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## Morality as a factor of production: Moral commitments as strategic risk management

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Stefan Hielscher

# Morality as a Factor of Production: Moral Commitments as Strategic Risk Management

Diskussionspapier Nr. 2009-14

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des Lehrstuhls für Wirtschaftsethik  
an der Martin-Luther-Universität Halle-Wittenberg,  
hrsg. von Ingo Pies,  
Halle 2009

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*Kurzfassung*

Der Artikel entwickelt in Auseinandersetzung mit Alfred Krupps Wohlfahrtsprogramm aus dem 19. Jahrhundert einen ordonomischen Beitrag, wie Unternehmen ‚Moral als Produktionsfaktor‘ einsetzen können. Die These dieses Beitrags lautet, dass „Corporate Social Responsibility“ als strategisches Management moralischer Bindung konzeptualisiert werden kann, mit dessen Hilfe Unternehmen Kooperationsrisiken erfolgreich angehen können, die zwischen dem Unternehmen und seinen Stakeholdern entstehen. Dieser These liegt das Verständnis zugrunde, dass ohne ein geeignetes Risikomanagement wichtige Wertschöpfungsbeziehungen des Unternehmens deswegen scheitern können, weil ihnen soziale Dilemmata zugrunde liegen.

*Schlüsselwörter:* Strategisches Risikomanagement, Ordonomik, Corporate Social Responsibility, Corporate Citizenship, Moral als Produktionsfaktor, strategische Bindungen

*JEL-Klassifikation:* A12, D02, M13, M14

*Abstract*

Through an analysis of Alfred Krupp's 19th-century social welfare program, this paper employs an ordonomic perspective on how morality can be employed as a factor of production. The paper's main argument is that corporate social responsibility (CSR) can be conceptualized as a corporate strategy of moral commitments to manage the relationship-based risks that arise out of social dilemma situations between the company and its stakeholders. Focusing primarily on relationship-based social risks that emerge from antagonistic cooperation, this paper also develops an ordonomic contribution to corporate risk management.

*Keywords:* corporate risk management, ordonomics, corporate social responsibility, corporate citizenship, morality as a factor of production, strategic commitments

*JEL-Classification:* A12, D02, M13, M14

# Morality as a Factor of Production: Moral Commitments as Strategic Risk Management

Stefan Hielscher

## *Introduction*

((1)) Business scandals such as Contergan, Bhopal, Brent Spar, and Lehman Brothers are excellent examples of how societal criticism of business is intimately related to the process of value creation. Civil society actors (CSOs) such as Greenpeace, Amnesty International, Transparency International, and trade unions, as well as important corporate stakeholders, increasingly urge companies to assume responsibility in a widening field of social interests, even to the extent of demanding that firms abandon business-as-usual-strategies in order to meet this responsibility. Suppliers may push through the adoption of ethics codes in a fight against corruption, consumers may use boycotts to force the improvement of social and labor standards, investors may exert pressure on companies to implement new environmental or health standards, and employees may decelerate or even inhibit the implementation of technological or organizational innovations if they feel it runs against their interests. As a consequence, core business relationships between companies and their important stakeholders are increasingly becoming precarious situations of voluntary cooperation and, consequently, primary sources of corporate risk.

((2)) In the literature, relationship-based risks that arise out of the process of corporate value creation always play a certain role in justifying the corporate social responsibility (CSR). The management literature, however, is only recently starting to emphasize the strategic importance of CSR for value creation,<sup>1</sup> as is the more specialized field of corporate risk management. For instance, Kytte and Ruggie (2005; p. 1) state that with the advent of globalization, businesses now face a “significant shift in market power—not just to customers and traditional investors, but also, and more importantly, toward stakeholders: communities, employees, regulators, politicians, suppliers, NGO’s and even the media. As a result of this shift in market power, ‘social risk’ is a rising area of concern for global corporations.” In view of this global competitive environment, the authors take a practical hands-on management perspective and argue that, properly understood, global firms can (and should) employ CSR as a professional tool of corporate risk management.<sup>2</sup>

((3)) This paper takes an ordonomic view of relationship-based risks in corporate risk management. The paper’s main argument is that CSR can be conceptualized as a corporate strategy of moral commitments to manage the relationship-based risks that arise out of social dilemma situations between the company and its interaction partners.

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<sup>1</sup> See, for example, Porter and Kramer (2002) or Porter and Kramer (2006).

<sup>2</sup> Cf. Kytte and Ruggie (2005; p. 15). For the German academic discussion, cf., e.g., Fürst (2005).

Through an analysis of Alfred Krupp's 19th-century social welfare program, this paper employs an ordonomic perspective<sup>3</sup> on how morality can be employed as a factor of production. The argument is developed in three steps. The first step (Section 1) interprets selected elements of Alfred Krupp's social welfare program as a differentiated management of strategic commitments to overcome social dilemma situations. By successfully experimenting with such commitments, Krupp established cooperative relationships with core business partners. The second step (Section 2) demonstrates that such corporate risk management is productive by illustrating how Krupp managed to (a) reduce unpreferable core business risks and (b) increase preferable risks in the process of innovation. The third step (Section 3) argues that insurance-like commitments qualify as "moral" commitments if they further not only the company's self-interest, but also the interest of others. The article concludes with an outlook on CSR.

### *1. The Krupp Welfare Program as Risk Management of Moral Commitments*

Alfred Krupp is deemed one of the most successful and also most controversial corporate patriarchs of 19<sup>th</sup>-century Germany.<sup>4</sup> Krupp is not only renowned as the mighty "canon king" but also as a pioneer of corporate social policy. This section argues that Krupp was a successful entrepreneur mainly because he was able to organize a strategic risk management of moral commitments—a social arrangement widely known as the Krupp social welfare program.

Instead of presenting a detailed account of the numerous provisions of the Krupp welfare program, the argument is developed by reconstructing the underlying logic of Krupp's social policy. To do so, this section is divided into two parts: Part ((1)) elaborates on the pivotal importance of dilemma situations in social cooperation and on the logic of strategic commitment as a device to overcome collective self-damage. Part ((2)) illustrates this logic with two elements of the Krupp welfare program that tackled two risks Krupp faced in the 19<sup>th</sup> century: fluctuation-induced risk and the risk of epidemic plagues.

((1)) Value creation is a process of social cooperation. Companies engage in various cooperative relationships with customers and investors, but also with communities, employees, regulators, politicians, suppliers, CSOs, and even the media. Companies engage with these partners to reap the benefits for cooperation or, put differently, to create value.

Social cooperation, however, is antagonistic cooperation. Cooperation always involves common interests but also conflicting interests. Take the relationship between a company and its investors. Managers prefer to work for a successful market leader; investors want a high return on their deposits. Hence, both parties have a common interest in the business flourishing. There are, however, also conflicting interests between the two parties. Managers are risk averse and, hence, tend to engage in mainly low-risk projects with a certain payoff; investors, however, prefer managers to invest in high-risk

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<sup>3</sup> For the ordonomic approach cf. Pies (2009a) and Pies (2009b) as well as Pies, Hielscher and Beckmann (2009), Beckmann and Pies (2008), Pies and Hielscher (2008) and Pies and Hielscher (forthcoming).

<sup>4</sup> For a general discussion of Krupp's social policy with a detailed bibliography of the relevant business history literature, cf. Hielscher and Beckmann (2009).

projects that yield—although more uncertain—higher expected payoffs. Successful cooperation between managers and shareholders requires, therefore, a suitable institutional arrangement that minimizes the frictional impact of conflicting interests on the one hand, but that emphasizes the common interests of cooperation on the other. In fact, the whole system of traditional corporate governance is an attempt to institutionally stabilize the precarious cooperation between management and shareholders—a principal-agent relationship that constantly runs the risk of not reaping the full benefits of cooperation.

From an ordonomic perspective, the simultaneous presence of common and conflicting interests can be understood as a social dilemma situation. The defining feature of a social dilemma is that it is a situation of collective self-damage: a situation in which a win-win solution cannot be realized due to an incentive structure that makes it difficult (if not impossible) for rational actors to behave in a mutually beneficial way even though it would be in their common interest to do so. Paradigmatically, the ordonomic approach distinguishes between two types of collective self-damage: one-sided dilemma structures and many-sided dilemma structures. Analogously, there are two ways of overcoming collective self-damage: individual commitments in one-sided dilemma situations and collective commitments in many-sided dilemma situations.<sup>5</sup>

Social dilemma situations are a major source of company-related entrepreneurial risk. However, engaging in professional risk management through strategic commitments can reduce the entrepreneurial risks of social cooperation. By analyzing two elements of his social welfare program, the next part demonstrates how Krupp successfully experimented with institutional provisions to solve those dilemma situations crucial to Krupp's process of value creation.

((2)) When, in 1826, Alfred Krupp took over the small crucible steel company of Essen, the main asset he attained was knowledge of how to produce high-quality cast steel. Over the next 20 years, Krupp industriously sought to tap new markets, searching for new products that could take advantage of his ductile cast steel. In the beginning, the crucible steel company produced simple tanner tools, steel cutlery, and steel roll work pieces; later, production mainly shifted to complex products. Krupp manufactured the first seamless engine steel tire, ship and locomotive axles, and steel canons of all sorts.

In the early days, however, Krupp faced severe problems due to an uneven product quality. Two major risks were responsible for this problem—(a) a fluctuation-induced quality risk and (b) an epidemic-induced production risk. Both risks were directly attributed to one important stakeholder group—Krupp's employees—and were tackled by Krupp's social welfare program.

(a) Krupp offered extensive product guarantees in an effort to convince new customers to buy his innovative products and tap into new sales markets, and he thus needed to be able to keep his promises of high quality. This required highly qualified and trained personnel. In the early stages of industrialization, however, the industrial workforce typically consisted of migrant workers who jumped companies in the expectation of higher salaries at other plants. Highly mobile workers refrain from company-specific investments both in human capital (in-plant training for firm-specific skills) and

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<sup>5</sup> The pivotal importance of social dilemmas for social theory explain Buttkereit and Pies (2008). For one-sided social dilemmas and the important role of individual commitments, cf. Kreps (1990). For many-sided social dilemmas and the important role of collective commitments, cf. Bowles (2004). For a dilemma-based plea for (ethical) voluntarism, cf. Freeman (2007).

in social capital (in this case, settling down near Krupp's factories with their families) and related investments. Employees were worried that Krupp would exploit their company-specific investments and thus preferred to remain flexibly deployable as migrant workers. Especially after the introduction of the Bessemer process, an innovation that made possible the mass production of cast steel, low-qualified migrant workers became a source of company-specific risk: a fluctuation-induced quality risk.

Krupp took steps to avoid this risk as early as 1844 by promising to pay higher wages than his competitors. In addition, however, Krupp provided his workers with institutional benefits, including a company-owned bakery (1858), an employees' retail store (1868), hostels for unmarried workers (1856), company dwellings for foremen, and workers' housing estates (1861 and 1863, respectively).

If increasing wages was sufficient to bind his employees, why did Krupp make the effort to increase not only their monetary income, but also paid them in kind? To answer this question, it helps to view the situation Krupp faced at the beginning of the 19<sup>th</sup> century as a one-sided social dilemma that had the potential to result in collective self-damage. Such a situation is characterized by the possibility of *asymmetric exploitation*. Employees had the option of making a specific investment in Krupp's company, but if they did so, Krupp had a strong incentive to exploit such investment. Anticipating Krupp's noncooperative ex-post conduct, his workers refrained from investing in specific human capital. The result was a collectively self-damaging equilibrium. Because simply promising to pay higher wages did not solve this dilemma, Krupp had a strong interest in making his promise of higher wages more credible so as induce his workers to bind themselves to the company, to settle down and make company-specific investments in human capital. This required not only higher nominal wages, which are relevant in only the short term at best, but also long-term provisions such as workers' housing estates or a retail store.

This is precisely the underlying logic of Krupp's method of addressing the fluctuation-induced quality risk: Krupp used an individual self-commitment to make his pay promise credible by rendering himself more vulnerable—i.e. more exploitable through fluctuation—in order to solve this hold-up situation and to be able to jointly create value through social cooperation.

(b) High-quality steel production requires a healthy and reliable workforce. In the early stages of industrialization, workers began to loosen their once-strong ties to extended family by moving from rural areas to places of more opportunity employment-wise and thus also lost much of the support they had previously been able to access in times of illness, unemployment, and when old. In the expanding and overpopulated urban area of Essen, this lack of community support resulted in a particularly weak local health infrastructure, which directly translated into an epidemic-induced production risk for Krupp's crucible steel company. Three disastrous cholera epidemics (1831, 1854, and 1874) that caused numerous deaths are grim illustrations of the hygiene problems and the underdeveloped health infrastructure in Essen at the time. To address this risk, in 1836, Alfred Krupp introduced a voluntary health and dependents' pension fund for his approximately 60 workers. In 1853, by which time the number of employees had increased to around 1,000, the fund was converted into a compulsory health and death insurance scheme. A pension fund followed in 1855.

In principle, the public goods of "health protection" and "prevention of epidemics" could have been organized by the workers themselves, but trying to get workers to vo-



luntarily contribute to a common fund is an excellent example of a many-sided social dilemma. Such a situation involves symmetrical interaction between actors whose cooperation fails because of the reciprocal opportunity for *mutual exploitation*. Each worker would find it advantageous to free ride on the contributions of others, with the consequence being that the aggregate contributions are insufficient to render the services needed (a mortality statistics, sanitary infrastructure, hospitals, etc.). By introducing health and death insurance and related services, Krupp organized a functional equivalent for collective action on behalf of his workers. What is most interesting is that Krupp did not bind himself, but instead offered a service for committing others. He introduced this *service* of self-commitment in two steps. At first, in 1836, the enforcement mechanism was informal as the small size of his staff allowed for a voluntary scheme of funding. However, by the 1860s, informal mechanisms no longer sufficed due to the much larger workforce. Therefore, a formal compulsory scheme became necessary to organize collective action. In fact, by linking the insurance to the employment contract, Krupp simultaneously avoided free riding by means of an ex-ante sanction *and* made cooperation among workers their best strategy.

This is precisely the underlying logic of Krupp's method of addressing the epidemic-induced production risk: Krupp rendered a *service* of collective self-commitment to solve a problem of collective action on the part of his workers, a problem that negatively affected his business. This strategy enabled Krupp to reap the full benefits of social cooperation.

((3)) To summarize, Krupp was such a successful entrepreneur because he was able to manage risk by way of well-designed strategic commitments. Using both (individual) self-commitments and *services* for (collective) self-commitments,<sup>6</sup> Krupp successfully addressed important relationship-based risks of social cooperation that had the potential to threaten his main competitive edge: the quality of his innovative cast steel.

## 2. Commitments as Insurance-Like Protection Against Relationship-Based Risks

Strategic commitments enable social cooperation. The argument of this section is that social cooperation can work to a company's good in several ways. First, strategic commitments are productive if the corporation manages to reduce unpreferable core business risks. Second, strategic commitments can be even more productive if the corporation is willing to use the protection provided by strategic commitments to engage in innovation risks. This argument is developed by means of an economic model of insurance introduced by Sinn (1982) and Sinn (1985, 1986), that maps expected returns over risk. Arguing that strategic commitments have properties similar to those of market-based insurance schemes, the model provides two major insights. First, the model shows that by insuring against relationship-based risks, moral commitments provide higher security in the production process. As a result, corporations may conduct the

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<sup>6</sup> Obviously, Krupp's social policy also had an impact on other stakeholders, such as politicians, regulators, the media, and other companies, and it also contains other forms of commitment. For a detailed analysis of the Krupp social welfare program, cf. Hielscher and Beckmann (2009) as well as Hielscher (2009), who develop a strategy matrix of four insurance-based commitments organized by Krupp. The matrix comprises four types of commitments: individual and collective self-commitments, as well as services for individual and collective self-commitments.

same production scheme with lower risk. Second, the model implies that after establishing insurance-like commitments, continuing the same manufacturing schedule as previously is no longer optimal for rational managers. Under these circumstances, a risk-averse rational management will select projects that are not only higher in risk, but also have the possibility of higher expected returns to investment. Thus, this section argues that moral commitments are valuable for businesses precisely because they make it possible to take chances on innovation. Below, these two insights are illustrated by examples from the Krupp case.

((1)) From an ordonomic perspective, the key argument is that strategic commitments play a functional role when it comes to risk management. In fact, properly understood, strategic commitments are very similar to conventional insurance: they enable the company to trade an insecure income distribution scheme for a more secure expected value of the distribution. This implies that strategic commitments enable a risk-averse company to protect itself against core business risks and provide higher security in the production process.

Figure 1 illustrates this logic using a  $(\mu, \sigma)$ -diagram in which  $\mu$  represents the expected profit—the expected value of return—and  $\sigma$  is the risk—the standard deviation of the income distribution—both from the perspective of the insurance holder. The diagram includes three convex indifference curves,  $IDC_1$ ,  $IDC_2$ , and  $IDC_3$ , which start horizontally at the ordinate and display the manager's risk preference: Starting at the ordinate, the manager will take a higher risk only if a higher expected return compensates the risk-based reduction of utility. The indifference curves hence map the subjective propensity of the manager to trade off return against risk, where the manager evaluates movements between indifference curves in the northeastern direction as an increase in utility and movements in the southeastern direction as a reduction in utility.

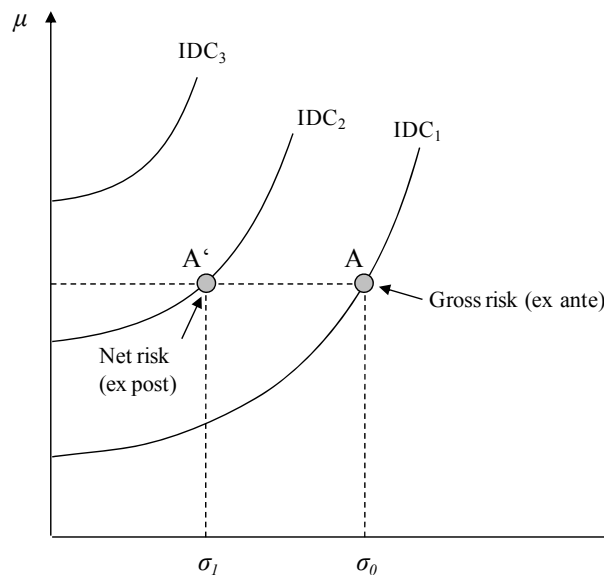


Figure 1: Higher utility through strategic commitments<sup>7</sup>

In the context of the Krupp case, Figure 1 can be interpreted as follows. Point A indicates the situation when Krupp took over the crucible steel company from his father. Point A' represents a  $(\mu, \sigma)$ -combination, the point at which Krupp introduced essential

<sup>7</sup> The graphical representation refers to Sinn (1988; p. 13).

elements of his welfare program. As discussed in Section 1, the social welfare program successfully reduced unpreferable risks, such as, among others, the fluctuation-induced quality risk and the epidemic-induced production risk. Krupp's insurance-like moral commitments enabled the company to reduce the standard deviation from  $\sigma_0$  to  $\sigma_1$ . Note that this model assumes Krupp's moral commitment to run cost-free so that both point A and point A' are drawn on the same horizontal line.<sup>8</sup> Therefore, Krupp's commitment strategy enabled the company to reach a higher indifference curve (IDC<sub>2</sub>), which corresponds to a higher level of utility. In short, the welfare program sustainably reduced the core business risks and, therefore, acted as an insurance scheme. Moral commitments are valuable because they provide security in the production process.

((2)) Moral commitments do not just provide security. Krupp was not merely faced with income risk; his was a two-faceted problem. In addition to investing in moral commitments, Krupp also had to make production plans.

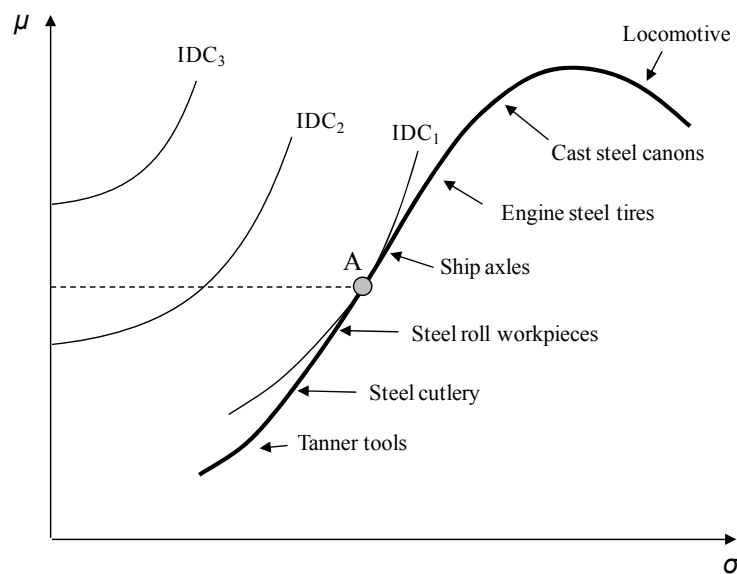


Figure 2: The S-shaped production-possibility frontier<sup>9</sup>

The S-shaped graph in Figure 2 illustrates a situation Krupp might have faced in the 1830s. On the one hand, Krupp could expect a relatively secure income stream if he confined himself to producing simple equipment or intermediate products, such as tanner tools, steel cutlery, or simple steel roll work pieces. On the other hand, Krupp could take the chance of producing more complex products. Products such as ship axes, engine steel tires, and cast steel canons would have a higher profit margin than the simpler products due to Krupp's competitive edge as an innovative first mover. Producing such products, however, entailed more risk: the production process is more difficult and the facilities and investment needed to produce such items are more product-specific. For example, to produce an engine steel tire, Krupp needed to know not only how to produce firm and elastic steel, but also how to adapt the steel for usage in a locomotive. Furthermore, in the case of poor quality, losses would be higher for these more specialized products than for the simple ones: if a defective tanner tool breaks, Krupp could

<sup>8</sup> This assumption may be very close to reality because Krupp promised a high gross wage and thus was able to substitute the monetary wage with payments in kind.

<sup>9</sup> The graphical representation refers to Sinn (1988; p. 16).

lose the custom of a few tanners; if, however, an engine steel tire bursts, Krupp ran the risk of losing the business from an entire railroad company. The S-shaped production-possibility frontier in Figure 2 sorts the products according to how difficult and complex it is to produce them and assumes that risk increases with complexity. Up to a certain point, it is fairly safe to assume that not only is the risk positively correlated with the complexity of the production process but also with the expected returns. But it is also safe to assume that there are certain products for which this relationship is in the opposite direction. For example, Krupp would need other than his core competencies to produce a steam locomotive. Such a radical departure from his core business would so dramatically increase the expected costs that they would by far exceed expected profits.

The indifference curves display the *subjective willingness* to trade profit for risk, whereas the efficient production frontier represents the *objective possibility* of trading profit for risk. A risk-averse actor will chose a production scheme at tangent point A at which subjective willingness exactly equals the objective potential to trade off. Furthermore, the actor is located on the highest possible indifference curve that still touches the efficient production frontier in the part of positive inclination.

Interpreted as a system of insurance-like moral commitments engaged in to reduce unpreferable risks, the Krupp social welfare program not only shifts point A to the left, but also each point on the production possibility frontier—in this case, by half the interception of the abscissa. As a consequence, a net production possibility frontier results that represents all  $(\mu, \sigma)$ -combinations possible after introduction of the welfare program (Figure 3).

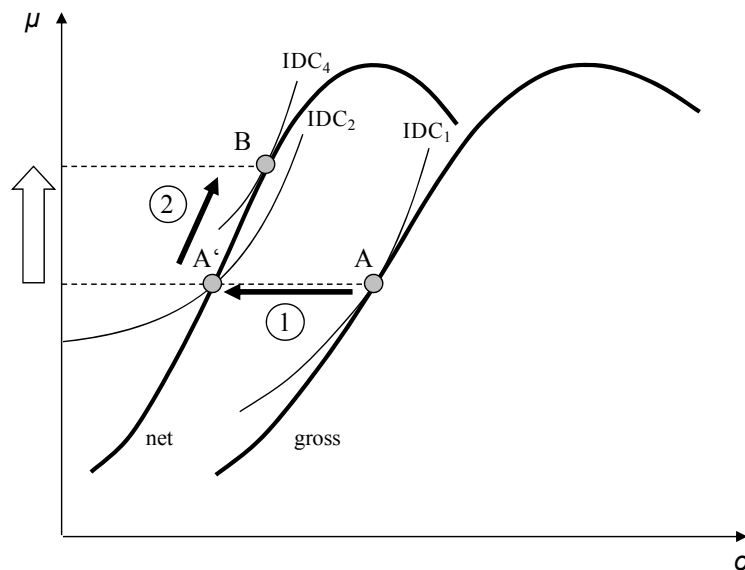


Figure 4: Value creation through moral commitments<sup>10</sup>

In the situation illustrated by Figure 3, Krupp could continue to confine himself to the production of simple steel roll work pieces (represented by arrow 1). After introducing insurance-like moral commitments, point A', however, doing so is no longer optimal

<sup>10</sup> The graphical representation refers to Sinn (1988; p. 18).

because Krupp could increase expected profits by raising the net risk of production.<sup>11</sup> In terms of Figure 3, point A' is not tangent to indifference curve IDC<sub>2</sub> but intersects with it. Consequently, Krupp has an incentive to take higher risks and choose point B instead of point A' (represented by arrow 2). In our case, Krupp does not need to confine himself to simple steel roll work pieces or steel cutlery, but can risk producing complex products, such as engine steel tires or cast steel canons, which yield higher expected profits. In short, moral commitments are valuable because they make it possible to take a chance on innovation. Krupp realizes indifference curve IDC<sub>4</sub>.

### 3. Insurance-Like Provisions as "Moral" Commitments

The previous two sections argue that strategic commitments enable social cooperation and that social cooperation can be productive for a company if the commitments display insurance-like properties. But should insurance-like commitments qualify as "moral" commitments?

This section argues that the answer to that question is yes. The argument is developed in two steps. In Step ((1)), it is shown that commitment devices aim at a win-win solution to morally relevant conflicts of social cooperation. In Step ((2)), it is shown why such a win-win orientation that aims at overcoming conflicts between private interests and public interest interests qualifies as being truly "moral."

((1)) As discussed in Section 2, Krupp organized strategic commitments in order to solve situations of collective self-damage, meaning situations in which neither interaction partner reaps the benefits of social cooperation. With regard to fluctuation-induced production risk, Krupp bound himself to his promise not to exploit the company-specific investments of his workers by means of a short-term wage premium and additional long-term social benefits. With regard to the epidemic-induced production risk, however, Krupp did not bind himself, but instead provided his workers a service for a collective self-commitment—company-wide health insurance and a pension fund. Both provisions aim at a win-win solution: Krupp not only reduced the chances of at least two production-related risks,<sup>12</sup> he also significantly improved the lives of his employees. In other words, Krupp's social welfare program was a sustainable solution to social problems in that he envisaged both his *self-interest* as a competition-driven industrial entrepreneur *and* the legitimate interests of his partners, the workers. Or, as Eugen McCreary put it, "one of Germany's greatest industrialists began doing something at a time when few did; that his were among the first steps toward industrial social responsibility .... [F]or its time it was a remarkable effort, revealing an intelligent understanding both of an employer's *self-interest* and the most pressing needs of a new but constantly expanding industrial labour force."<sup>13</sup>

((2)) Some approaches to business ethics take the stance that only acts that go beyond the self-interest of corporate actors have a genuine moral quality.<sup>14</sup> Such a defi-

<sup>11</sup> One effect was neglected here: Low residual absolute risk induces the actor's marginal risk aversion to decrease as well. As a consequence, also the inclination of the indifference curves decreases and Krupp can realize production plans which are located even further to the right.

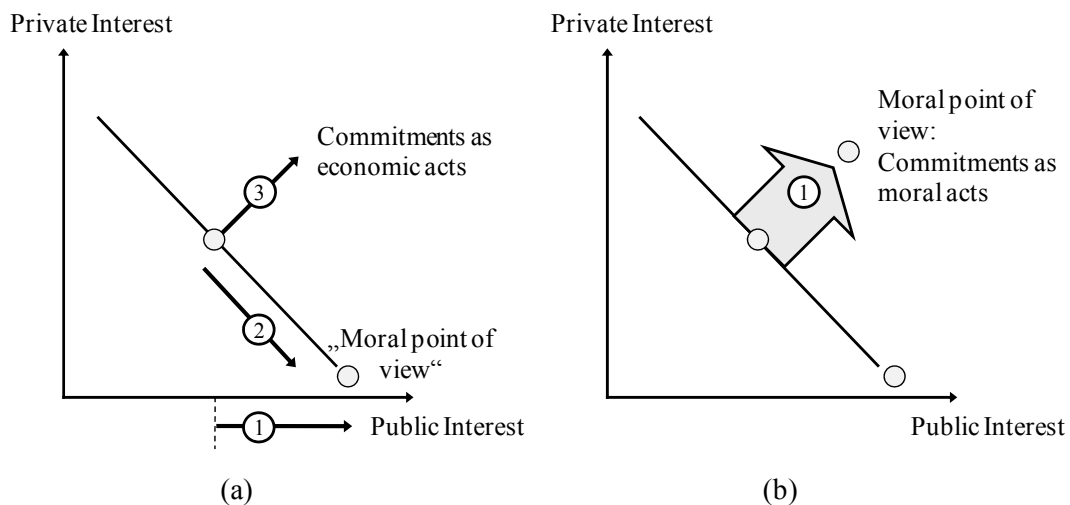
<sup>12</sup> Cf. McCreary (1968; p. 42): "Mobility of trained manpower meant a constantly recurring loss of time and effort, which would be translated directly into higher production costs."

<sup>13</sup> McCreary (1968; p. 25, emphasis original, and p. 49, emphasis added).

<sup>14</sup> Cf. Ulrich (2008; p. 105 et seq.).

nition turns a blind eye on those acts that by furthering public interests (i.e., legitimate interests of others in society) also advance the self-interest of corporate actors.

The results of this “blindness” are illustrated in figure 4a. This view of morality runs the risk of putting those who try to conform to it in a conflict of interest situation—a situation that would imply that making a profit (which is acting in a business's self-interest) means harming (or at least not benefiting) the larger society and vice versa. As a consequence, the moral impetus (arrow 1) can be realized only if companies at the same time curb their profit-seeking self-interest (arrow 2). Indeed, under this view, it is not obvious how strategic commitments that sustainably further the public interest and also advance the private interest could qualify as “moral”: such commitment strategies are merely economic acts without a specific moral quality (arrow 3).



Figures 4a and 4b: Ethical orientation: Win-Lose vs. Win-Win

The main problem with this ethical proposition is that an act deemed as having a genuine moral quality would not be sustainable in the long run. As a consequence, corporate actors that follow this proposition in a competitive market economy either cease to act according to “genuine morality” or vanish from the market, neither of which seems desirable. The ordonomic approach proposes a different understanding of morality that is better tailored to the social structure of corporate commitment strategies: The ordonomic perspective suggests classifying as genuinely moral those acts that aim at an orthogonal position (arrow 1 in figure 4b). Such ethical orientation would qualify strategic commitments as moral commitments if the institutional provisions have a win-win orientation and enable social cooperation by overcoming a seeming conflict between the profit-seeking of corporate actors and the legitimate interests of other actors in society. The Krupp case is a good illustration of the ordonomic approach. Krupp’s social welfare program not only furthered the interests of his partners (the workers), but also advanced the interests of his company—the program, in short, used *moral commitments* as a risk management strategy. To put it even more precisely, Krupp employed morality as a factor of production.

((3)) The ordonomic approach holds that it is misguided to see only those acts as moral that neglect or even run against self-interest. The ordonomic approach instead takes the stance that the moral quality of corporate acts should primarily be judged by

whether they further the legitimate interests of others. Under this understanding of “morality,” even acts undertaken in the furtherance of self-interest can be called moral if they also further the public interest.<sup>15</sup>

The economic tradition is well acquainted with such view of morality. As early as 1921, Ludwig von Mises, for example, states:

“Morality consists in the regard for the necessary requirements of social existence that must be demanded of each individual member of society. ... In requiring of the individual that he should take society into consideration in all his actions, that he should forgo an action that, while advantageous to him, would be detrimental to social life, society does not demand that he sacrifice himself to the interests of others. For the sacrifice that it imposes is only a provisional one: the renunciation of an immediate and relatively minor advantage in exchange for a much greater ultimate benefit. ... The meaning of this regard for the general social interest has frequently been misunderstood. Its moral value was believed to consist in the fact of the sacrifice itself, in the renunciation of an immediate gratification. One refused to see that what is morally valuable is not the sacrifice, but the end served by the sacrifice, and one insisted on ascribing moral value to sacrifice, to renunciation, in and for itself alone. But sacrificing is moral only when it serves a moral end. There is a world of difference between a man who risks his life and property for a good cause and the man who sacrifices them without benefiting society in any way. *Everything that serves to preserve the social order is moral; everything that is detrimental to it is immoral.*”

While such ethical orientation may seem rather unorthodox in the context of (business) ethics, the identification of the tension between self-interest and the “moral point view” as an as yet unsolved issue is also prominent in the philosophical tradition. Richard Rorty, for instance, argues:

Plato thought that the philosopher’s task was to answer questions like: “Why should I be moral?” ... He thought this because he thought that the best way to deal with people like Thrasymachus and Gorgias was to demonstrate to them that they had an interest of which they were unaware, an interest in being rational, in acquiring self-knowledge. Plato thereby saddled us with a distinction between the true and the false self. The distinction was, by the time of Kant, transmuted in a distinction between categorical, rigid moral obligation and flexible, empirically determined self-interest. Contemporary philosophy is still lumbered with this opposition between self-interest and morality, an opposition which makes it hard to realize that my pride in being a part of the human rights culture is no more external to my self than my desire for financial or sexual success.”<sup>16</sup>

#### 4. Conclusion

This paper’s main argument is that CSR can be conceptualized as a corporate strategy of moral commitments engaged in for the purpose of managing the relationship-based risks that arise out of social dilemma situations between the company and its interaction partners.

The Krupp case is a vivid example of how effective a risk management tool of moral commitments can be, especially in a fast-changing competitive environment. Such an environment makes cooperative value creation an especially risky undertaking and, therefore, requires professional management of the essential, but precarious, relationships necessary for value creation. Two major lessons can be learned from Krupp’s employment of insurance-like moral commitments. First, such commitments can consider-

<sup>15</sup> Mises (1927, 2002; p. 14-15, emphasis added). Cf. also Mises (1922, 1981; p. 357).

<sup>16</sup> Rorty (1998; p. 176).

ably reduce a firm's exposure to the unpreferable risk of losing important cooperative business relationships. Second, such commitments can make it possible for a company to take a chance on innovation, which is essential to long-term value creation.

The current process of globalization is similar in many respects to the Industrial Revolution of 200 years ago. Both then and now, competition increases the pressure to innovate. Both then and now, professional management is required to establish or stabilize precarious situations of cooperation pivotal to the process of value creation. Both then and now, as the Krupp case reveals, CSR, interpreted in ordonomic terms as a risk management of moral commitments that addresses social dilemma situations, is one way of successfully dealing with these issues.



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