to capture value created. Capturing value from 'advantages', is widely seen to be a major objective of firms (see Brandenburger and Nalebuff 1995; Teece et al. 1997). Assuming that a firm has come up with a useful, innovative idea, a fundamental challenge is how to obtain the maximum possible NPV of the anticipated future income streams of this innovation. In addition, the firm faces the wider consideration of how to capture the maximum possible value created by itself, but also by other firms. In general, total value created is the sum total of all firms' (as well as others) value adding activities. The part of value captured by a firm, however, however can be larger, the same, or less than the value it has helped create and co-create (Brandenburger and Nalebuff 1995, Pitelis and Teece 2010). This will depend on the firm's ability to device and implement a portfolio of value capture strategies superior to that of its competitors. These include barriers to entry, positioning, differentiation-branding, and integration, diversification and co-operation strategies. These strategies are well rehearsed in literature (Pitelis 2009a) and will not detain us further here. For our purposes, important is that the sustainability of a firm's competitive advantage over time will depend, as a result, on its ability to keep abreast of rivals in terms of capturing value created by itself and/or other firms. Similar considerations can apply to the case of nation states, which can also adopt value appropriation strategies (Pitelis 2009b). Such strategies for value capture, however, may not always foster economic sustainability. Whether the capture of value presupposes the creation of value, and how this is achieved, is therefore a critical issue to be addressed. We turn to this below.

A Hierarchy of Agencies and a New More 'Ethically Correct' Governance for World-Wide Economic Sustainability

As already noted, the way through which firms acquire and sustain SCAs can be of importance to the performance of the industry, the nation, and the world at large, hence, to the longer-term sustainability of the CA of firms too.[5]

There is extensive literature on potential barriers to economic sustainability. These include 'conflict,' 'agency', 'rent seeking' and issues of myopia and time-inconsistency (Mahoney et al. 2009). The possibility of divergent

[5] Put differently, a genuine firm-level SCA should be defined as one that is taking into account all static and inter-temporal externalities of the firm's activities. SCA in this definition would be equivalent to a firm's net value added, or, differently put, the Net Present Value of its value added throughout its existence, calculated to have internalized all potentially negative externalities. This is not easy to calculate not least because the issue of externalities is far too vexed (see Dahlman 1979), and we do not, and cannot possess in advance all requisite knowledge. However, this should not stop us from addressing the problem.

interests between economic agents, or groups of them, has been explored by scholars such as Adam Smith, Karl Marx, and more recently literature on 'agency', the 'managerial revolution', and the behavioural theory of the firm; see Pitelis (2007). The question is how in the presence of conflicting interests, 'interest alignment' can be achieved. As noted, in corporate governance, the focus is on the 'agency' between managers and shareholders and/or stakeholders. The potential for multiple, and hierarchically layered agencies, has been not been adequately explored (Pitelis 2004). We focus on this below.

A Multiple, Hierachically Layered Set of Agencies

As already noted, in market economies, value is engendered largely at the level of production by producers-firms, and is realised in exchange through the sale of commodities in markets for a profit. In this context, the infra-structure of the firm (organisation management, systems culture), and its strategy and governance, its technology and innovativeness, the quantity-quality and relations of its internal human resources (managers, entrepreneurs, labour), as well as non-human, especially VRIV-type resources, its ability to benefit from increasing returns to scale, are important determinants of productivity and value creation. These are influenced by the external environment. This comprises the meso-economic one, which includes industry conduct and structure, and the industry- wide 'degree of monopoly'. This 'degree of monopoly' can serve to realise value by determining the price–cost margin of the industry, see Cowling (1982). The meso-economic environment also includes the locational and regional milieu, such as a region's 'social capital' (see Putnam 1993; Dasgupta and Serageldin 2001). The four determinants of value creation, at the firm level, in their interrelationship with the external meso-economic environment, impact on value creation at the industry, sectoral and regional levels (Pitelis 2009b).

Encompassing the firm-level and meso-economic environment, is the macroeconomic and the institutional environment. This includes the macroeconomic policy mix, between, for example fiscal and monetary policies, and the nature and level of effective demand. These impact upon the context within which firms and industry operate, and help determine the 'size of the market', hence the total value that can be realised at any point in time. It also includes the institutional environment, in particular the overall 'governance-mix', which is the 'market-hierarchy-cooperation' mix of nation-wide governance. This is in effect the way and degree in which, different nations rely on market-based, corporation-based, government-based, and/or 'polity' ('third sector')-based governance of the nation, as a whole, Pitelis 2009b). The institutional environment provides 'sanctions and rewards', culture, ideology and attitudes and the overall 'rules of the game' (North 1990). It helps determine the overall efficiency of the national economy.

The national economy, in turn, is itself surrounded by the supra-national environment. This in effect is the sum of each nation's (determinants of) value, their synergies, and the institutions and organisations of supra-national governance. These impact upon the size of the global market, and the overall ability of 'The World' to engender worldwide value.

As noted, the private corporation has a central place in this context, for its ability to commercialise ideas and innovations, hence co-create appropriable value. Important, moreover, is also the public sector-the government and its policies. It impacts on the institutional and macroeconomic environment, through laws, regulations, 'leadership', legitimacy, ideology, enforcement, and economic policies. It can influence the meso-economic environment through its competition, industrial and regulation policies, and the macro-environment through its macroeconomic policies. It can impart upon the determinants of value, through education and health policies, the provision of national infrastructure, its policies on innovation and 'social capital' (Stiglitz 2011).

Accordingly, our analysis points to a multitude of 'agencies' which, moreover, are hierarchically layered. This **hierarchy of agencies**, and the concomitant need for objective alignment, renders the conventional focus in corporate governance narrow, to the extent of being naïve. While the range of potential agencies is likely to be very high, here we identified three as the most critical. These are between the 'controlling group' of a corporation, and the corporation as a whole, the nation and the corporation, and the world on the one hand, and the nation, on the other. Moreover within the first type of agency, we highlighted that between the controlling group and labour-employees, as most critical.

As noted in second section, the focus on a 'controlling group' (as opposed to management), which comprises top management and large shareholders, is in line with extensive analyses on the control and ownership of corporations (Pitelis and Sugden 1986). In the above context, it is possible that the pursuit of its own interests by the 'controlling group (here the agent), can compromise those of the corporation as a whole (here the principal). This, will be the case when, for example, the former pursue strategies that favour short-term share valuation growth and personal compensation packages and perks, beyond those required to provide them with adequate incentives to pursue the longer term interest of the corporation as a whole (that is SCA) and undermine its sustainability. The continuing debate and even uproar (such as the 'occupy the Wall Street movement), on executive compensation, and the

bonuses of, for example, bankers, in a context of failure and value destruction, attest to that possibility.

Concerning the 'employer'–'employee' relationship, disaffected labour is likely to be less productive (Pfeffer 1998, 2010). This can undermine the very objectives of the corporation and its controlling group. In this context, employees can be said to be privileged 'stakeholders'. This is not just merely because they invest in firm-specific assets, as do shareholders (Klein et al. 2012), but notably because they are a critical determinant of a firm's ability to create value and determine SCA. The already alluded to possibility that in knowledge- based activities, knowledge employees are also more likely to be self-motivated and monitored, further weakens the idea of privileging shareholder value, over employee value, or corporate value.

The second agency we focus upon, is that of the corporation, seen as the agent, and the government, seen as the principal. As noted, in some cases, firms can capture value as 'rent' through monopolistic and restrictive practices. A high degree of market power can thwart incentives to innovation and be inimical to value creation. In such cases, the sustainability of value creation requires competition, regulation, and related policies, by the public sector, that aim to prevent the creation and abuse of monopoly power, while allowing for an innovation-inducing 'degree of monopoly'. Such policies also can also include support of small firm creation and growth, and of regional clusters, that can challenge larger firms (Pitelis et al. 2006).

The third agency we examine involves the nation as the agent, and the world as the principal. As noted, nations too, often aim to capture value by adopting protectionist, strategic trade policies. These, can harm the process of sustainable world-wide value creation, especially when adopted by developed nations, by prejudicing the catching up efforts of developing and emerging economies. The aim of the 'global community' (as a principal), in this context, should be to ensure that policies adopted by individual governments, do not thwart, and ideally foster world-wide value creation. Indicatively, while governments of developed economies could be encouraged to refrain from policies that restrain trade, they should nonetheless be prepared to recognise the need of developing countries to 'foster' infant entrepreneurs, firms, industries, and indeed economies, because of their expected positive impact on competition, innovation, productivity and value creation and co-creation (Pitelis 2004, Pitelis and Teece 2010).

The impact of monopolistic practices on social welfare has been explored extensively in the Industrial Organisation literature, in the context of the 'welfare losses of monopoly' power (see Scherer and Ross 1990). The potential detrimental effects of 'strategic trade' policies, especially by developed nations on the ability of developing nations to develop and therefore on long-term value creation at the world level, have been discussed, in the context of the 'new' (or strategic) trade theory (see Krugman 1986, 1987, 1992; Rodrik 2009; Pitelis 2009b). The wider effects of 'rent-seeking' and a rent-seeking society have been explored by political economists (see, for example Krueger 1974; Stiglitz 2012). The general idea is that the way in which one achieves ones' advantages matters. If these are achieved through rent-seeking (for example entrepreneurship that focuses on value capture and value redistribution, not value creation), this will tend to undermine inter-temporal value creation (Mahoney et al. 2009).

An example on how the pursuit of narrowly conceived 'national interest', may undermine global value creation (and therefore in the long-term national interest as well), can be the attitude of Western Governments and international organisations such as the IMF and the World Bank towards the 1997 East Asian Crisis, as compared to the recent financial crisis of the Western World. The advice to the Asian governments was to liberalise financial markets and increase interest rates. This led to a worsening of the crisis for the countries that followed this advice, in contrast to those who did not follow it (such as India and China), which were least affected. In contrast, during the recent crisis Western Governments such as the US, reduced interest rates and bailed-out, even nationalised, companies, despite the 'moral hazard' problem that this entails (Hart and Zingales 2010). For Stiglitz (2007) this is no less that 'financial hypocrisy', explicitly aimed to serve the interests of a group of people, mainly from a handful of countries. Such 'hypocrisy' and the pursuit of sectional interests is a classic case of 'rent-seeking' that could undermine inter-temporal world-wide value creation.

To conclude this sub-section, firm-level SCA need not lead to industry-wide SCA, which need not lead to national SCA, which need not lead to world-wide sustainable value creation. Much depends on how each agent captures value. When they do so through restrictive practices, and/or 'rent-seeking', this undermines overall world-wide value creation, leading to a 'systemic failure'. This may also come about because of 'myopia', mistakes and time inconsistencies (Mahoney et al. 2009). Importantly, 'system failures' can arise even when there exists interest alignment; see for example Metcalfe (2003). All these render of the essence, the issue of the type of governance most conducive to world-wide economic sustainability.

A New More 'Ethically Correct' Governance for World-Wide Economic Sustainability

Diagnosing the complex hierarchy of 'agencies', is a major prerequisite for addressing the issue of (supra-national) governance for world-wide economic sustainability. This is more critical than ever, in the presence of what is arguably

one of the biggest systemic failures of capitalism, and the failure of neoclassical economics to anticipate and regulate it. Such anticipation and regulation, requires a recognition of the importance of institutional and organisational configurations, which help create knowledge, and challenge concentrated and embedded power structures (Cowling and Sugden 1999; Cowling and Tomlinson 2011), that have arguably contributed to the recent crisis (Stiglitz 2012).

Besides corporate governance, the governance of a nation as a whole by its controlling group, usually its government (public governance), and the governance of the world as a whole (supranational governance), as well as the potential 'agencies' between them, and the need for incentive alignment, can be of critical importance for the sustainability of world-wide value creation. Typically national governance involves the institutions, laws, and policies that a national government puts in place, in order to foster its objectives. It includes macroeconomic and micro-supply-side policies, such as regulation, industrial and innovation policies. Public governance is sometimes exercised by an elected government through majority voting. Supra-national governance is typically orchestrated though a hegemonic power that provides international public goods (Kindleberger 1986), or a constellation of powerful nations, such as the G8.

Both national and supranational governance, as currently exercised, face limitations in terms of degree of monitoring and possible collusive behaviour by the lead players. These are well rehearsed in literature on regulatory capture and hegemonic power failures (Pitelis 1991). A possible alternative to the extant dominant model could involve the fostering of pluralism and diversity, both intra and inter-national, alongside a representative supranational organisation, aiming to foster sustainable world-wide value creation. This type of governance, is not without limitations, but could well be better than the extant approach, that, in view of the current systemic failure, stands discredited. We elaborate on this idea below.

In all countries, there exist a host of organisations and institutions, such as the family, the church, NGOs, state-owned enterprises, that can impact on the ability of firms' and governments' incentives and capabilities to foster value and wealth creation. These are usually referred to as the 'third sector', albeit in our view a better description would be the term 'polity'. In this context, value is in effect co-created by complementary and co-specialised economic agents (Pitelis and Teece 2009). This renders critical the identification of the respective advantages and capabilities of the co-creating agents, as well as the specialisation and division of labour between them. Competition and co-operation (co-opetition), self-interest and altruism, big businesses and smaller ones, usually when co-located in clusters, can all help foster value creation. This renders important the identification of the respective advantages and capabilities of the co-creating agents, as well as the specialisation and division of labour between them. It is arguable that firms are relatively 'better' in commercialisation for profit, markets in exchange for realisation of profit, states in policy-making, ideology, and legitimacy and the 'polity' in social capital and sustainability. Within the corporate sector, small firms can have advantages in flexibility, large ones in unit cost economies. Inter-firm cooperation, for example, in clusters, can benefit from 'external economies' and foster innovation, productivity and value creation (Porter 1990).

The interplay, pluralism and diversity of institutions, organisations, individuals, ideas, cultures, religions, norms, customs and civilisations, can in part, play the role of a 'steward' and 'monitor' of each other, hence also promote the realisation and pursuit of enlightened self-interest by all, notably the most powerful, stakeholders. This can serve as a better approximate configuration to economic resilience and sustainability than the extant one. At the same time, however, it is important that this process is 'managed', 'guided' and 'moulded' through informed, motivated and (self) monitored agency, so that 'democracy' is aligned to performance-sustainable value creation. It is arguable that a representative supra-national organisation with economic sustainability as its Core Agenda and Mission could help serve this purpose. This could be the fashioned in the model of the 'third party' (the Board of Directors) of the corporation, in the work of Blair and Stout (1999). Similar considerations, relating the need to sustain the investments of actors with co-specialised and complementary capabilities for value creation apply at the supra-national level, as they do to the corporate and national ones. Allocating the role of the guardian of economic sustainability to a Global Board of Directors, with representatives from the private–public-polity nexus, and aimed at fostering the systemic interest in sustainable world-wide value creation, may appear utopian, but it could be one way through which, crises such as the present one, may be anticipated and their strength and impact at least moderated.

To summarise, for corporate governance to help foster sustainable world-wide value creation, it should be aligned to public and supra-national governance. Corporations and all economic agents should be expected and required to internalise the potentially negative externalities from their operations, to the environment and the society as a whole. For this to happen, internal and external controls may be required, including national and supra-national incentives and sanctions. Concentrated and embedded power structures, hence corruption, should be eliminated at all levels: intra-firm, intra-country (regulatory capture), between host governments and multinationals, and supra-nationally.

It is a fascinating feature of the recent European crisis, that so much attention is paid to corrupt politicians-receivers of bribes, and so little to their pay masters, yet all know that it takes two to tango (Pitelis 2012). Improving upon this, requires also a trust, social capital and the 'ethical dimension'. Exclusive focus on self-interest may well be the biggest foe of economic sustainability. The recent crisis attests to this (Hart and Zingales 2010). Fostering pluralism, diversity, the polity and a representative and self-monitored Global Board of Directors, can serve as a move in the right direction.

However, there are no panaceas. For one, a self-interested and/or captured Global Board can be worse than just diversity, and even than what we now have. Yet what we now have is in need of a major revamp. In this context, we hope for to open up further discussion on the need, prerequisites and mechanisms for supra-national governance for world-wide economic sustainability, as a topic worthy of further investigation.

Concluding Remarks

The successful capture of value by (especially large) firms, need not be beneficial for the economy as a whole, if it thwarts competition and innovation. Public policies to capture value for a nation, such as strategic trade, neo-protectionist ones, may thwart the process of sustainable world-wide value creation. For sustainable world-wide value creation to be fostered, economic agents should internalise the negative externalities of their actions, which may prejudice the sustainability of system-wide value creation, and eventually their own success. Public policy should aim to enhance competition through innovation, by regulating anti-competitive practices and promoting productive entrepreneurship (Baumol 1990), and new firm creation and growth. Nation states (especially developed ones) should avoid 'strategic trade policies' and/or the pursuit of sectional interests of powerful groups, at the expense of the wider interest of economic sustainability. Pluralism and diversity, through the fostering of the 'polity', such as NGOs, consumer associations, public–private partnerships, clusters and overall 'social capital' creation (see Moran and Ghoshal 1999; Putnam 1993; Branston et al. 2006) should be encouraged, in order to ensure a degree of mutual stewardship and monitoring that aims to address the problem of 'who monitors the monitor' (Alchian and Demsetz 1972), and motivates a more enlightened appreciation of 'self interest'. In practical terms this implies the avoidance of 'regulatory capture' and other types of concentrated and embedded power structures, by 'elites' in pursuit of rent-seeking (Stigler 1971; Olson 1971; Krueger 1974).

Setting-up a supra-national organisation, a representative Global Board of Directors, that places world-wide economic 'sustainability' at the centre-stage of its Agenda, could be another complementary way of fostering sustainable world-wide value creation. Such an organisation can, however, may also be captured by organised sectional interests. In this context, diversity and our proposed supra-national organisation, are not panaceas. In the longer term, decency, dignity and culture, alongside diversity, may hold the key to world-wide economic sustainability. This should be the pursuit of us all.

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