State involvement as a necessary condition for the development of banks

Using institutional economics to describe the development of banks' corporate citizenship

Jan Zonneveld
University of Applied Sciences Amsterdam
Center of Applied Research on Economics and Management
Wibaustraat 3b, 1091 GH, Amsterdam
j.a.w.zonneveld@hva.nl

Abstract

This paper aims to further develop an institutional perspective on the development of banks. We perceive banks as integrated institutions in the network of society and focus on the decisive role of formal and informal state-involvement for institutional change with banks. We assume that the extent to which banks embed 'themselves' in society depends primarily on their responsiveness (reflexivity) to formal and informal governmental influence. We review what effects on bank behavior are caused by varieties of formal state-involvement and explore the construct of corporate citizenship to address the ethical issue of public discontent with banks.

Key words: Integrated institutions, state-involvement, banks, institutional change, corporate citizenship, institutional networks, mental models.

1. Introduction

Since 2007, when the worst financial-economic crisis since the 1930's started, we have seen an explosion of scholarly and media debates emerged to discuss the position and behavior of banks in society. Many scholars state(d) that banks were (and still are) too heavily tilted toward short-term policies in order to satisfy shareholders and their personal interests, rather than the public interest (Van Staveren, 2012; Minsky, 2015). Some doubt the economic viability of banks (IMF, 2016) or even the current worldwide financial market system (Vogl, 2014, Pettifor, 2013). Discontent in the public opinion on financial institutions has been triggered by the role, size, influence and operation of these companies and their managers (King, 2016, Larkin, 2015). Journalists and other media have been unveiling fraudulous or sub-optimal performance of banks with regards to lending, interest manipulation, selling derivatives to SME's and housing corporations, diminishing the number of jobs, reducing payment levels at lower levels in the company, while continuing to pay high salaries and bonuses to (top) managers and traders. Ten years after the initial shock of the crisis, there is still much public distrust with the banking sector, in spite of banks being compliant with regulation and therefore thinking they are doing a good job[1].

We ask ourselves how the corporate contribution to societal goals of banks is perceived and addressed by society and banks. We want to know if (and how) this perception changed over the past ten years and what are the key drivers for change. In The Netherlands, recent research of the Dutch Monitoring Committee Code Banks (2017) concludes that banks are compliant with regulation and managers are rather satisfied with their social performance, while society is not. The inconvenience of society with banks is still alive and discussed through scholarly work, in the media and in the political arena. Our question is how banks responded to these discussions and did (or did not) change their behavior as responsible "corporate citizens" after 2007. In the words of Aoki (2005): How did the changes in

[1] This is a key conclusion of the Monitoring Committee of the Dutch Banking Society, 2016

perception and expectations towards banks in the political and social institutional domains after the crisis resulted in actions to influence bank behavior and did it actually had the (envisaged) effects on changes in the organizational and economic institutional domains in the financial sector? How do the mental models in the different institutional domains match and (consequently) are new rules effective "rules-in-use", leading to the desired institutional change in the financial sector?

In an attempt to generate more responsible bank behavior, a huge amount of new regulation has been introduced (Jooste, 2015) on top of increasingly higher financial buffers (Brunnermeier, 2009). Well known examples are the Dodd-Frank Act in the U.S. and the Report of the Independent Commission on Banking (the so-called Vickers report) in the UK. In addition, surveillance and control of the sector is strengthened (Boonstra, 2014). And although laws and other regulation will undoubtedly help to change behavior, research also shows that regulation is expensive and can be even counterproductive (De Graaf, 2013). In order to be effective, regulation should be institutionalized as "rules-in-use", meaning that the underlying values, assumptions, goals etc. should be understood and "lived" (Ostrom (1998, 2007). Simply complying with regulation may mean nothing more than implemented "rules-in-form". Veldman and Willmott (2016) add to this that institutionalization happens through "double loop" reflexive learning, in which companies are reflexive to their activities in the light of regulation and give precedence to substance over form. Only following formal regulation, they call single loop learning, which only enforces current situation, instead of changing it. If formal regulation fails to address important social issues properly, it results in lower confidence in banks (Kay, 2015). Such issues may concern (lending) services to local communities, customers relations, market trading ethics, private debt loads, remuneration, key appointments in the boards, handling of privacy related data, employment practices, creating meaningful products, investments in sustainable business, innovations and local entrepreneurship. Not much is known about if (and how) the formal attempts by the state to change financial institutions were accompanied by informal influencing, leading to social embeddedness of changes and eventually to a new equilibrium, acceptable for all players in the economic, political, organizational and social domains.

Banks are not regular companies, but execute typical public functions like creating, saving and lending money and facilitating payment services, while providing risk transformation, through financial mediation (largely based on monopolistic client relationships and information) and ensuring financial stability (Boot & Ratnovsky, 2016). A typical element of banking products is that consumers perceive them usually as important, but also as "low interest", comparative to electricity and water. Banks are looked at as (big) abstract bureaucratic institutions, built on ict systems, figures and calculations, which make it even more unattractive and difficult to understand. As a result of all this, we would expect banks not only to work on individual customer intimacy level, but also be very closely related and responsive to opinions and developments in the public (political) domain, which are important factors determining the image of the company and the sector. In this paper we assume that this is the case and therefore state-involvement is decisive for changes in banking institutions and has been so particularly after 2007, when many banks were taken over by governments to prevent bankruptcy. Banks are an integral part of a tied institutional network. Within our perspective banks act as corporate citizens, entities that are part of the public interest and have certain social responsibilities. The conditions and characteristics of banks are interrelated to the society in which they exist.

Our attempt to develop a 'state-centered' perspective is not a theoretical endeavor only. From the onset of crisis in 2007, governments took financial stakes in more than 32 banks in 25 countries (Laeven and Valencia, 2012) through share purchases, emergency loans/guarantees and liquidity provision, and bought securitized debt obligations from banks on the brink of bankruptcy. State share purchases cost society approximately 7% of GNP (Gandrud, Haller and Berg, 2015). By supporting banks, governments

became owners of key functions for society and the economy, including payment systems, money creation, providing loans and risk-transformation. Some political parties[2] and scholars argue that banks should stay nationalized (longer), assuming that state-owned companies will do better in addressing issues of public interest (Buiter, 2009, Toussaint, 2016).

The forced change of ownership of major banks after 2007 changed the power balance in the sector overnight, creating an interesting, uncomfortable and complicated situation for every institution involved and providing a fertile ground to realize a major shift in institutional equilibria. Nevertheless, authors (De Graaf, 2005; Butzbach, 2015, Musacchio et. al., 2013) also show that state-involvement is not a new phenomenon. Also in neo-liberal market situations, governments are dominantly present on the financial markets. For example, in current times this dominance becomes manifest through the "Quantitive Easing" programmes of central banks in the USA, EU and Japan. This involvement has been legitimized by the important role banks have in economies and society at large.

In spite of the clear presence and active role of the state in the financial sector, much is unclear about the social impact of more or less state-involvement in banks. The response to the financial crisis of 2007 enables us to assess if state-involvement of banks also leads to behavior in the financial industry that is more responsive to societal needs and the demands of national economic development. For example, we would like to know if, –given more state-involvement - banks developed and implemented new CSR-policies, showing institutional change in response to societal needs. The answers to those questions require further building on the analysis of relationships between economical, organizational, political and social domains with regards to financial institutions.

Our premise is that the state will have used its property rights to stimulate the "right" corporate citizen behavioral changes with its "own" banks. By explaining how banks are influenced by governments through other means than regulation or market transactions only we want to contribute to a more comprehensive view on the relationships between banks and society, in which not only the centrally designed regulatory "bones" are visible, but also the evolution of norms and values (mental models), influenced by informal relationships between banks and the state, serving as the "cartilage"[3] for socially embedded institutional change within banks.

2. Setup of paper

We propose a perspective on the development of the social role of banks in society from a structural, institutional perspective in which sociological, economical, legal, ecological and psychological ideas merge. This perspective assumes that organizations are social constructs; certain mental models that guide individual behavior (e.g. Hodgson, 1989; Nooteboom, 2000; Grandori, WINIR spring 2017).

The third paragraph explorers theoretical backgrounds on institutional change, incorporating theories on human behavior. The fourth paragraph addresses the theoretical debate of (varieties of) state involvement in private companies. In the fifth paragraph we create a framework for capturing the ethical issue of "societal (dis)content" by exploring and using the construct of corporate citizenship.

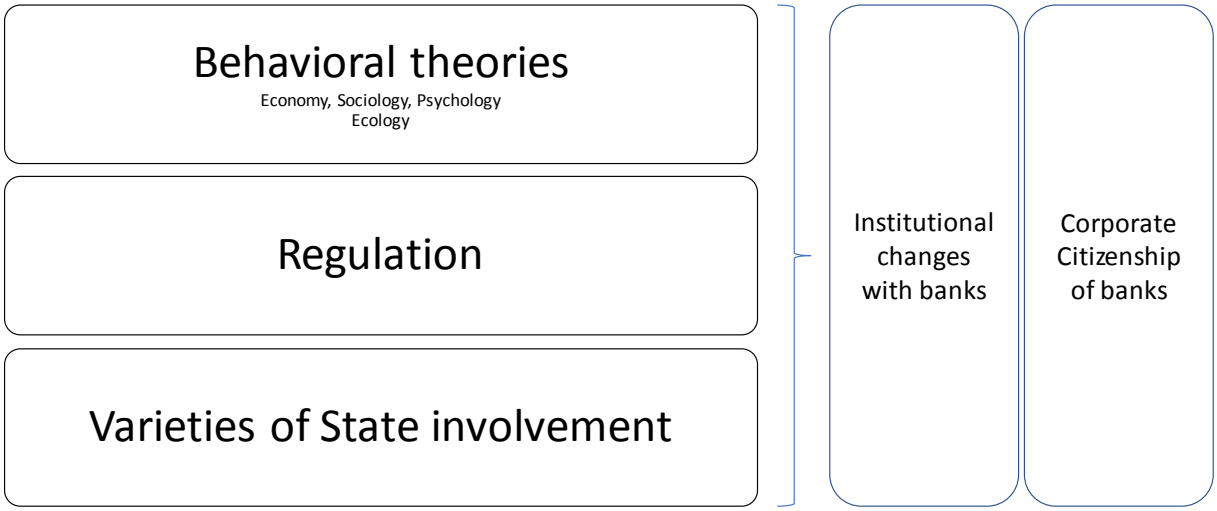
Describing the (inter)action of the state and banks, their role in financial crises and how changes after such crisis are institutionalized in banks through economic, social, regulatory, political, psychological and

[2] In The Netherlands: Groen Links and SP, two left wing parties

[3] Cartilage occurs mainly at the ends of the bones. It is coated over the surface of the joints, providing the bones sliding easily over each other and reducing friction, preventing surrounding tissue from being damaged. Cartilage is similar to bone and also has a bearing function, but it is not as strong as real bone

ecological disciplinary interpretations is useful to understand (and deal with) the complexity of this matter and maybe also why so much debate about banks continues to go on.

Setup of paper



3. Behavioral theories on institutional[4] change and banks: Economical, regulatory, psychological, sociological and ecological perspectives.

Debates about financial markets still seem to be dominated by neo-liberal ideologies, translated within neo-classical theoretical approaches and or principal-agency theory (Veldman & Willmott, 2016). Within these debates, a simple dual relationship is dominant between the principal, the owner of the shares of the company, and the agent, the manager that is running the company on behalf of the owner. The state serves to set the regulatory boundaries in which these two actors interact (De Graaf & Williams, 2009). The principal-agent dichotomy is useful to describe relationships between companies and their owners, but even more fertile ways to describe the development of networks and its participating institutions have been developed by Grandori (2001, 2012) aiming for an interdisciplinary approach to researching (networks of) organizations and stressing that not only macro and sociological disciplines should be researched, but also micro-analytical analysis of organizations and the processes that develop network relationships.

Companies are changing in interaction with their environment (Oliver, 1991, 1997, Salancik and Goodrick 1996, Scott 2001) and take part in this change actively. Scott (2001) and Nooteboom (2000) argue that an eclectic approach of scientific theory is necessary in an attempt to describe reality and should include cultural and social systems and processes.

Grandori (2017) distinguishes the interpretation and institutionalization of (financial) companies, as economical, regulatory, social or political constructs. Within an institutional economic perspective, we further develop this eclectic theoretical point by relating it to economic, political, psychological and anthropological insights on financial markets. Within an institutional perspective, we describe banks as behavioral constructs in a societal context.

[4] We use North (1990) to define institutions as "humanly devised constraints that structure political, economic and social interactions"

Theoretical descriptions of institutional change may choose a “design” approach of change, which assumes centrally organized cognitively intentional and formal collective action (a.o. Libecap, 1993; Ostrom, 1998; Alston, 1996; Kantor, 1998; Hodgson, 2004; Kaufman, 2007). Other theories choose more evolutionary ways of describing reality, assuming development to take a more decentral, irrational and informal route (Veblen, Hayek, Sugden). In combination, like for example in theories of changing equilibria, these theoretical approaches provide important insights for describing formal and informal sources of change within and between institutions (Kingston and Caballero, 2009).

We argue that phrasing a bank as corporate citizen better describes these organizations than the construct that seems to be dominant in mainstream economics and law, in which banks are perceived as independent entities in a market competition in which governments set legal constraints to influence (ethical) behavior (De Graaf & Williams, 2009). From the different perspectives we distill and combine theories that are relevant and valuable for our goals: Researching formal and informal state influence on banks.

3.1. Economic perspectives

From a functional economic point of view banks can be viewed as organizations to provide for money creation, efficient and innovative payment systems, providing loans and risk-transformation. From an economic perspective, larger buffers are required by regulators to prevent insolvency (and a cascade of bankruptcies) in future crises, deriving from crises in the financial markets. Economic views are intended to be rational, but can also be perceived as normative and have been adopted by political institutions, in order to shape society, including other institutions, like banks.

Underhill argues that the policy domains involved are those of financial supervision and the lender-of-last-resort facility for the banking sector; macroeconomic adjustment, exchange rate and monetary policy; and (sovereign) debt work-out processes. The interlinkages among these policy domains in crisis and good times alike should be emphasized. However, it is not the case that these policy domains are necessarily formally linked in terms of decision-making processes, and this is definitely part of the problem with how crises are dealt with (Underhill, 2014).

From a normative angle, economists like Friedman (1962, 1970) and Jensen (2000) suggest that, from an economic point of view, shareholders are the ultimate owners of the company and should have the ultimate say in how companies (like banks) should be run and developed in the construct of a “free” market and with the goal of financial return on investment only. Other economists criticize the neoclassical or neoliberal view on the economy, like Wartick & Cochran (1985). Herkstroter (1999, 2002) argues that companies have a broader social responsibility, which involves social acceptance and legitimacy through accountability towards all stakeholders. According to Ackerman (1973), the responsibility of companies will be institutionalized in the processes of the company and the responsiveness of companies should be researched (Bauer and Ackerman, 1976).

According to Underhill (2014) the advantages of the international markets are mainly for the creditors, while the disadvantages deriving from crises are mainly for the debtors and little has been done to tackle this asymmetry. Kaye (2015) also describes brilliantly how the financial sector is playing and gambling with money from others, while the bill of losses is paid for by society.

In the institutional theory Williamson (1985), building on the work of Coase (1937), says that within economic science, the role of organizations in economic processes deserve separate attention. Building on this we follow this view and research banks as organizational institutes in society.

Economic conflicts can be repaired by corrective justice, based on laws, moral, good or wrong and causal relationships. In addition to this principle, Coase's economic theory (1937, 1960) states that

usually conflicts will be solved because the parties find a solution whereby the maximum return is achieved for society as a whole at the lowest possible cost. Both parties compete for the same resources. By negotiating parties, and under the discipline of the market, a solution to the conflict is found.

From an economic-political point of view, combined with psychological insights, scholars like Vogl (2014) argue that the financial (or even the capitalist) system will collapse as a result of neo-liberal economic thinking. Systematic derailment of human economic behavior inevitably would result again in a new catastrophe, partly because of the enormous (and still fast growing) size of the globalized financial markets. From this angle, there are continuous warnings about the growing amounts of debt of individual households and governments. The quantitative easing measure taken by governments, but also the Chinese investments, intended to boost economic growth, is a growing source for anxiety and possible future crises (….)

3.2. Regulatory and behavioural perspectives

In legal constructs companies, like banks, can be viewed as public limited liability or joint stock companies, where each shareholder has his own piece of a bank. With regards to ownership, Haan & Vlahu (2015) state that the effects of ownership on banking are always mediated by regulation. Furthermore Butzbach argues that banks have a peculiar business model, with the assets not being the property of the bank and there are multiple providers of capital, like depositors and shareholders (Butzbach, 2016).

We know that property rights (or: equity owners) and firm-ownership are not the same. Fama (1980) and Hodgson (2015) state that “property is a legally sanctioned right, not to be confused with possession, which indicates the effect control of an asset”. Also Grandori (2017) argues that shareholders possess only a part of the company and do not control it. Shareholders have rights towards the companies for the part of their own share, but they are not the sole owners of the company as such (Ghoshal, 2005:79, Ireland, 1999). Grandori argues that the real principals of banks are also employees and society at large, having rights according to other “constructs” than from an economic point of view. For example, employees spend their energy and time and banks are embedded in societies, where political parties, scholars and media have their normative views on how banks should behave in society. The important role and influence of banks in the economy provides them with responsibilities that go far beyond profit-making. As sole integral representatives of the company, in all its shapes and with all its responsibilities, executives are the agents of more principals than the shareholders only (Boatright, 1984). Good governance should take this into account.

In another part of the legal construct, low confidence in the financial sector has been answered by governments with large amounts of new legislation, which is to be supervised by authorities. Through legislation and control (enforcing compliance), governments are directly influencing banks to act and behave according to norms and values prevailing in society. The strengthened monitoring and regulation are intended to prevent new emergencies (Brunnermeier, 2009). However, banks experience the (rigid) measures of laws, rules and control mostly as a bureaucratic and expensive burden and are largely paid for by customers (and to some extend the shareholders), while they may prove to be insufficient to prevent new derailing of banks and sometimes be even counterproductive (De Graaf, 2013).

Governments want companies that were rescued by the taxpayer after 2007 to return to the (private) stock exchange as soon as possible. Especially western governments are choosing to stay away from the ownership of banks. The free market is still a widely accepted mantra in western societies and its negative side-effects should be tackled by regulation and control. But can laws fully change or enforce behavior in the way “society” wants it? There is much evidence that it is not enough. In this discourse,

(a.o.) Veldman argues that the legitimacy of the company is at stake if boards do not act upon their fiduciary duties or “ethical leadership” (Veldman, 2016), going beyond regulation.

According to Prast (2004), psychological constructs related to the financial sector can be split in approaches that are based on the hypothesis that people behave rationally and theories that show how emotions rather than rational thinking explain behavior. Cognitive rational models are describing how people respond to information in a rational manner and can be categorized and labeled as models dealing with reputation (do what is expected from you by the group), external effects (going along with the herd) or as waterfall models, growing bigger and faster while falling down (Devenow en Welch, 1996). In addition to the cognitive-rational models, Kahneman (2011) shows the irrational (emotional or intuitive) part of human behavior. An important reason for irrational behavior is loss aversion. (Kahneman en Tversky, 1979, 1985). Kahneman argues that most economic decisions are being taken by thinking fast (which can be irrational), instead of slow and rational. Irrational behavior may become irresponsible and even catastrophic in the financial industry, for example when bankers start gambling with “other people’s” money (Kaye, 2015).
Supervision by financial authorities has its limitations, because the supervisors identify themselves (partly) with the financial sector they are supposed to supervise, deriving from the fact that many of them are former employees of the banks they supervise (Veltrop en de Haan, 2014), which poses questions with regards to their personal preferences and bounded rationality.

3.3. Socio-economic perspectives

Actors in the political and financial sector struggle with (legal) agreements. There is continuous debate and collaboration between governmental, political and financial actors in order to create acceptable solutions for new issues, deriving from (new EU) legislation, which complicates the finding of solutions for failing banks that are interwoven in financial and political institutional networks. An example of how this works is shown by how the crisis of Venetian banks was solved in the spring and summer of 2017.

Galbraith (1973), Sen (1999) and Ostrom (2004) are important contributors to an political economy in which companies get a moral role, involving the war against poverty, sharing wealth, contributing to the freedom of people, which are issues going beyond regulation.

From a political point of view, banks are centers of power in society, playing a key role in increasing welfare of (parts of) society. Banks provide financial platforms for economic and social development. Not only groups with a direct stake in the company (like its own shareholders, customers or employees) are seeking power in order to create advantage for their own interests, but also the state, as the protector of broader social and economic interests is an important stakeholder in banks, effectuating its stake through regulation, control and continuous discussion with representors of banks and the banking industry.

In Dutch society, from a social-politicological perspective, the historical continuity of the Dutch corporatist culture may have played a role in the way the government dealt with the crisis. In The Netherlands government and banks have always maintained close relations. So for example, Government Commissioners came at ING in 2008, a situation that also existed until 1994. (De Graaf, 2012). In (political) elite theories (Heemskerk, 2009), banks can be regarded as important vehicles to operationalize elite-interests and therefore they will seek direct influence in banks. Corporatism describes how elites are effective in addressing their mutual interests.

Granovetter (1992) argues that economic relations between individuals or companies take place within and are structured by existing, layered social relationships. From this social point of view, banks are

groups in interaction with other groups in society, while facilitating, providing and innovating services to society, employment and centers of business and other societal activities and markets.

Social networking analysis is a widely accepted method for studying this phenomenon and also the historian North (1990), and sociologists Meyer and Rowan (1977) address the (normative) role of institutions in this context. According to Scott (2011), institutional theory views questions like: Why do companies look alike? Why do regulation and normative systems exist? How is the environment playing a role here? What are the interests regarding organizations and how do order, stability and change coincide? Isomorphism and other institutional are constructs in this respect to describe how norms and values are being institutionalized.

3.4. Society first: Institutional and evolutionary economics as an integrative developmental perspective

Developments within and amongst institutions are created by regulative, cognitive and normative processes, which can be studied at the same time. Selznick (1948) views organizations as a continuous interaction between the processes creating procedures and rules and the processes that shape the organization as an adaptive organic system.

Nooteboom (2000) argues that the 'institutional arrangement' (the organization) can be observed and described and will be (normatively) influenced by its environment continuously through exchange of information between societal actors. In this perspective, an institution is not an entity, but an activity and it is important to research how norms and values are being institutionalized in rules and customs. Key is not to research everything, but especially the decisive moments that change organizations or their environment, which can be seen by studying critical decisions that change structures, procedures and processes. Isomorphism helps to determine the key moments of institutionalization (DiMaggio and Powell, 1983, p. 149), also by looking at exceptions or deviations to it.

In addressing the dynamics of (historical) developments with and within companies, developments and diversity can be described as a continuous process of creation and (creative) destruction, which should be (re) interpreted continuously (a.o. Veblen, 1899; Sugden, 1989; Williamson, 1989; North, 1990).

Butzbach (2017) uses an ecological approach to address the dynamic development of banks as institutions. He shares the insight that diversity spurs dynamical evolution, while isomorphic tendencies (deriving from the wish to be more efficient) may lead to systemic risks and too big to fail companies) which have proven to turn out dangerous for a healthy development over time. Examples of diversity are found in the kind of shareholdership (joint-stock or not), in organizational differences or in differences in the (mix of) the fundamental company-goals, like peer-to-peer lending, Islamic finance, microfinance, sustainability, profit maximation etc. (Butzbach, 2017).

Also Van Assche states that institutions are dynamically developing constructs, which are (re)interpreted continuously (Beunen, Duineveld and Van Assche, 2015). Berman & Rowley (2000) Jawahar & McLaughlin (2001), Margolish & Walsh (2003) are advocates of a descriptive explanation of processes between companies and their environments, leading to answer on what kind of social responsibility companies have. They argue that deductive research is not useful, because a broadly accepted normative framework is lacking. Their inductive approach is based on pragmatic philosophies, like Johnson and Duberley (2000), stating that people cannot completely reconstruct their own reality, but an opinion can be said to be "true" when it helps a group of people to cope with their world and broadly accepted theoretical foundations are necessary to define what is true.

4. Institutional change as a result of formal and informal state influence: Conceptualizing state involvement after the financial crisis of 2007

Through state involvement in banks, the political institutional domain claims its position in the financial industry and we suggest state-involvement to be the key driver for institutional change with banks. Obviously formal involvement comprehends legislation and other kinds of regulation. Furthermore controlling institutions, like central banks and other authorities and also the ownership create formal and informal ways to get involved closely to banks, triggering institutional changes. State-ownership of banks is relatively common in countries like India and China, but seemed to be "out of bounds" in the western world. But after the recent financial crisis, 25 countries took over more than 32 banks, creating unintended principal-agent relationships. We assume that this new situation also created new lines of formal and informal communication and adjusted the mental models of the institutions involved.

Before we focus on the institutional changes with banks through state involvement, we first want to address the matter of privatization, because we assume this debate has influenced the mental models with regards to state ownership. Most research on privatization and state capitalism has focused on studying the (in)efficiencies creating such a performance gap between SOEs relative to private firms, what Lazzarini et al (2014) refer to as "liability of stateness." Only in a few exceptions has there been an attempt to uncover what determines this performance gap, either by looking at different ownership configurations (Cuervo & Villalonga, 2000; Ramamurti, 2000) or by outlining institutional conditions that may lead to smaller performance gaps (Bartel & Harrison, 2005; Mahmood & Rufin, 2005; Vickers & Yarrow, 1988). As such, the dominant view is that SOEs underperform their private counterparts under almost any circumstance. However, recent literature on state-owned enterprises also reveals that many of these firms are taking center stage in the global economy and are often performing at least equal to, if not better than, their private counterparts. For instance, the 25 largest SOEs among the top 100 firms in the Fortune Global 500 have an average return on assets of 3.49% and an operating margin of 14%, which is comparable to the 3.44% and 5.7%, respectively, we find among the largest 75 private firms in the world (Lazzarini, Quatá, & Musacchio, 2014). Furthermore Mazzucato (2013) show that public institutions (army, universities) play a crucial role in key innovations, which are used for further development by private companies, providing them a competitive edge to generate profits, originating from tax payer funding.

A "liability of stateness" is that the state nudges companies to adopt socially desired changes, which may not be beneficiary for short term profitability. In The Netherlands, an example of this are the articles of Association of the NLFI, the foundation that holds the shares on behalf of the State, allowing for state influence on (e.g.) remuneration of the bank executives. And the state actually used this possibility, in an attempt to keep the remuneration of the board low(er). The Dutch financial sector experienced different types of state capitalism over the past ten years. Research is needed to assess to what extent the liability of stateness can be found with partly 'nationalized' banks.

Instead of focusing on the rather binary discussion regarding whether public or private ownership is the most efficient, Musacchio, Lazzarini and Aguilera (2013), developed a theoretical perspective on various forms of State interference in different (national) institutional conditions, allowing us to discuss state ownership in a more fertile way. The authors distinguish four forms of State participation: a. Full owner, b. Majority interest c. Minority interests and d. Strategic aid (via policy). These shapes can be approached from four distinct points of view: 1. Management Agency, 2. Social goals, 3. Political goals and/or 4. the Institutional conditions. In the array of shapes and theoretical angles creates a varied landscape of (sixteen) ways in which cooperation and mutual supplement between the State and enterprises can be described. See also table 1 on page 23.

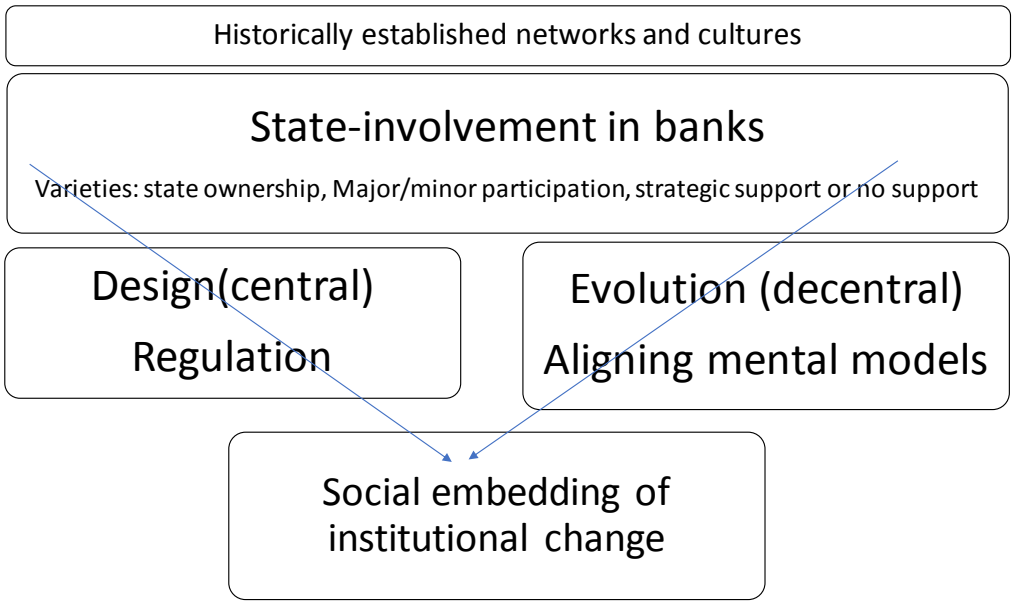
The framework and typology of Musacchio et al emphasizes both the degree and strategic type of state

involvement. We rely on the interdisciplinary range of theoretical perspectives to identify and describe the functional traits of four varieties of state participation: traditional wholly owned SOEs, SOEs with majority state capital, SOEs with minority state capital, and a variety of state capitalism in which the state provides strategic support through policies stimulating new firm capabilities and upgrading. The combinations shape the existing strategic capabilities/liabilities and corporate governance patterns in varieties of state capitalism. For instance, the institutional environment will determine the degree to which each typology will succeed in reducing traditional agency and political challenges associated with SOEs, and how much it will constrain or enable governments to intervene in firm-level management.

The model of Musacchio et al (2013) is more fertile than the dichotomous image of the State versus the private company and does justice to the complexity of the cooperation between the Government and strategically important companies. And even though the model was not developed for the financial sector, the different ways in which the Dutch Government dealt with banks after 2007 can be described this way. According to the model we would expect full ownership political to result in politically motivated appointments, policy-changes towards more social goals and more responsiveness towards public and political anger. A Dutch example was the claw-back of bonuses with ABN AMRO in the spring of 2015. We may also expect the responsiveness to societal demands decreases as the participation in the company is scaled down.

We currently lack understanding of the ties between ideologies or mental models of the financial market and state-involvement. Is state-involvement something extra, or is it a crucial determinant? To what extent do national cultures influence banks, or are banks more corporate cultural institutions that cannot be separated from their roots. For example, would it be possible to run an Italian bank in the Netherlands? And if an Italian bank starts a branch in the Netherlands, would that bank have more characteristics of the Italian mother, or would it become more comparable with Dutch Banks, given the dominance of Dutch regulation and other specific institutional circumstances.

How the state shapes corporate citizenship with banks



5. Corporate citizenship as a guiding construct within institutional economic approaches to banking

Corporate (Social) Responsibility and corporate citizenship refer to (ethical) responsibilities of the firm going far beyond satisfying shareholders only. The dualistic construct of principal-agent relationships and the economic notion of banks as profit making players in a competitive marketplace are both far too limited to fully understand the role of banks in society. Starting in the seventies of last millennium, scholarly debates on this matter resulted in a shift with corporations form philanthropy and attention to corporate action "beyond law", to an inquiry into how a company conducts its business with regards to the responsibilities of corporations towards society (Williams, 2016). In 2010, the debate on CSR resulted in the International Standards Organization (ISO) developing the ISO 26,000 standard for corporate responsibility in 2010, by using the following useful definition:

"*CSR is the responsibility of an organization for the impacts of its decisions and activities on society and the environment, through transparent and ethical behavior that contributes to sustainable development, including health and the welfare of society, takes into account the expectations of stakeholders, is in compliance with applicable laws and with norms of behavior, and is integrated throughout the organization and practices in its relationships*."[5]

This definition allows the assessment of the firm as an institution with regards to changing behavior towards society and shows what kind of responsibility we have in mind with regards to banking.

While the definition of CSR tells us what kind of corporate responsibility of banks we are addressing here, we suggest the framework of corporate citizenship to explain why and when society is not satisfied with the banks with regards to this responsibility. The understanding of citizenship in most industrialized societies is located in the liberal tradition, where citizenship is defined as a set of individual rights (Faulks, 2000: 55-82). Following the widely accepted categorization by T.H. Marshall, liberal citizenship comprises three different aspects of entitlement: civil rights, social rights and political rights (Marshall, 1964). We use these three aspects to describe responsible corporate citizen behavior of (western) banks and bankers, who are (usually) also operating their business in a largely liberal moral framework.

a. Civil rights consist of those rights that provide freedom from abuses and interference by third parties (most notably the government); among the most important of which are the right to own property, to engage in "free" markets, privacy or freedom of speech. Relating this construct (of sheltering weaker parties from abuse by dominant ones) to banking, we do not suggest that privately owned banks should be sheltered from government interference (although this might be argued by neo-liberal bankers), but that (groups of) civilians should be sheltered from abusing activities by powerful banks. The state provides this shelter through regulation and control.

b. Social rights consist of those rights that provide the individual with the freedom to participate in society, such as the right to education, healthcare or various aspects of welfare. Both types of rights are clearly focusing on the position of the individual in society and help to protect its status (Eriksen & Weigård, 2000). As such, civil and social rights are to some extent extremes on the same continuum: civil, sometimes called "negative" rights, protect the individual against the interference of stronger powers; social "positive" rights are entitlements towards third parties. The key actor here is the government, which on the one hand respects and grants the civil rights of "citizens" and – generally by the institutions of the welfare state – cares for the fulfillment and protection of social rights. With regards to banking and banks, this construct

[5] ISO, I. (2010). 26000: guidance on social responsibility. *Ginebra: ISO*.

relates to the accessibility of (semi-public) banking facilities, like affordable payment services and lending, to all citizens and institutions in society.

c. In contrast to these more passive rights (with the government as active respecter or facilitator) the third category of political rights moves beyond the mere protection of the individual's private sphere towards his or her active participation in society. This includes the right to vote or the right to hold office and, generally speaking, entitles the individual to take part in the process of collective will formation in the public sphere. Wood and Logsdon (2001) suggest that corporations enter the picture – not because they have an entitlement to certain rights as an individual citizen would – but as powerful public actors which have a responsibility to respect those individual citizen's rights, which are not only constituted in formal legislation, but are also present in unwritten generally accepted norms and values. Taken into account the power of banks (and its managers) we see an important gap here between the public and banks. Since banks are private companies, the public as a stakeholder will feel powerless towards these institutions. Society can only influence banks in an indirect manner, through state involvement.

We see the relation of corporations to citizenship (CC) in the context of shifts in business-society relations which have seen corporations take over many of the roles and actions previously expected of governments (Hertz, 2001). With banks this entails the creation and transfer of money, including lending and payment systems, but also the transformation of risk and ascertaining economic stability or growth. CC is not simply about corporate social policies and programs which might (or might not) be adopted in the same vein as CSR (and related constructs). Rather, the effective functioning of liberal citizenship has been sufficiently affected by the corporate uptake of government functions to render corporate involvement in "citizenship" as a largely unavoidable occurrence.

For example, in the realm of civil rights, we might suggest that in a world which is economically interlinked by global financial markets, nation states have only limited ability to protect certain aspects of their citizens' property (one of their civil rights). With pension funds and life insurance being linked to international capital markets, pensioners rely on these markets to protect their property, yet they are beyond the full control of the national governments. The same goes for the relationship of banks (so also for the owners of savings accounts) and the international financial markets. In terms of social rights, it is evident that in a global economy, the welfare state is under constant threat, and state regulation of social and environmental standards, particularly in less developed countries, is increasingly shaped by the FDI decisions of MNCs. It has been argued that only if governments can offer "favorable" conditions to corporations in terms of low social standards, depressed wages, and limited regulation of working conditions are they able to survive the "race to the bottom" and attract much desired foreign investment (Scherer & Smid, 2000). Finally, where political rights are concerned, it is particularly the right to take part in political decisions and the right to hold office which are increasingly taken in arenas beyond the nation state, such as in the European Union, World Bank, IMF, or the United Nations. In order to participate in these decisions, or to hold office in the relevant institutions, the nation state is still important, but not the only institution to guarantee access to the exertion of these rights. The current developments with central banks and QE prove this latter phenomenon.

Our premise is that corporations enter the arena of citizenship at the point where traditional governmental actors fail to be the "counterpart" of citizenship. As one of the actors most central to globalization, and indeed one of its principal drivers (Scholte, 2000: 98), corporations have tended to partly take over certain public functions with regard to the protection, facilitation and enabling of citizen's rights – formerly an expectation placed solely on the government. We thus contend that if a term such as "corporate citizenship" makes any sense in the proper meaning of the term, "corporations" and "citizenship" in modern society come together at the point where the state ceases to be the only guarantor of citizenship any longer. With banking functions this is clearly the case.

Matten and Crane (2005) suggest to define CC as follows: Corporate citizenship describes the role of the corporation in administering citizenship rights for individuals. Corporations (and certainly banks) have taken over considerable responsibility for such administration from governments. With regard to social rights, the corporation basically either supplies or does not supply individuals with social services and hence administers rights by taking on a providing role. In the case of civil rights, corporations either capacitate or constrain citizens' civil rights, and so can be viewed as effecting administration through more of an enabling role. Finally, in the realm of political rights, the corporation is essentially an additional conduit for the exercise of individuals' political rights – hence the corporation primarily assumes administration through a channeling role and this is why we would expect the state, representing the dominant political institutions to provide the norms and values, which should be taken into account by banks and thus safeguarding (developing) individual and collective political rights. In this way state involvement is key with institutional developments.

In presenting this conceptualization of CC, however, it is important to recognize that CC in these terms may be the result either of a voluntary, self-interest driven corporate initiative, or of a compulsory, (collective) public pressure driven corporate reaction in the same way as conceptualized by North (1991) and Ostrom (1998). The point is that CC so defined is essentially a descriptive conceptualization of what does happen, rather than a normative conceptualization of what should happen.

The notion of citizenship can be most appropriately introduced to management theory as a way of descriptively framing the empirical relation of the individual to the corporation, regardless of one's normative assumptions about what role corporations should play. As Livesey (2002) has shown, corporations such as Shell – which have been under pressure to assume political responsibilities beyond those traditionally expected of corporations – have frequently sought to downplay this extended role and elucidate to the public the "proper" (i.e. more limited) role of business.

This calls for more research: first to examine the true extent to which corporations have undertaken such practices; second to reveal whether corporate managers have, or feel that they have, a mandate for such action; and third to understand more clearly how to resolve the tensions created by the apparently contradictory demands placed on management in this respect. This leads to a third observation: corporate "citizens" normally assume their roles only if it is in their self-interest to do so. This leads to activities of CC which are, in the majority, for the benefit of society and praiseworthy. If governments fail in their responsibility to facilitate citizenship, society can only be happy if corporations fill this gap. But should society really be happy about this? The immediate question is: if corporations have assumed such a pivotal role in society, what happens if CC – in its extended sense – is not in their self-interest? Research efforts should be redirected towards assessing whether corporate actions are in society's interests. A more general, and in fact more fundamental problem connected to CC is that, if corporations take over vital functions of governments, one could argue that they should also take over exactly the type of accountability which modern societies demand from government as a facilitator of citizen rights.

Governments are accountable to their citizens and, in principle, could be approved or discharged of their responsibilities through the electoral process. Similar mechanisms however do not exist with regard to corporations. Such a demand would, however, of course represent an importation of a normative assumption from political theory – that the administration of citizenship should be balanced with a degree of accountability. However, the question of corporate accountability has been rising up the social, political and economic agenda, and is one which management theory and practice is increasingly having to take seriously (Zadek, Pruzan and Evans, 1997). Clearly this is an area where more research is needed. However, one stream of literature has examined the possibility for corporations to audit and report on their social, ethical and environmental performance through new accounting procedures (e.g. Gray, Dey, Owen, Evans, & Zadek, 1997; Livesey, 2002; Zadek, Pruzan, & Evans, 1997).

Another stream of literature has looked at broader issues of communication with stakeholders, and development of stakeholder dialogue and stakeholder partnerships (e.g. Bendell, 2000; Crane & Livesey, 2002, De Graaf, 2005), while a third stream is focusing on how organizations internalize change (Veldman & Willmott, 2007). Management research has yet to fully get to grips with the question of how (or whether) stakeholder engagement, reporting – and more broadly even "stakeholder democracy" – can play a role in managing the relationship between us as citizens, and corporations as administrators of our citizenship. Similarly, since corporations have emerged as active players in the administration of citizenship, we question how their role interlocks with that of governmental and non-governmental actors.

6. Concluding remarks

Public pressure and political influence have formal and informal influences on companies in the financial sector. From our perspective, state involvement is not an addition, but rather a cornerstone of how banks develop. A lasting healthy financial sector depends on laws, regulation and supervision, which means it depends on state-involvement. These institutional structures influence the development of habits (Hodgson, 2004), and thereby they are decisive in the behavior of agents. Banking can happen only in close cooperation and often integration with the government. Government uses its power as state, and creates when necessary extra entrances as owner to control the company, also in informal ways, working well to ensure the establishment of "good" corporate citizenship with banks, allowing banks to be (more) socially embedded in society.

Formal and informal interference by the state in financial institutions is of all times. The government will have direct impact on the long term policy of banks with a view to reliability and continuity on social and political areas. Musacchio, Aguilera and Lazzarini (2013) show that in modern democratic societies, with well-developed public administration, successful varieties of combined ownership exist, in which the Government and private investors both have an interest in strategically important companies. Ownership by the State may increase stability and more attention for the long term, with a sharp eye for the citizen rights in society, while the efficiency-advantages of private enterprises can be maintained. Governments are to be integrated in the way financial institutions are governed, not just through (rigid and expensive) regulation and supervision, but also by (more flexible) continuous intensive communication and informal influence.

Corporate citizenship could help to further develop this perspective. As a construct, it binds economic, regulatory, sociological and psychological terms together. Where principal-agent theory has dominated the societal debate on financial markets for more than three decades, another perspective is necessary to take the societal embeddedness of banks into account. Critical weakness of the construct is its methodological openness. Where within dominant economic perspectives relationships can be modelled by using the principal agent-theory, corporate citizenship does not have a simple binary relationship that can guide researchers and policy makers. Within a corporate citizenship perspective, the purpose of the company is critical. Within certain jurisdictions, the purpose of a company is getting renewed.

The recognition of public interest in banks and jointly taking responsibility for the financial sector is necessary to create a common European culture and structure in the governance of financial institutions, with the aim of a healthy financial sector, which is at the service of society.

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Table 1.
Varieties of State Capitalism
(Musachio et al, 2015)

Theoretical Perspectives and Their Contribution to Understanding the Varieties of State Capitalism				
	Wholly owned state-owned enterprises (SOEs)	State as majority investor	State as a minority investor	State strategic involvement
Managerial agency view	Managerial agency is likely an important cause of poor performance, given the absence of external, for-profit investors and the lack of improved governance practices in wholly owned SOEs (e.g., boards and executive teams are packed with members of the government).	Managerial agency problems will be moderate if SOEs have improved governance practices (e.g., boards with independent external members), pay-for-performance executive salaries, and enhanced accounting standards.	Managerial agency problems will be moderate to low, as SOEs with minority state capital are not directly controlled or run by the government.	Managerial agency problems will be low, as the government may support private firms run by professional managers.
Social view	Managers will likely face a "double bottom line" (e.g., social objectives such as low customer prices or higher employment beyond profitability). Mixed, complex objectives will likely undermine the quest for efficiency and profitability.	"Double bottom line" still present, but with an enhanced emphasis on profitability depending on the presence of external, for-profit investors and the existence of improved governance practices that insulate the SOE from excessive governmental influence.	There is likely an emphasis on profitability, except in cases where the state has a residual ability to intervene (e.g., there is collusion between state-related minority shareholders).	There is likely an emphasis on profitability, subject to policy goals (e.g., state capital supports riskier projects with high social externalities).
Political view	Use of SOEs for political gain undermines profitability (e.g., SOEs will be run by politically appointed managers and benefit politically connected capitalists).	Soft budget constraints are present (governments will likely bail out poorly performing projects). Soft budget constraints are still present (SOEs with majority state control will hardly go bankrupt). However, improved governance practices may make it more difficult the use of SOEs to support political allies.	There are moderate budget constraints, given that there is still minority state capital. Constraints will be softened, however, if the firm is singled out as a national champion and has extensive political connections.	There are moderate to hard budget constraints, depending on the extent to which industrial policies have clear performance metrics and "sunset" clauses.
Institution-based view	The institutional environment will act as a contingency-based factor that will affect performance of each model			