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# Delegated Social Responsibility: Is Managerial Prosociality a Source of Agency Cost?

## Abstract

Agency theory holds that managerial discretion over stakeholder decisions creates agency costs through altruistic redistribution. We test this claim in a principal-agent experiment where agents choose effort and transfers affecting a third party under unenforceable flat-wage contracts. We find that principals set ethically constrained targets and wages that track fairness benchmarks. Agents, however, do not divert resources to stakeholders: transfers are negative on average, and prosocial traits do not increase giving. Instead, contract terms, though unenforceable, systematically shape effort, transfers, and returns. Notably, prosocial agents generate higher total returns. Prosociality appears to mitigate rather than create efficiency losses, suggesting that discretion channels norm-sensitive loyalty rather than stakeholder redistribution.

*Keywords: agency theory, behavioral contracts, corporate social responsibility, experimental economics, managerial discretion, prosocial motivation*

*JEL classification: C91, D23, D64, G30, M52*

# 1 Introduction

Agency theory implies that managerial discretion over stakeholder-related decisions can generate agency costs. In the corporate governance and CSR literature, discretionary stakeholder engagement, such as charitable giving, environmental initiatives, or community involvement, is therefore often interpreted as an expression of managerial private preferences that diverts value from shareholders rather than serving firm objectives (Friedman, 1970; Jensen and Meckling, 1976; Baron, 2007). Under this view, prosocial motivation exacerbates agency problems precisely because it introduces objectives that are difficult to contract upon and weakly monitored. Empirical studies document that corporate social responsibility (CSR) activities correlate with weak governance and managerial entrenchment (Masulis and Reza, 2015; Cespa and Cestone, 2007), and that such activities are associated with lower firm value (Barnea and Rubin, 2010). These findings have commonly been interpreted as evidence that prosocial discretion enables moral self-dealing, allowing managers to pursue reputational gains or ethical satisfaction at shareholders' expense.

The relevance of this concern is amplified by mounting evidence that managerial preferences shape corporate policies. Managers' personal characteristics and preferences predict systematic differences in corporate CSR policies (e.g., Petrenko et al., 2016; O'Sullivan et al., 2021; Szymczak et al., 2025), accounting for a substantial share of the observed variation (Davidson et al., 2019). This "managerial fixed effects" literature demonstrates that discretion matters precisely because individual preferences influence organizational decisions (Bertrand and Schoar, 2003). When applied to stakeholder-affecting choices, this logic is often interpreted as implying that prosocial managers, if granted discretion, will systematically redirect resources toward external constituencies. However, whether prosocial preferences translate into stakeholder redistribution—and at what cost to shareholders—remains empirically unclear.

The agency-based interpretation of CSR rests on two core assumptions. First, that prosocial motivation is unconditionally stakeholder-directed—that is, prosocial agents will systematically redistribute resources from principals to external constituencies when given the opportunity. Second, that stakeholder-oriented actions can be treated as a single phenomenon—transferring value to external parties—whereas in practice such actions encompass distinct behaviors, including mitigation (preventing harm or negative externalities that would otherwise be imposed on stakeholders), donation (creating additional stakeholder value beyond neutrality), and varying degrees of stakeholder extraction. These behaviors differ in their normative foundations, legal standing, and implications for agency costs, yet are rarely distinguished in agency-based discussions of CSR. Moreover, this literature often presumes a natural baseline in which firms either create additional stakeholder value or remain neutral, overlooking the possibility that discretion can also generate harm.

We investigate both assumptions empirically and conceptually. Drawing on behavioral research, we emphasize that prosocial preferences are conditional on relational context and perceived role obligations (Fehr et al., 2002; Akerlof and Kranton, 2000; Haidt, 2007). Organizational roles shape how individuals interpret their responsibilities (Tenbrunsel and Messick, 1999), and fiduciary relationships can redirect moral concern away from third parties (Hamman et al., 2010; Bartling and Fischbacher, 2012). This suggests that prosocial motivation need not conflict with principal interests when discretion is exercised within a delegated relationship. In addition, we distinguish analytically between mitigation—preventing harm to stakeholders—and donation—creating additional stakeholder value. The normative status of these actions differs fundamentally: mitigation can be understood as respecting property rights or avoiding negative externalities (Coase, 1960), whereas donation represents voluntary redistribution (Friedman, 1970). While the managerial fixed effects literature demonstrates that preferences matter for corporate outcomes, it re-

mains silent on how such preferences are expressed under competing role obligations or how they map onto mitigation versus donation. We argue that understanding prosociality in delegated CSR requires recognizing both the relational embeddedness of discretion and the conceptual distinction between harm prevention and beneficence.

We conduct an incentivized principal–agent experiment in which agents choose productive effort and allocate payoffs between principals and an external stakeholder. Agents can increase, maintain, or decrease stakeholder welfare relative to a reference endowment, allowing us to distinguish between donation, mitigation, and extraction. Contracts are flat-wage with unenforceable performance targets, creating discretion over both effort provision and stakeholder impact. We measure agents' social value orientation (SVO) and charitable giving preferences to identify prosocial types, and examine whether these traits predict discretionary stakeholder transfers. To isolate the role of framing, we elicit principals' own behavioral forecasts when asked to imagine themselves in the agent role and compare these to the contract terms they design.

Our findings qualify standard predictions. First, agents on average impose negative transfers on stakeholders, reducing charitable donations below the reference endowment. This pattern holds regardless of social preferences: neither SVO nor charitable giving predicts higher stakeholder transfers. If anything, high-SVO agents allocate slightly less to stakeholders than low-SVO agents. Second, prosocial agents generate higher total performance—measured as the sum of principal returns and stakeholder payoffs—than less prosocial agents, suggesting that prosociality enhances efficiency rather than generating redistribution costs. Third, principals design contracts that avoid requiring stakeholder harm and offer wages aligned with fairness benchmarks, even though these terms are unenforceable. Fourth, higher wages correlate with greater effort and lower stakeholder transfers, consistent with reciprocity-

based rather than altruism-based behavior.

We interpret these findings as evidence that prosocial motivation operates through role-contingent norms rather than unconditional altruism. Within the principal–agent relationship, agents—regardless of ethical disposition—systematically favor principal returns over stakeholder redistribution. This pattern is not reducible to self-interest: prosocial agents exert higher effort despite flat wages, suggesting intrinsic motivation to fulfill perceived obligations. At the same time, principals signal ethical expectations through contract design, setting targets and wages that respect normative boundaries even when enforcement is absent. Together, these patterns indicate that the principal–agent relationship activates a relational logic in which prosocial agents align with principals rather than pursuing independent moral agendas. Managerial preferences matter, but their organizational expression is mediated by the relational structure of agency rather than determined by intrinsic traits alone.

Our contribution is threefold. First, we provide direct experimental evidence that managerial prosociality does not generate agency costs through stakeholder redistribution. Prosocial agents demonstrate higher effort and greater value creation without corresponding increases in stakeholder transfers, qualifying the common agency-based interpretation that prosocial motivation diverts resources from principals to external constituencies. Second, we show that prosocial motivation operates through role-contingent norms rather than unconditional altruism. Within a fiduciary relationship, prosocial agents prioritize alignment with principals over stakeholder redistribution. This result extends stewardship theory (Davis et al., 1997; Donaldson and Davis, 1991) by providing microfoundations for alignment under prosocial preferences, and complements behavioral contract theory (Fehr et al., 2007; Kőszegi, 2014) by demonstrating that unenforceable contract terms function as normative anchors. Third, we highlight a conceptual distinction often overlooked in CSR research: mitigation (preventing harm to stakeholders) versus donation (cre-

ating additional stakeholder value). These behaviors differ fundamentally in their normative status—mitigation addresses stakeholder entitlements and property rights, while donation represents voluntary wealth transfers (Coase, 1960; Hart and Zingales, 2017)—yet are frequently conflated in the CSR literature (Friedman, 1970; Lantos, 2001; Barnea and Rubin, 2010). Our design permits agents to mitigate, donate, or extract value from stakeholders, and we find that mitigation is the modal outcome, while extraction is sufficiently common that average transfers are negative, irrespective of agent prosociality or charitable preferences.

These contributions have implications for corporate governance theory and practice. If prosociality mitigates rather than exacerbates agency problems, policies that restrict discretion may eliminate valuable behavioral mechanisms, such as trust, reciprocity, and role identification, that sustain effort under incomplete contracts. Governance design should therefore focus less on constraining discretion and more on shaping the relational context in which it operates. Contract framing, transparency in goal-setting, and ethical baselines matter not as symbolic gestures but as behavioral anchors that guide how agents interpret fiduciary obligations. These implications are most informative for settings in which stakeholder claims are weakly enforced and managerial discretion is substantial.

The remainder of the paper proceeds as follows. Section 2 reviews the theoretical foundations of agency theory, prosocial motivation, and relational contracts. Section 3 describes the experimental design, measures, and procedures. Section 4 presents a set of pre-registered hypotheses. Section 5 reports the experimental results. Section 6 discusses implications, limitations, and directions for future research. Section 7 concludes.

# 2 Background

## 2.1 Discretion and the Ambiguity of Prosocial Agency

A central concern in agency theory is that managerial discretion can generate agency costs when managers are able to pursue objectives that are weakly contractible or difficult to monitor. In its canonical formulation, agency theory emphasizes that when managers are granted control over resources without enforceable performance contingencies, they may engage in self-serving behavior that diverges from shareholder value maximization (Jensen and Meckling, 1976). Discretion expands the set of feasible actions available to the agent, thereby increasing the scope for opportunism when incentives and monitoring are imperfect (Fama and Jensen, 1983; Holmstrom and Milgrom, 1991).

Stakeholder-facing decisions are viewed as particularly problematic within this framework. Activities such as charitable giving, environmental initiatives, or community engagement typically lack clear output measures and are not directly contractible. As a result, they are often interpreted as expressions of managerial private preferences—reputational, psychological, or moral—that may divert value from shareholders (Bebchuk et al., 2002; Shleifer and Vishny, 1997). From this perspective, discretion over stakeholder outcomes is not a neutral managerial capacity but a channel through which agency problems may manifest. Empirical evidence linking weak monitoring to value-destroying managerial behavior has reinforced this concern (Bertrand and Mullainathan, 2003; Yermack, 2006).

Legal and governance-oriented strands of the literature echo this logic. The contractarian view of the firm emphasizes fiduciary duties and shareholder-oriented default rules as mechanisms to constrain discretion and prevent opportunistic redistribution across corporate constituencies (Easterbrook and Fischel, 1991; Bainbridge, 2008). Even stakeholder-inclusive governance frameworks, such as the team pro-

duction model (Blair and Stout, 1999), acknowledge that unconstrained discretion creates scope for rent-seeking and coordination failures (Stout, 2001). As Roe (2001) cautions, expanding managerial accountability beyond shareholders risks enabling agendas that maximize managerial utility rather than aggregate welfare.

Taken together, these arguments motivate a widely held concern: that discretion over stakeholder-related decisions is inherently prone to agency costs. Importantly, however, this concern rests on a set of implicit behavioral assumptions—namely, that prosocial or ethical motivations are inherently stakeholder-directed, that they override fiduciary obligations, and that discretion activates moral opportunism rather than norm-constrained behavior. These assumptions are rarely made explicit and are seldom tested directly. The contribution of this paper to the agency literature is to take this canonical concern seriously while shifting the level of analysis: rather than inferring agency costs from governance structures or firm-level outcomes, we study how discretion is exercised when enforcement is absent and trade-offs must be resolved by the agent.

## 2.2 Empirical Evidence on Stakeholder Actions and Managerial Motives

A large empirical literature examines stakeholder-oriented activities through the lens of corporate governance and firm performance. This work is often interpreted as corroborating agency-based concerns about managerial discretion. Firms with stronger shareholder rights exhibit higher valuations and operating performance (Gompers et al., 2003; Bebchuk et al., 2009), while weaker governance and managerial entrenchment are associated with increased engagement in corporate social responsibility (CSR) activities that appear to reduce firm value (Masulis and Reza, 2015). These patterns are frequently taken as evidence that discretionary stakeholder engagement reflects agency costs rather than value creation, serving managerial private benefits

such as reputation building or moral self-expression (Barnea and Rubin, 2010; Cheng et al., 2023).

Related studies link managerial discretion to empire building (Hope and Thomas, 2008), entrenchment (Cespa and Cestone, 2007), and impression management (Ingram and Frazier, 1980). Firms also appear to increase CSR spending following negative publicity, consistent with strategic reputation repair rather than intrinsic concern for stakeholders (Cahan et al., 2015). Event studies of CSR announcements often find neutral or negative abnormal returns (Krüger, 2015), although effects vary with credibility, stakeholder salience, and institutional context (Servaes and Tamayo, 2013; Flammer, 2015).

Despite its influence, this empirical paradigm faces important identification challenges. First, it typically infers managerial motives from correlations between observed CSR outcomes and governance characteristics, without observing discretionary decision-making directly (McWilliams and Siegel, 2000). The same CSR outcome may reflect altruism, strategic investment, regulatory compliance, or constrained choice, making it difficult to attribute behavior to underlying preferences. Second, discretion is treated as a homogeneous condition, proxied by governance indices or ownership structures, rather than as a set of concrete trade-offs faced by agents. Third, cross-sectional designs average over institutional context, obscuring how role expectations, fiduciary cues, or relational framing may shape behavior under incomplete contracts (Akerlof and Kranton, 2000; Chen and Li, 2009).

As a result, existing evidence cannot distinguish whether prosocial managers use discretion to redistribute value to stakeholders, to mitigate harm, or to enhance efficiency under weak incentives. Nor can it identify how behavior responds when enforcement is absent and decisions are guided by norms rather than contracts. The contribution of this paper to the empirical governance and CSR literature is to complement outcome-based evidence with a controlled setting in which discretionary

choices, trade-offs, and motivations are directly observed.

## 2.3 Negative Externalities and Normative Baselines

A large part of the literature on corporate social responsibility evaluates stakeholder-oriented action through the lens of shareholder costs and benefits. In this view, discretionary engagement on behalf of external constituencies is typically framed either as corporate charity that diverts value from shareholders (Jensen and Meckling, 1976; Friedman, 1970), or as a strategic investment that generates long-run returns through reputational gains, human capital attraction, innovation, or risk mitigation (Fombrun et al., 2000; Turban and Greening, 1997; Greening and Turban, 2000; Bocquet et al., 2013; Cassar, 2019; Godfrey et al., 2009; Minor and Morgan, 2011). Although these perspectives differ in their assessment of whether CSR is value destroying or value enhancing, both evaluate discretion by asking whether firms should actively *increase* stakeholder welfare, and at what cost or benefit to shareholders (Baron, 2001; Kitzmueller and Shimshack, 2012).

What both perspectives underplay is a distinct and economically fundamental margin: the prevention of harm. Mitigation refers not to the voluntary creation of additional stakeholder benefits, but to the avoidance of negative externalities that corporate activity might otherwise impose. From a Coasean perspective, mitigation is not altruism but the preservation of stakeholder entitlements in settings where property rights are incomplete or transaction costs preclude bargaining (Coase, 1960). The economics of externalities has long recognized that firms may impose uncompensated costs on third parties—such as environmental damage or community harm—when enforcement is weak or regulation is ambiguous (Pigou, 1920; Baumol and Oates, 1988). In such cases, stakeholder losses reflect not the absence of generosity but the active erosion of existing value.

Legal and regulatory scholarship documents how discretion over externalities is

shaped by enforcement gaps and institutional ambiguity. Firms strategically exploit regulatory uncertainty to externalize costs when violations are unlikely to be detected or sanctioned (Ayres and Braithwaite, 1987; Kagan, 2010). Empirical evidence shows that environmental compliance responds strongly to enforcement intensity (Viscusi, 1991), and that financial penalties for environmental harm materialize primarily when violations are prosecuted (Karpoff et al., 2005). Undetected externalities therefore function as implicit subsidies to shareholders, making discretion a mechanism for value transfer rather than value creation (Heal, 2005).

Recognizing mitigation as a distinct domain exposes a deeper conceptual challenge: there is no natural zero point against which stakeholder redistribution can be measured. Profit-making inherently involves rent extraction, and what counts as legitimate surplus appropriation is determined not by efficiency alone but by legal and social norms (Rajan and Zingales, 1998; Zingales, 2000). Contractual incompleteness creates scope for ex post opportunism, including hold-up and cost shifting (Williamson, 1975; Hart and Moore, 1986), particularly when stakeholders lack voice or bargaining power (Shleifer and Summers, 1988). As illustrated by Shapira and Zingales (2017), corporate value may be increased for shareholders precisely by imposing uncompensated losses on stakeholders.

The contribution of this paper to the CSR and externalities literature is to make this margin explicit. We introduce an experimental framework in which stakeholder outcomes are defined relative to a reference entitlement, allowing discretionary behavior to generate positive externalities, mitigation, or extraction. By distinguishing value creation from value destruction, the design separates behaviors that are typically conflated in empirical and experimental studies of CSR, providing a clearer basis for analyzing how discretion is exercised under normative ambiguity.

## 2.4 Prosociality: Always Stakeholder-Oriented?

Once discretion is understood as encompassing both value creation and value destruction, a central behavioral question arises: how do agents navigate such choices when normative baselines are ambiguous? A large behavioral literature documents that individuals exhibit prosocial preferences, including altruism, fairness concerns, and reciprocity (Fehr et al., 2002; Falk and Fischbacher, 2006; Charness and Rabin, 2002; Malmendier and Schmidt, 2017). Importantly, however, these preferences are not expressed as unconditional concern for all affected parties. Instead, prosocial behavior is highly sensitive to institutional context, framing, and perceived obligations.

Social identity and organizational roles play a central role in shaping moral behavior. Individuals cooperate more with in-group members even when group boundaries are minimal (Chen and Li, 2009), and organizational roles activate normative schemas that guide behavior toward what is perceived as role-appropriate rather than utility-maximizing (Tenbrunsel and Messick, 1999). Identical material choices elicit systematically different behavior when framed as business decisions versus ethical decisions (Ellingsen et al., 2012), while fiduciary language can activate role-based ethical commitments that increase effort and reduce self-dealing (Bhattacharya et al., 2019). These findings suggest that moral motivation is directional: it depends on whom the agent perceives as the relevant moral reference.

Relational and behavioral contract theories further emphasize that prosocial motivation interacts with institutional design. Reciprocity motives lead agents to reward principals who offer generous or fair contracts, even when incentives are unenforceable (Fehr et al., 2007; Falk et al., 2008). At the same time, explicit incentives may crowd out intrinsic motivation by signaling distrust or redefining the task as purely instrumental (Bowles, 2008; Frey and Oberholzer-Gee, 1997; Titmuss, 1970; Gneezy and Rustichini, 2000; Bénabou and Tirole, 2006). In such settings, agents may substitute across behavioral margins, meeting perceived obligations through actions that

are normatively permissible within their role.

By contrast, much of corporate governance theory treats prosociality as a generic disposition to "do good," implicitly assuming that prosocial motivation under discretion manifests as stakeholder-oriented redistribution (Baron, 2007). This view abstracts from role-based moral trade-offs and from the possibility that loyalty, authority, or fiduciary duty may dominate fairness or harm-prevention concerns (Haidt, 2007; Graham et al., 2013). If moral motivation is conditional and relational, discretion need not exacerbate agency problems but may instead channel prosocial behavior toward alignment with principals (Bosse and Phillips, 2016).

The contribution of this paper to the behavioral and organizational economics literature is to provide direct evidence on how prosocial preferences are expressed under delegated authority. By embedding agents with measured prosocial traits in a principal–agent relationship with unenforceable contracts and stakeholder externalities, the design allows us to distinguish whether prosocial motivation manifests as stakeholder-oriented redistribution or as role-based alignment when fiduciary expectations are salient.

# 3 Experimental Design

While CSR may, in certain case, contribute to shareholder value, our experiment is designed to capture the pivotal cases where it is not: specifically, cases where agents face a discretionary trade-off between value creation and value extraction. The design does not aim to replicate the average CSR decision environment but rather provide a conservative test of core assumptions underlying the agency account of CSR.

## 3.1 Core Design and Task Structure

Building on the gift exchange setting implemented in Fehr et al. (2007), we introduce a third party—a passive stakeholder—whose welfare is directly affected by the agent's decisions but is not included in the contract. This structure allows us to examine how social preferences and perceived fairness interact with incentives when agents face a trade-off between firm performance and external welfare. The experiment involves three roles: a Principal (P), an Agent (A), and an External Stakeholder (S), represented by a real charitable organization. Each participant begins with an endowment of 40 experimental currency units (ECU). Each round consists of two stages:

*Stage 1: Contract Offer.* The principal offers a contract with a fixed wage $\omega$, a non-binding target $\pi^\star$. The agent decides whether to accept or reject the offer. If accepted, the interaction moves to Stage 2. Else, the round ends and all players keep their endowments.

*Stage 2: Agent Decision.* If the contract is accepted, the agent chooses:

1. **Effort level ($e \in [0, 10]$):** Each unit of effort increases firm value by 10 ECU and incurs a convex cost $c(e)$ to the agent (see Table 1). Effort is symbolic and not linked to real tasks.

2. **Transfer ($d$):** The agent selects an amount $d$ to reallocate between the principal and the stakeholder. A positive $d$ benefits the principal (at the stakeholder's expense), while a negative $d$ benefits the stakeholder (at the principal's expense). Feasible transfers range from $d \in [-10e, 40]$.

Since value targets can be achieved through various effort-donation combinations, they provide only an imprecise signal of principals' desired outcomes. To obtain more precise information, we ask principals to enter hypothetical effort and transfer levels they would have chosen if they had been agents in this encounter.

Firm value is computed as:

$$\pi = 10e + d$$

Payoffs are:

$$M^P = 10e + d - \omega \tag{1}$$

$$M^A = \omega - c(e) \tag{2}$$

$$M^S = -d \tag{3}$$

Effort incurs a private cost, while harming the stakeholder is monetarily costless. This setup creates a behavioral trade-off: agents can meet perceived expectations through productive effort or by extracting value from the stakeholder.

Table 1: Cumulative Cost of Effort

| $e$ | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| $c(e)$ | 0 | 1 | 2 | 4 | 6 | 8 | 10 | 13 | 16 | 20 |

## 3.2 Implementation

### 3.2.1 General Protocol

The experiment was conducted in five sessions at the University of Hamburg with 146 participants. Roles were randomly assigned and fixed throughout. Each session consisted of 15 rounds, implemented as a repeated stranger-matching protocol with no feedback between rounds.

Participants were seated in private cubicles and completed incentivized pre-task modules measuring Social Value Orientation (SVO; Murphy et al., 2011) and risk preferences via the Bomb Risk Elicitation Task (BRET; Crosetto and Filippin, 2013). Instructions were delivered via a standardized oral script and comprehension was verified through mandatory checks.

Earnings were determined from six randomly selected rounds and converted at a rate of 40 ECU = 1 EUR.

### 3.2.2 Stakeholder Payments

The stakeholder's cumulative payoff, as determined by agents' transfers from the selected six rounds, was donated to a charitable organization selected by participant vote at the end of each session. Participants received a QR code to verify the successful payment of the session donation.

To capture both positive and negative externalities in the laboratory without generating actual harm outside the experiment, we endowed the stakeholder with a fixed amount of 40 ECU at the start of each round. This *reference endowment* was presented as the stakeholders's initial payoff. Agents' transfer decisions were then framed as changes relative to this reference: positive transfers reduced the charity's payoff (negative externality), while negative transfers increased it (positive externality). In the accounting of final payoffs, all amounts remained positive donations to the selected charity, yet the framing allowed participants to experience their choices as either diminishing or increasing an existing entitlement.

# 4 Preregistered Hypotheses

To assess the empirical plausibility of core claims in agency theory, we preregistered a series of directional hypotheses derived from a stylized normative benchmark. In its canonical form, agency theory is unconcerned with social norms: managers are modeled as agents of shareholders who maximize profits whenever contracts leave them discretion. The analytical focus lies on incentive compatibility, not on moral or ethical considerations. An interesting exception is Friedman (1970), often cited as a leading critic of corporate social responsibility. While Friedman famously insisted

that managers are responsible for increasing shareholder value, he also qualified this mandate by stating that profit-seeking should occur "so long as they stay within the rules of the game," including respect for property rights. He did not, however, specify what such rules or norms entail. This omission points towards what is arguably the most complex aspect of human behavior and institutional design: how norms shape the exercise of discretion.

Taking Friedman's benchmark literally allows us to formulate a conservative test of agency theory. We assume that both principals and agents internalize minimal ethical constraints. This differs from a pure *homo oeconomicus* assumption, which abstracts from norms altogether and predicts unconstrained self-interest. Behavioral economics, by contrast, has demonstrated that norms and role expectations systematically guide decision-making, making a norm-sensitive benchmark descriptively more plausible.

From this perspective, the agency-theoretic concern is straightforward: when contracts are flat and non-incentive-compatible, agents may use discretion to pursue their own moral or social preferences, thereby imposing agency costs on principals. Corporate social responsibility is thus treated as discretionary "corporate charity" that reduces firm value, with prosocial agents expected to generate larger divergences from principal interests.

Our experimental design directly implements this setting. All contracts provide flat wages and contain no enforceable incentives. Agents retain full discretion over both productive effort and transfers that affect an external stakeholder, reflecting the institutional environment assumed to be problematic in canonical accounts of managerial discretion. The five preregistered hypotheses outlined below follow from the expectation that, under these conditions, discretionary behavior will diverge from principal interests in ways consistent with "enlightened" agency theory:

**H1 (Directional, Negative): Principals respect third-party property rights.** If principals aim to maximize profit while avoiding harm to uninvolved third parties, they should not induce contracts that rely on stakeholder extraction. Since performance targets above 100 ECU require transfers away from the stakeholder, we hypothesize that observed performance targets will be significantly lower than the maximum of 140 ECU and, on average, not exceed the ethical threshold of 100 ECU.

**H2 (Directional, Positive): Contracts are quasi-incentive compatible.** Respect for agent autonomy implies that principals should not offer exploitative contracts. We hypothesize that most wage offers will be sufficient to implement the performance target through effort alone, without stakeholder harm. In other words, flat wage contracts will typically be quasi-incentive compatible, even in the absence of enforcement.

**H3 (Directional, Positive): Agents engage in altruistic CSR, generating agency costs.** Under classical agency assumptions, flat compensation creates scope for agents to pursue personal moral goals. If agents are prosocial, they may use discretion to benefit external stakeholders at the expense of the firm. We therefore hypothesize that average transfer payments will be significantly different from zero and positive, reflecting discretionary redistribution.

**H4 (Directional, Positive): Agency costs increase with agents' prosociality.** If discretionary CSR reflects altruistic moral preferences, then agents with higher social value orientation (SVO) should be more likely to transfer resources to third parties. This implies a negative relationship between agent SVO and principal payoffs, with prosocial types generating higher agency costs.

**H5 (Directional, Positive): Discretionary behavior is shaped more by agent preferences than by contract terms.** In the absence of enforceable in-

centives, behavioral variation under flat wage contracts is expected to arise primarily from agent-level heterogeneity. We hypothesize that effort and transfer decisions will be more strongly predicted by stable preferences—such as SVO—than by contract parameters such as wages or performance targets. This reflects the broader view that under minimal formal control, organizational outcomes depend more on agent type than on formal design.

Each hypothesis is tested using procedures detailed in the pre-analysis plan, which was registered prior to data collection on the Open Science Framework (OSF) (Szymczak, 2021).

# 5 Results

We now turn to the empirical evaluation of our preregistered hypotheses. These build on a stylized agency-theoretic benchmark in which managers maximize shareholder value subject to minimal ethical constraints. Unlike a pure *homo oeconomicus* model of unconstrained self-interest, this framework assumes that principals avoid inducing stakeholder harm (H1–H2), while agents—especially if prosocial—are expected to use discretion for altruistic redistribution, generating agency costs (H3–H5).

Our data diverge from these predictions. Principals largely respect ethical thresholds in contract design, and agents, regardless of social value orientation, do not systematically divert resources from the firm to external stakeholders. Instead, behavior reflects role-specific obligations and norm-sensitive restraint. The following subsections present these findings in detail, organized around the registered hypotheses.

## 5.1 Principal Behavior and Ethical Target Setting (H1–H2)

Agency theory predicts that when left unconstrained, principals may seek to maximize profit at the expense of uninvolved stakeholders. However, if principals in-

ternalize minimal ethical norms—such as respect for third-party endowments—they should avoid setting performance targets that rely on stakeholder harm (H1). Likewise, respect for agent autonomy implies that wages should be sufficiently generous to implement targets through effort alone, without inducing stakeholder extraction (H2).

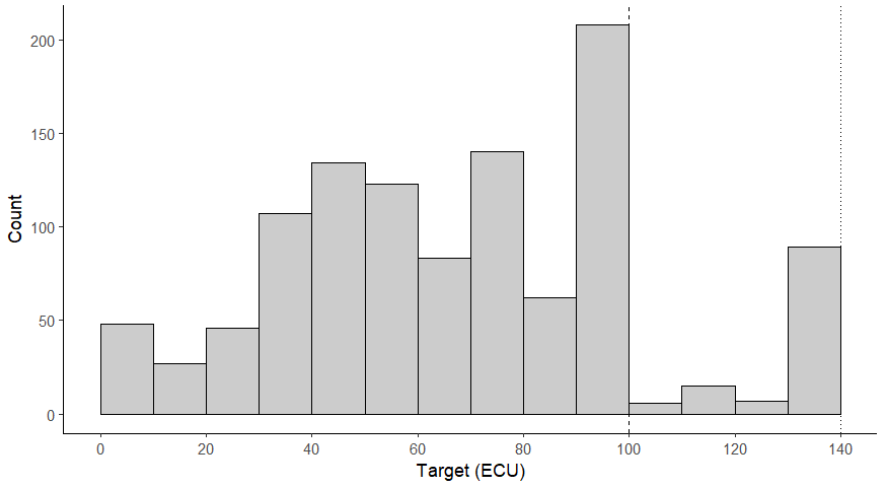


Figure 1: **Distribution of Performance Targets.** This figure plots the frequency distribution of performance targets chosen by principals. The dashed vertical line marks the ethical threshold of 100 ECU, above which targets require stakeholder harm. The dotted line at 140 ECU indicates the maximum feasible performance target under full extraction of stakeholder resources. Most contracts cluster well below the threshold, with a pronounced focal mass at exactly 100 ECU.

**Performance targets.** Descriptively, principals rarely exploit the redistributive potential of flat contracts. The mean performance target is 72.5 ECU (SD = 33.5), and fewer than 11% of contracts exceed the ethical threshold of 100 ECU. Only 7.9% request the full 140 ECU, the maximum possible under complete stakeholder extraction. Nonparametric tests strongly reject the null that the distribution equals either the exploitative upper bound or the ethical ceiling ($p < 0.0001$ in both cases).

A noteworthy asymmetry emerges when comparing principals' actual contract design to their hypothetical behavior in the agent role. While performance targets

overwhelmingly fall below the ethical threshold, principals' self-reported transfers as agents are, on average, negative (−7.02 ECU, SD = 15.3). More than half of responses (52 percent) involve stakeholder extraction with roughly 10 percent choosing the maximally harmful option, and only 13 percent indicate positive transfers. In contrast, one third of responses involve no redistribution. These patterns suggest that principals impose more norm-conforming expectations on agents than they apply to themselves. Put differently, contract design appears guided by role-specific ethical considerations, whereas personal behavior in the agent role reveals a greater willingness to extract stakeholder value.

*Observation I.* (a) Most principals avoid setting performance targets that require stakeholder harm. Although discretion permits extraction, over 89% of targets fall at or below the ethical threshold. (b) Yet principals' own hypothetical choices as agents are predominantly extractive, indicating that ethical restraint in contract design reflects role-specific expectations rather than personal preference.

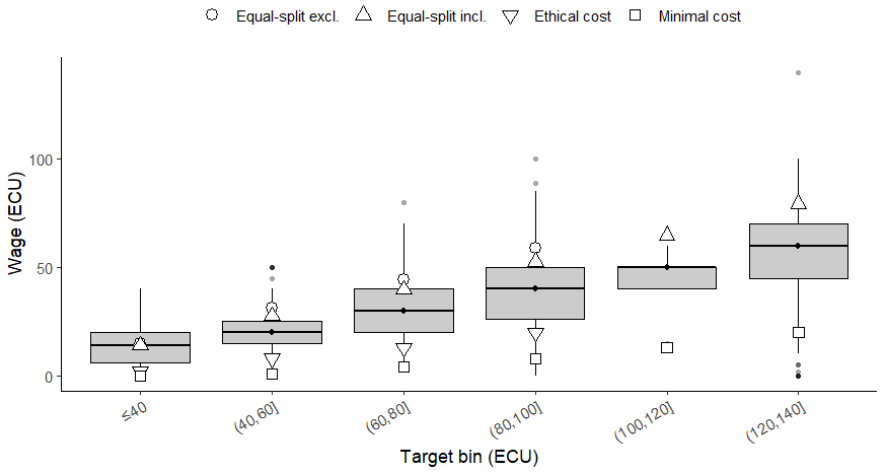


Figure 2: **Wage Offers by Target Bin.** This figure shows box plots of fixed wages offered by principals across performance target bins. Hollow markers indicate benchmark wage levels computed at the bin means: equal-split without stakeholder extraction (circle), equal-split with extraction (triangle), ethical cost of effort (flipped triangle), and minimal cost with extraction (square). The two equal-split benchmarks differ in whether extraction from the stakeholder is treated as part of the surplus to be shared.

**Wage offers.** Wages follow a norm-based rather than a cost-minimizing logic. Across target bins, principals offered wages that substantially exceed the minimum cost of hazardous implementation and closely track an equal-split benchmark. This pattern holds independently of social value orientation.

*Observation II.* Under flat compensation and full discretion, principals set wages consistent with fairness and reciprocity rather than with strict cost minimization.

## 5.2 Agent Discretion and Social Preferences (H3–H4)

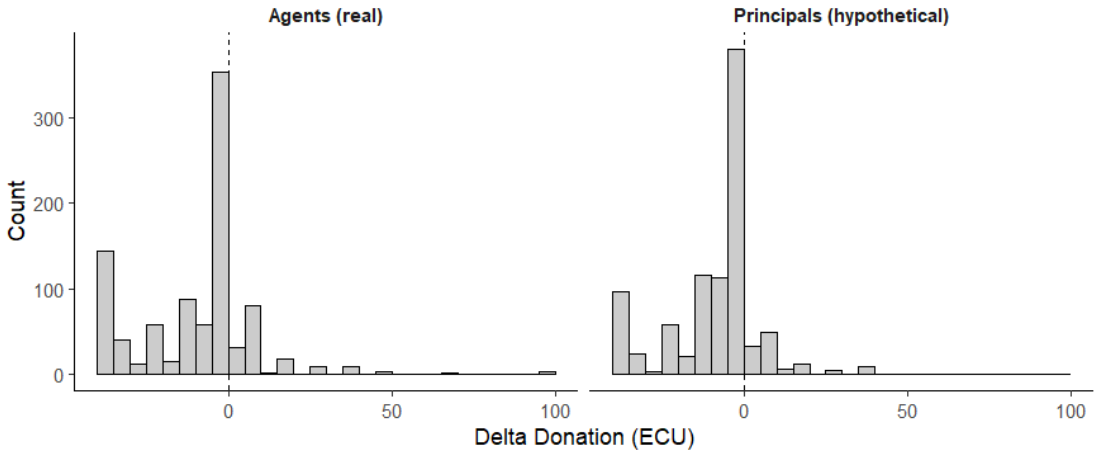


Figure 3: **Distribution of Transfers:** Agents vs. Principals (Hypothetical). This figure compares the distribution of discretionary transfers made by agents in the experiment (left panel) with principals' self-reported choices in the hypothetical agent role (right panel). The dashed vertical line indicates zero (no redistribution relative to the endowment of 40 ECU).

Transfers are, on average, negative ($-7.80$ ECU, SD $= 19.3$), with more than half of all agent decisions (53.5 percent) reducing stakeholder payoffs. One-sample tests strongly reject the null of zero transfers ($p < 0.0001$). Figure 3 shows that this extractive pattern closely parallels principals' own hypothetical choices when asked to imagine themselves in the agent role (mean transfer $-7.02$, 52 percent negative, 35 percent zero, 13 percent positive). In both real and hypothetical settings, the modal outcome is either no redistribution or stakeholder extraction, while positive

donations are comparatively rare. This symmetry suggests that ethical restraint in contract design does not stem from principals' personal preferences, but from role-specific expectations associated with their position.

*Observation III.* Agents do not exploit discretion to engage in altruistic CSR. On average, transfers are significantly negative, and the distribution of their choices mirrors principals' own self-reported behavior in the agent role.

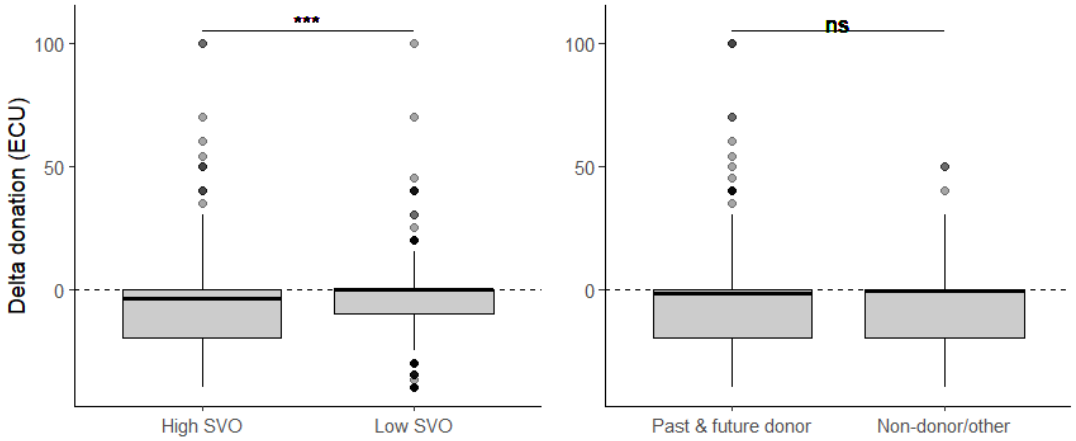


Figure 4: **Agent Transfers by Prosocial Preferences.** The left panel compares delta-donations for agents with high versus low social value orientation (SVO). The right panel compares agents who reported both past donations and future donation intentions ("Past & future donor") with all others. Box plots display medians, interquartile ranges, and outliers; dashed horizontal lines indicate zero (no redistribution relative to the endowment of 40 ECU). Stars denote significance levels from two-sample rank-sum tests ($^{*}p < 0.05$, $^{**}p < 0.01$, $^{***}p < 0.001$).

Figure 4 presents agent transfers by prosocial preferences. Contrary to Hypothesis 4, high-SVO agents do not allocate more to stakeholders; instead, they diminish the charity endowment significantly more than their low-SVO counterparts. A similar tendency appears when prosociality is defined through charitable preferences (donor vs. non-donor), yet here the difference is not statistically significant. Taken together, these findings reinforce that discretionary redistribution is not driven by prosocial dispositions. If anything, agents with higher levels of prosociality exhibit a relatively higher tendency to favor principals over stakeholders, consistent with a

loyalty-based rather than altruism-based interpretation of role obligations.

*Observation IV.* Prosocial preferences do not translate into stakeholder generosity. High-SVO agents reduce the charity endowment significantly more than low-SVO agents, and donors exhibit the same tendency relative to non-donors, though without statistical significance. This counterintuitive pattern suggests that prosocial dispositions are overridden by role-specific obligations, with stronger prosocial types displaying greater loyalty to principals rather than redistributing to stakeholders.

Table 2: Effect of Contract Terms and Agent Covariates on Outcomes

| | FE models | | | + Agent covariates | | |
|---|---|---|---|---|---|---|
| | Donation | Effort | Total $\pi$ | Donation | Effort | Total $\pi$ |
| Target | 0.062 | 0.013** | 0.066 | 0.046 | 0.015** | 0.106 |
| | (0.041) | (0.005) | (0.065) | (0.046) | (0.005) | (0.070) |
| Wage | –0.236** | 0.046*** | 0.699*** | –0.186* | 0.047*** | 0.654*** |
| | (0.077) | (0.009) | (0.135) | (0.076) | (0.011) | (0.145) |
| Low SVO | | | | 2.329 | -0.693$^{+}$ | –9.263* |
| | | | | (2.987) | (0.408) | (4.563) |
| Non-donor | | | | -2.925 | –0.255 | 0.380 |
| | | | | (3.207) | (0.544) | (5.855) |
| Constant | | | | -5.957$^{+}$ | 2.123*** | 27.183*** |
| | | | | (3.437) | (0.375) | (4.755) |
| Observations | 934 | 934 | 934 | 934 | 934 | 934 |
| $R^2$ | 0.437 | 0.530 | 0.492 | 0.028 | 0.204 | 0.206 |
| RMSE | 14.46 | 2.09 | 25.48 | 19.00 | 2.71 | 31.86 |

Standard errors clustered at the agent level in parentheses. $^{+}p < 0.1$, $^{*}p < 0.05$, $^{**}p < 0.01$, $^{***}p < 0.001$.

## 5.3 Preferences versus Contract Design (H5)

We finally assess whether discretionary behavior is driven primarily by contract design or by agent-level traits (H5). Table 2 reports regressions of donations, effort,

and total performance on contract terms, either with agent fixed effects or agent covariates, clustering standard errors at the agent level. The results show that contract terms systematically shape behavior even when they are unenforceable. Higher wages are associated with significantly lower transfers to stakeholders, but also with substantially higher effort and total performance. Targets exert a consistent positive effect on effort and overall return, though their association with transfers is not significant. Adding agent covariates does not alter these patterns. While social preferences do not predict incremental donations, agents with lower prosociality generate significantly lower total performances. This implies that less prosocial types reduce efficiency in the principal–agent relationship, even though they do not transfer more to stakeholders. The finding runs counter to the agency-theoretic view that prosociality is primarily a source of agency costs. In our setting, prosocial preferences do not create value for stakeholders, but they appear to prevent value destruction for principals.

*Observation V.* Discretionary behavior is not determined primarily by stable agent preferences. Instead, contract terms—in particular wage offers and performance targets—systematically shape both transfers and effort, underscoring the normative force of symbolic design features even when they cannot be enforced.

## 5.4 Summary of Findings

Table 3 summarizes the preregistered hypotheses and their outcomes. Principals set ethically compatible targets and offered wages that align with fairness benchmarks (H1–H2). In contrast, agents did not exploit discretion for altruistic CSR; their transfers were on average negative, and more than half of their decisions reduced stakeholder payoffs (H3). Prosocial traits did not translate into higher transfers; if anything, high-SVO agents diminished stakeholder payoffs more strongly than their low-SVO counterparts, with donor status pointing in the same direction (H4). Finally,

Table 3: Summary of Preregistered Hypotheses and Results

| **Hyp.** | **Benchmark** | **Result** |
|---|---|---|
| H1 | Principals avoid performance targets that require stakeholder harm (targets $\leq$ 100 ECU). | Supported. Mean target = 72.5 ECU; fewer than 11% above 100 ECU; fewer than 8% at 140 ECU. |
| H2 | Wages are quasi-incentive compatible, sufficient to implement targets without stakeholder harm. | Supported. Wages track the equal-split benchmark and lie well above minimal implementation cost. |
| H3 | Agents exploit discretion for altruistic CSR, transferring resources to stakeholders. | Not supported. Mean donation = –7.8 ECU; 53.5% of decisions reduce stakeholder payoffs. |
| H4 | Agency costs increase with agents' prosociality (higher SVO $\rightarrow$ higher transfers). | Not supported. High-SVO agents reduce stakeholder payoffs significantly more than low-SVO agents; donor status shows the same tendency but without significance. |
| H5 | Variation in behavior is driven more by agent preferences than by contract terms. | Not supported. Contract terms (targets, wages) strongly predict transfers, effort, and total performance, while agent preferences appear less important predictors. Yet, less prosocial agents generate significantly lower total performances, the opposite of agency-theoretic expectations. |

behavior was shaped primarily by contract design rather than stable preferences: wages and targets systematically influenced transfers, effort, and total performances, while individual prosocial dispositions had little explanatory power. Strikingly, less prosocial agents generated lower overall returns, suggesting that prosociality mitigates rather than exacerbates efficiency losses in the principal–agent relationship (H5).

# 6 Discussion

We examine how prosocial agents behave under discretion in stakeholder-affecting decisions—a setting that canonical agency theory predicts should generate substantial agency costs. Our experimental findings qualify this prediction. Using a principal–agent game with unenforceable flat-wage contracts and bi-directional stakeholder externalities, we document three main results. First, agents on average impose negative transfers on stakeholders, indicating that discretion is exploited to extract value rather than to redistribute it altruistically. Second, neither social value orientation nor charitable giving preferences predict higher stakeholder transfers; if anything, high-SVO agents reduce stakeholder payoffs more than low-SVO agents. Third, prosociality correlates with higher total performance and principal returns, suggesting that prosocial motivation mitigates rather than exacerbates efficiency losses. Together, these findings imply that managerial prosociality does not function as an agency cost in the way standard theory presumes.

## 6.1 Theoretical Implications

Our results carry several theoretical implications for agency theory, behavioral contract theory, and the governance of stakeholder-oriented decisions.

*Rethinking the agency cost of prosociality.* Agency theory traditionally treats discretion over stakeholder-affecting decisions as a structural vulnerability. The canonical argument holds that prosocial agents, unconstrained by enforceable contracts, will divert resources from principals to external constituencies, thereby generating agency costs (Jensen and Meckling, 1976; Masulis and Reza, 2015). Our findings invert this logic. Prosocial traits do not predict altruistic redistribution; instead, agents—regardless of social preferences—behave extractively toward stakeholders when acting in a fiduciary role. This pattern is inconsistent with models that

equate prosociality with unconditional stakeholder orientation. Rather, it suggests that prosocial motivation is conditional: expressed preferences depend on relational framing and perceived role obligations (March, 1994; Tenbrunsel and Messick, 2003; Haidt, 2007).

This result aligns with stewardship theory (Davis et al., 1997; Hernandez, 2012), which posits that agents may identify with principals' interests and derive satisfaction from faithful service. However, stewardship theory has often been critiqued for lacking behavioral microfoundations (Chrisman, 2019). Our experimental design provides a controlled test: when discretion is framed as part of an agency relationship with explicit principals, even agents with strong prosocial dispositions prioritize loyalty over redistribution. This finding extends behavioral agency theory (Pepper and Gore, 2015; Wiseman and Gomez-Mejia, 1998) by showing that intrinsic motivation need not conflict with principal interests when role-based norms are salient.

*Role expectations and normative framing.* A striking feature of our data is the asymmetry between agent behavior and principal preferences. Agents impose negative transfers on stakeholders, yet principals—when asked to imagine themselves in the agent role—anticipate similarly extractive choices. At the same time, principals design contracts that avoid requiring stakeholder harm and offer wages aligned with fairness norms. This divergence implies that behavior is not determined solely by intrinsic traits but by how individuals construe their responsibilities within a given role (Akerlof and Kranton, 2000; Weber et al., 2006; Chen and Li, 2009).

The implication is that discretion does not operate in a normative vacuum. When agents perceive their role as fiduciary—representing principals who delegate authority—they interpret prosocial motivation through the lens of loyalty rather than altruism. Conversely, principals, who occupy a position of authority and resource control, signal ethical expectations even when enforcement is absent. These patterns are consistent with behavioral contract theory, which emphasizes that trust, reciprocity, and

reputation concerns can sustain cooperation without formal monitoring (Fehr et al., 2007; Herold, 2010; Bénabou and Tirole, 2006). Our results suggest that fiduciary framing activates such norms, channeling prosocial motivation into alignment rather than redistribution.

*Symbolic contracts and behavioral guidance.* Our findings reveal that unenforceable contract terms influence behavior systematically. Higher wages are associated with increased effort and principal returns, consistent with reciprocity and gift-exchange models (Fehr and Schmidt, 2004; Falk et al., 2008). Performance targets similarly increase effort, even though agents cannot be punished for falling short. At the same time, higher wages correlate with lower stakeholder transfers, suggesting that compensation signals entitlement or reciprocity obligations that crowd out third-party generosity (Bowles, 2008; Gneezy et al., 2011).

These results resonate with the gift-exchange view that flat wages provide incentive power absent enforcement. Contract design functions as a normative anchor, shaping expectations of effort, fairness, and loyalty (Fehr et al., 2011; Baker et al., 1997). The effect is not reducible to monetary incentives; rather, it reflects how agents interpret their obligations in light of contractual signals. This interpretation aligns with reference-dependent accounts of contract design (Fehr et al., 2011) and with behavioral research showing that framing and expectations shape prosocial behavior (Ellingsen et al., 2012; Malmendier and Schmidt, 2017).

*Prosociality and efficiency.* Although prosocial agents do not redistribute to stakeholders, they generate higher total performances than less prosocial agents. This finding contradicts the assumption that prosocial preferences reduce efficiency in principal–agent settings. Instead, it suggests that prosociality operates through effort and value creation rather than through redistribution. One interpretation is that prosocial agents internalize principals' objectives more fully, consistent with goal alignment in stewardship theory. Another possibility is that prosocial agents

are more responsive to reciprocity and fairness cues embedded in contract design, leading to higher effort even when formal incentives are weak.

This result has implications for governance design. If prosociality enhances efficiency without generating redistribution costs, then policies that restrict discretion to prevent stakeholder redistribution may be counterproductive. Such policies risk eliminating the behavioral mechanisms—reciprocity, trust, role identification—that sustain effort under incomplete contracts. Instead, governance should focus on shaping the normative environment through contract framing, transparency, and ethical baselines.

## 6.2 Managerial Implications

Our findings suggest several implications for managerial practice and corporate governance. First, concerns that prosocial managers will divert resources to stakeholders at shareholders' expense appear overstated. In contexts where fiduciary expectations are salient, prosocial agents prioritize loyalty to principals. This implies that selecting managers based on ethical disposition need not conflict with shareholder value maximization.

Second, contract design matters beyond monetary incentives. Even unenforceable terms—such as target performance levels and base wages—shape effort, reciprocity, and role expectations. Firms can leverage these mechanisms by designing compensation structures that signal fairness and respect while reinforcing fiduciary obligations. Conversely, overly rigid or punitive contracts may undermine intrinsic motivation and erode trust (Frey and Oberholzer-Gee, 1997; Ghoshal, 2005).

Third, policies aimed at restricting managerial discretion may inadvertently eliminate valuable behavioral mechanisms. If discretion activates role-based norms that align agent and principal interests, then limiting discretion removes opportunities for trust, reciprocity, and stewardship to function. Governance reforms should therefore

balance oversight with autonomy, recognizing that certain forms of discretion enable rather than obstruct alignment.

## 6.3 Limitations and Future Research

Our study abstracts from several features of real-world corporate settings. First, we examine a one-shot interaction with flat wages and no reputation effects. Repeated interactions, career concerns, and reputational incentives may alter how agents exercise discretion (Holmström, 1999; Gibbons, 2005). Future research should explore whether role-based norms persist when agents face long-term reputational stakes or when principals can terminate relationships.

Second, our stakeholder is represented by a charitable donation, which may not fully capture the complexity of negative externalities imposed by firms. Real-world externalities—pollution, labor exploitation, community harm—involve tangible victims with potential recourse (Hart and Zingales, 2017; Shapira and Zingales, 2017). Whether agents behave similarly when stakeholders can retaliate or when externalities are more salient remains an open question.

Third, we focus on settings where principals signal ethical expectations through contract design. In environments where principals explicitly encourage extraction or where norms are ambiguous, agent behavior may differ. Comparative studies that manipulate principal signals or institutional norms could clarify the boundary conditions of role-based prosociality.

Fourth, our sample consists of student participants, not corporate managers. While experimental methods provide internal validity, external validity remains a concern. Field experiments or archival studies that link managerial traits to stakeholder-affecting decisions would complement our findings.

Finally, we measure prosociality through social value orientation and charitable giving. Other dimensions of prosocial motivation, such as moral identity, perceived

obligation, or adherence to deontological norms, may predict behavior differently (Aquino and Reed II, 2002; Reynolds, 2008). Future work should examine how different ethical constructs interact with role framing and discretion.

# 7 Conclusion

This paper revisits a central assumption of agency theory: that prosocial motivation generates agency costs when managers exercise discretion over stakeholder-affecting decisions. Using an incentivized principal–agent experiment, we find that prosocial agents do not redistribute value to stakeholders; instead, they impose negative transfers while generating higher total performances. Principals design contracts that avoid requiring stakeholder harm and signal fairness, even when enforcement is absent. These results imply that managerial prosociality operates through role-based loyalty rather than unconditional altruism.

Our findings qualify governance models that treat discretion as inherently dangerous and prosociality as a liability. When fiduciary expectations are salient, prosocial motivation aligns with rather than opposes principal interests. Contract design, though unenforceable, shapes behavior by anchoring expectations of reciprocity and role obligations. Prosocial agents contribute to efficiency without generating redistribution costs, suggesting that policies restricting discretion may eliminate valuable behavioral mechanisms. Future research should explore the robustness of these patterns across repeated interactions, alternative stakeholder representations, and field settings. Understanding how normative framing shapes the expression of prosocial motivation remains a critical frontier for governance scholarship.

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# A Appendix

## A.1 Theoretical Framework

Firms often rely on incentive contracts to align managerial behavior with organizational goals. Classical models in contract theory emphasize performance-based pay as a tool to mitigate agency problems (Holmstrom and Milgrom, 1991; **?**). Yet, these models typically assume that the only relevant dimension of managerial decision-making is the generation of shareholder value. In practice, however, managers also make choices with consequences for external stakeholders—choices that are difficult or impossible to contract upon. These externalities may include environmental impacts, labor conditions, or the provision of public goods. Their non-contractibility introduces a second layer of discretion that interacts with financial incentives in complex ways.

At the same time, growing evidence suggests that managers are not purely self-interested: they may possess intrinsic concern for others (Fehr and Gächter, 2000; Andreoni, 1989; Ashraf et al., 2020) and respond reciprocally to perceived fairness in compensation (Dufwenberg and Kirchsteiger, 2004; Kube et al., 2012). These behavioral traits become particularly salient in incomplete contract environments, where firms cannot enforce specific actions and instead rely on informal mechanisms such as gift exchange and trust.

To formalize these dynamics, we develop a principal-agent model in which the manager makes two interdependent decisions: (i) how much effort to exert to generate firm value, and (ii) how much to invest in—or extract from—external stakeholders. The model incorporates two behavioral dimensions: intrinsic prosocial preferences and role-dependent reciprocity. The agent may derive utility from benefiting stakeholders and may also reciprocate generous or fair treatment from the principal.

### A.1.1 Baseline Model: Gift Exchange with Stakeholder Impact

The first experimental setting models a stylized labor relationship in which contracts are incomplete and non-enforceable, reflecting the classical gift exchange framework (Akerlof, 1982; Fehr and Gächter, 2000). In this environment, the principal offers the agent a fixed, unconditional wage $\omega$ and a non-binding performance target $\pi^\star$, without the ability to enforce effort or condition pay on outcomes. This setup captures situations where formal monitoring is infeasible and cooperation must be elicited through informal mechanisms such as perceived fairness.

We extend the standard gift exchange model by introducing a second dimension of managerial choice: stakeholder impact $d \in \mathbb{R}$, which may represent socially beneficial ($d \geq 0$) or harmful actions ($d < 0$). Both effort $e \geq 0$ and stakeholder impact $d$ influence firm value:

$$\pi = \alpha e + \beta d,$$

where $\alpha > 0$ denotes the marginal profitability of effort, and $\beta$ captures the relationship between stakeholder impact and firm value. For $\beta < 0$, generating positive stakeholder impact or mitigating negative impact is costly to the firm, as typically assumed in agency theory. For $\beta > 0$, there exists a win-win situation – a business case for corporate social responsibility.

The agent derives utility from the wage, incurs convex costs for effort and stakeholder actions, and may also be motivated by intrinsic prosocial preferences and belief-dependent reciprocity. The agent's utility is given by:

$$U(e, d) = u(\omega) - C(e) - k(d) + \delta\psi d + \rho \cdot (\omega - \bar{u}) \cdot \pi,$$

where: $u(\omega)$ is utility from wage, increasing and concave; $C(e)$ and $k(d)$ are strictly convex cost functions; $\delta \geq 0$ reflects intrinsic concern for stakeholder welfare; $\psi > 0$ is the marginal utility weight placed on stakeholder outcomes; $\rho \geq 0$ captures

reciprocity sensitivity to fairness; $\bar{u}$ is the agent's reference utility (outside option or fairness benchmark).

The last term models reciprocity: when the wage $\omega$ exceeds the agent's reference level $\bar{u}$, the agent reciprocates by increasing firm value $\pi$, possibly by substituting stakeholder-harming actions $d > 0$ for costly effort $e$. This introduces a moral trade-off: agents may meet expectations through value-enhancing but morally questionable decisions when externalities are cheaper to generate than effort.

**Testable Predictions:**

- Higher wages $\omega$ increase firm value through reciprocal effort and/or stakeholder extraction: $\partial \pi^* / \partial \omega > 0$.
- Agents with higher $\delta$ (prosociality) are more likely to internalize harm to stakeholders: $\partial d^* / \partial \delta < 0$.
- When stakeholder harm is a low-cost substitute for effort, reciprocity may crowd out moral behavior.

## A.2 Instructions

### Background

This experiment simulates decision-making situations of shareholders and managers: shareholders ("Player A") set performance targets and define the remuneration conditions of their managers. Managers ("Player B") make decisions that determine actual profits as well as the payoff of a third party ("Player C", further information under "Payment").

### Procedure

At the beginning of the experiment, each participant is randomly the role of either "Player A" or "Player B". All participants keep their assigned role throughout the

experiment. In each round, you will play with a different participant who takes on the other role. Both you and your partner remain anonymous. The pairings are re-shuffled after each round, such that you only play with the same person once. Only you and your current partner will learn the outcome of any round.

The experiment comprises a total of 15 rounds. In each round, Players A, B and C receive an endowment of 40 Talers each. In the course of each round, you have the possibility to earn additional points. The rounds follow the following scheme:

**Phase I**

At the beginning of each round, Player A defines a performance target and draws up an offer about remuneration conditions of Player B. This offer may include the following payments:

- Flat Payment, which is automatically paid to Player B, regardless of his or her decisions (values from 0 to 40 Talers)
- Contractual bonus payment, which will be automatically paid to Player B if he / she achieves the performance target achieved (values from 0 to the performance target are possible)
- Voluntary bonus payment, which is made at the discretion of Player A after the announcement of the result. Player A can make a non-binding bonus announcement in his or her offer (values from 0 to the performance target are possible)

The terms of compensation only apply if Player B agrees to the terms. If the offer is denied, the round ends and Players A, B and C each receive their endowments. If Player B accepts the offer, Phase II will follow.

**Phase II**

If the offer is accepted, Player B decides how much effort he / she would like to invest. Player B has a total of 10 effort units available. Each invested effort unit increases the profit by 10 Talers and causes Player B costs. The total costs for a specific effort investment can be found in the following table:

| $e$ | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| $c(e)$ | 0 | 1 | 2 | 4 | 6 | 8 | 10 | 13 | 16 | 20 |

Player B may also determine a transfer amount, which affects the profit as well as the result of Player C. This amount can range from -10 x effort investment and 40 Talers. Positive transfer amounts increase profits by the chosen amount and reduce the result of Player C by that amount, negative transfers reduce profits and increase the result of Player C. Profits are calculated as follows:

Profit = 10 x effort investment + transfer amount

**Results of the round**

Once Player B has made his or her decisions regarding the effort investment as well as the transfer amount, Player A is informed about Player B's decisions and the resulting profit. After the announcement, Player A can make a voluntary bonus payment. Finally, the result of all three Players A, B and C are communicated.
Player A receives the profit minus Player B's payout.
Payoff (Player A) = 40 + profit - compensation (Player B)

Player B receives the agreed remuneration as well as the voluntary bonus minus expenses.

Payoff (Player B) = 40 + compensation (Player B) – cost of effort investment

Player C receives the endowment minus the transfer amount.
Payoff (Player C) = 40 - transfer amount

**Final payoff**

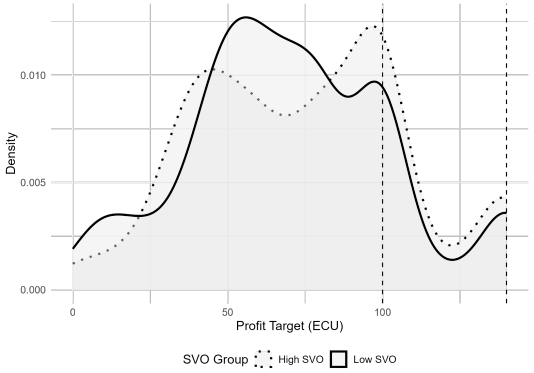
The final payoff is calculated based on six randomly chosen rounds. At the end of experiment, the cumulative result of these six rounds will be converted into EUR at a fixed exchange rate (1 EUR = 40 Taler). Players A and B each receive the sum of their in cash. The Payment to Player C is also calculated on the basis of these six rounds. The amount for Player C will be paid to a regional charitable initiative, which is chosen at the end of the experiment.

After the main experiment, you can choose your preferred recipient from a list of six regional initiatives. The initiative with the most votes will receive the payment. The payment will be transferred entirely to the chosen initiative. From 6 pm onward, you can check the total payment from this session as well as the supported initiative under the QR code on the payoff slip.

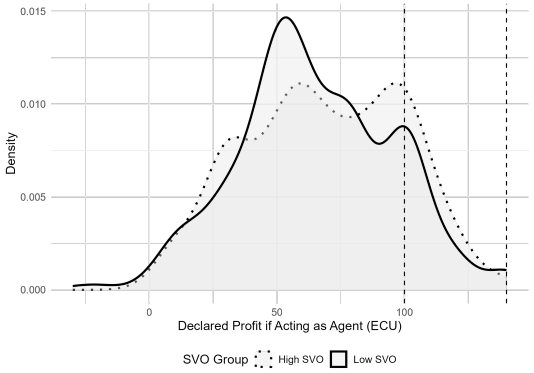
## A.3 Additional results

### A.3.1 Principal Behavior and Ethical Target Setting (H1)

### A.3.2 Agent Discretion and the Direction of Responsibility (H3, H4)

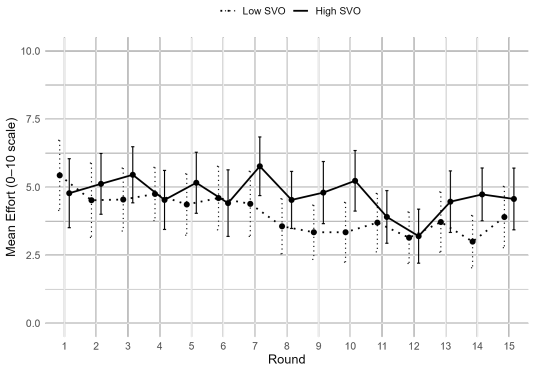



(a) Performance targets offered by principals, by SVO group.

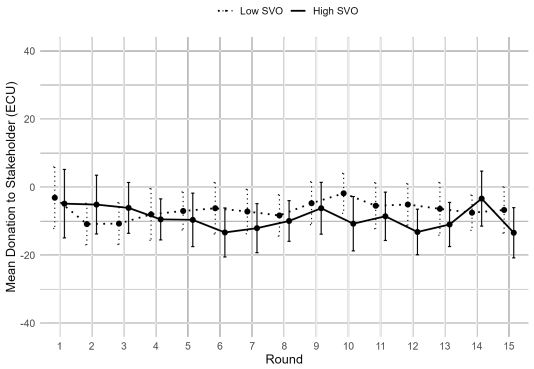



(b) Principals' declared behavior if placed in the agent role.

Figure 5: Distributional patterns of contract offers (left) and projected agent behavior (right), disaggregated by principal social value orientation. Vertical dashed lines indicate the ethical threshold (100 ECU) and the profit-maximizing upper bound (140 ECU).




(a) Effort levels over time, by agent SVO group.




(b) Donations to the stakeholder over time, by agent SVO group.

Figure 6: Average effort and donation decisions by round and agent social value orientation. Points indicate group means with 95% confidence intervals. High-SVO agents are represented with a solid line; Low-SVO agents with a dotted line.

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