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Rodolfo Apreda

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A CLINICAL APPROACH TO THE GOVERNANCE

OF CONFLICT-SYSTEMS

Rodolfo APREDA

Professor Rodolfo Apreda holds a Ph. D. in Economics (UBA, 1998) and a Master in Political Sciences (Ucema, 2005). He is director of the Ph. D. Program in Finance and director of the Center for the Study of Public and Private Governance, Ucema.

Personal Web Page: www.cema.edu.ar/u/ra E-Mail Address: ra@cema.edu.ar

ABSTRACT

Whereas a clinical approach to organizations has a well-deserved predicament, narrowing down such viewpoint to governance issues in organizations shows that there has been, so far, an almost complete neglect of this field of enquiry, on which this paper intends to make a contribution. Firstly, the basics of the clinical approach will be expanded on, moving on next to conflicts of interests. Afterwards, we are going to feature organizations as conflict systems. Next, the clinical approach will be applied to conflicts of interests among stockholders, directors, managers, creditors, and other stakeholders, drawing up from this context of analysis consequential elements of diagnosis and treatment for distinctive ailments pervading the governance of organizations.

JEL codes: G32, G34

Key words: clinical approach; corporate governance; conflict systems; conflicts of interests; coalitions.

Institutional disclaimer

INTRODUCTION

As organizations evolve, their governances follow suit. Contrariwise, when organizations grow older or ailing, it is likely that their governances provide causative factors in both decline and disease.

This paper deals with a clinical approach to governance dysfunctions, bringing forth insights and resources on how to cope with them through the diagnosis, prevention, and treatment for both the healing and turning around of failing organizations. I will take advantage of my own research on this subject[1], comprising my last book on governance risks (Apreda, 2012a).

In order to attain this program, section 1 handles the notion and scope of what I understand by the clinical approach to organizations. It is for section 2 to point out the linkage between stakeholders and corporate actors. Section 3 expands on conflicts of interests, distinguishing positives from negative ones. In section 4 we address the viewpoint of organizations as conflict systems. Lastly, section 5 shows how the clinical approach may handle conflicts of interests arising among the most conspicuous stakeholders.

1. THE CLINICAL APPROACH TO ORGANIZATIONS

Human beings usually visit a medical clinician on the grounds of two alternative concerns:

a) Firstly, to find out guidelines to overcome some illness, by means of treatment or surgery; or to know how the illness will unfold so as to get time in dealing with personal or family matters before passing away.

[1] See references at the end of this paper.

b) Secondly, to undergo a check out so as to prevent ailments or, at least, put them off.

This metaphor seems a suitable one to be mapped onto organizations. In point of fact, governance consultants, senior management, owners and boards, investment bankers, lawyers and auditors, market analysts and regulators, usually perform a sort of clinician role, to prevent organizations from growing ill or actually to treat the ailing ones[2]. Such was the starting point of Selznick (1943, 1948) and Pranger (1965), who favored the clinical approach to organizations. Both authors advocated doing research into organizations by changing the terms of observation so that the researcher could become an observer, a clinician that provides advice for the healing and redress of failing developments[3].

One of the main tenets of the clinical approach consists in linking facts with values. The clinician stands engrossed on "seeing" and 'listening" his distinctive patient in its entirety, giving heed to those corporate actors whose preferences count most in setting goals and values. It goes without saying that both the company and the clinician inherit values from the underlying culture and primary institutional settings that shape their behavior and fashion their preferences[4].

On the other hand, organizations should not only be regarded as mechanical devices, whose members are only rational economic agents only involved in being efficient and efficacious. Here lies the rationale from which Selznick challenged the emphasis Herbert Simon (1947) and others had put on rationality and efficiency. For him, organization theory is embedded in values, from which stems the need of training managers and directors about their responsibilities to setting targets and strategies, and ultimately

[2] More background in Apreda (2011b, 2005).

[3] On this account, Apreda (2007a, 2005) has set up a pragmatic standpoint.

[4] This feature comes strongly related to social capital, an issue widely researched by Coleman (1973a).

becoming political brokers[5]: "*Any concrete organizational system is an economy; at the same time, it is an adaptive social system.*"

For the sake of precision, we must notice that the governance of organizations related to the health industry has also been called Clinical Governance. For instance, in the Cambridge Business English Dictionary (2011) this notion is predicated on "the way organizations that care for people's health are managed at the highest level, and the systems for doing this." Far from holding this narrow and rather misleading meaning, we are engaged here in a comprehensive approach to deal with governance issues arising out of any sort of organization.

2. STAKEHOLDERS AND CORPORATE ACTORS

Although the notion of stakeholders sometimes goes assimilated to that of a claimant, such a connotation becomes rather fuzzy. To begin with, **claimants** are those who seek as due a right they consider being legally theirs, or who request something to which they presume to be entitled. This is an explanation that also encompasses infrequent demands arising from standalone transactions. For instance, how many times did you press claims to the lost baggage office at an airport?

Therefore, when using the term **stakeholder** we can't help thinking that albeit it refers to a claimant, we face a role that must be shaped within the context of down-to-earth organizations and hence it asks for a definition[6]. On account of this, figure 1 outlines who are the main players who hold their stakes in any organization.

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[5] Selznick (1948, page 25). Further analysis about the role of political brokerage will be found in section 4, point c) on coalition building.

[6] Definitions, within the scope of this paper, stand for a semantic and methodological vehicle on behalf of any considered reader who may ask himself: which is the meaning the author attaches to such and such expression? Under no circumstances our definitions intend to be regarded as the best available, still less the only ones that can be adopted.

Definition 1   ***Stakeholders***

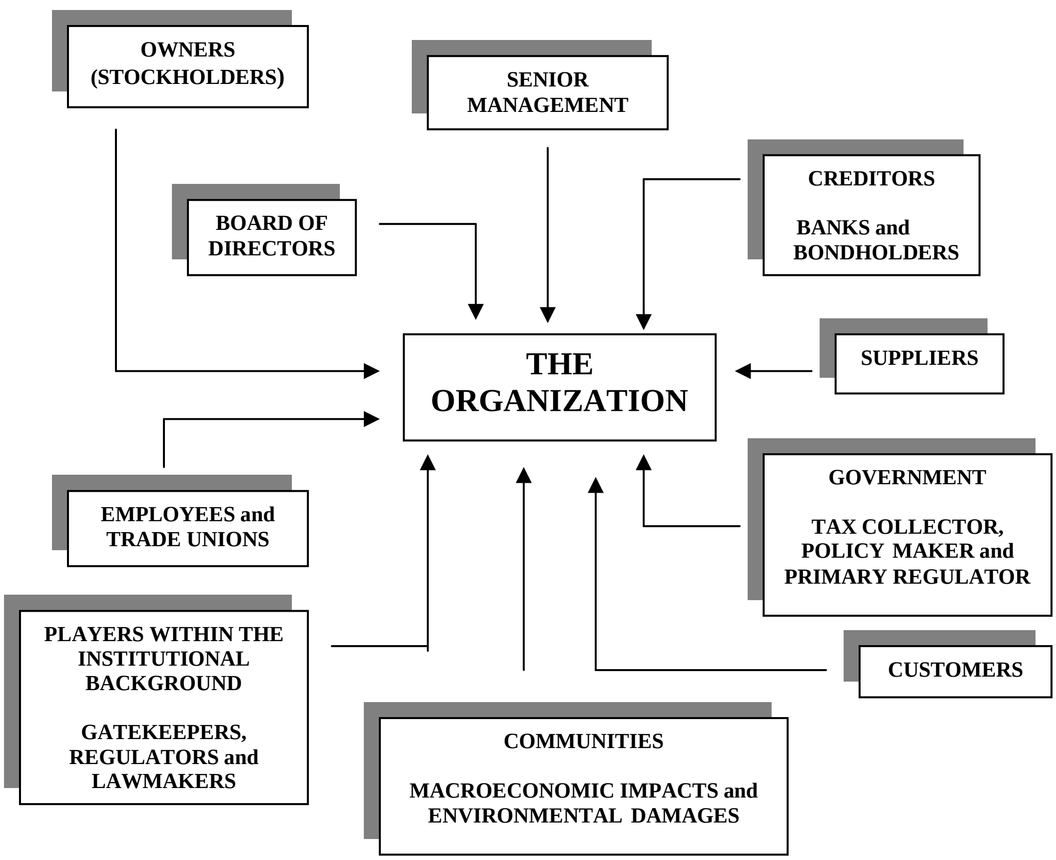
*By **stakeholders** of certain organization we mean single or collective agents submitting rightful claims that match two constraints:*

- *they arise out of persistent and enduring relationships;*
- *claimants are affected, either by the success or failure of the organization.*

Remarks

i) Emphasis should be placed on the relationship between the claimant and the organization like a persistent binding that remains steady along a relevant span of time, usually by means of a contract.

Figure 1   ***Main stakeholders in an organization of the private sector***



ii) We bring into a sharper view a recently introduced connotation, which asserts that in the relationship of claimants with organizations not only the success of the latter but also its failures pertain to the interests of the former. After the wave of corporate scandals that took place at the dawn of our century, awareness about this implicit covenant has grown out of necessity, as Enron stands to witness[7].

iii) ***Gatekeepers*** (see figure 1), also named reputational intermediaries, are those actors that must safeguard the interests and rights of different stakeholders: auditing and accountancy firms, investment banks, law firms, market regulators, institutional investors, creditors' trustees, NGOs (non-government organizations acting as watchdogs of organizations, markets, and government agencies), credit-rating agencies, economic and financial analysts. They can miserably flop in their expected tasks, as Coffee (2002) highlighted in the aftermath of Enron's demise. More on gatekeepers and what I have recently called the "preacher's waiver" can be found in Apreda (2012b).

A relevant contribution of the sociologist James Coleman (1974, 1973b) that has made inroads in the understanding of organizations, will allow us to reach a broader perspective about the role of stakeholders. He distinguishes between **natural** (or physical) **persons** and **corporate actors** (or "juristic persons"). Among the latter, for instance, we find corporations, limited liability companies, foundations, cooperatives, trade unions, cities and states, professional associations, churches, universities, clubs, partnerships, political parties, state-owned enterprises, even government agencies like the Internal Revenue Service.

Broadly speaking, organizations share the following attributes:

- they come to existence but not always to meet the purpose of profit seeking;

- they have many of the legal rights enjoyed by natural persons: claiming ownership, transacting with third parties, as well as acting under their own will to establish and break relationships, and to be held accountable for their actions. In fact they turn out to be self-governing entities.

[7] On the shameful story of Enron, and the lessons we can draw from its demise, see Apreda (2002a).

When a person relates to any corporate actor, let us say as an employee, a customer, or a creditor, a new kind of exchange emerges, quite different from the ones that shapes person-to-person relationships, as the box below brings into focus.

Under label 1, we find person-to-person interrelations, as they happen in everyday life. Labels 2a and 2b refer to trades or interactions between persons and corporate actors (or their representative agents). Last, label 3 pertains to what is an increasing trend, whereby corporate actors tie together and reveal a preference for establishing cross-corporate connections.

Coleman argues that any relation like type 2a or type 2b gives rise to a consequential mismatch between the own interests of certain person and those stemming from the interests he must support on behalf of the organization. Actually, the alignment of interests is not an easy task to be accomplished: "*its strength depending on how tightly the corporate actor has tied its agent's personal goals to the corporate goals*"[8]. Needless to say, this entails that any person yields direct control over his resources when he joins the corporate actor or invest their savings in it.

	Second Party (object of an action)		
First Party (actor)		*Person*	*Corporate Actor*
	Person	1	2a
	Corporate Actor	2b	3
	Source: Coleman (1974, p. 88)		

Drawing from the foregoing analysis, it's worth looking again at figure 1. Now stakeholders could be regarded from another standpoint: they are either natural persons or corporate actors. The consequence is that we have two parallel albeit intertwined

[8] Coleman (1974; p. 93)

relationships, those that arise among natural persons, and those established among corporate actors. Ultimately, and since the beginning of last century, there has been a steady loss of power from persons to corporate actors[9].

CLINICAL VIEWPOINTS AND GUIDELINES (1)

We introduce at this point a methodological device to enhance decision-making by using the clinical approach. It consists of some articulated viewpoints and guidelines to set up a protocol that will come in handy when in section 5 this approach will deal with conflicts of interest resolution.

1. Beware of the fact that in down-to-earth organizations, relationships between stakeholders grow complex and far from being easily handled.
2. Corporate actors and natural persons usually stand up for conflicting views of the world.
3. Claims from certain stakeholder may be contested, as a matter of course, either from other stakeholders or the company itself.
4. Covenants that explained linkages and commitments among stakeholders fairly well in the past, unavoidably become out of date, and should be revised or sized up now and then.

3. CONFLICTS OF INTERESTS

For better or for worse, conflicts are ingrained in the life of organizations. At first sight, this may be regarded as a nasty output of social settlements, but on a more careful approach to the topic, conflicts of interests may be placed along a continuous arch comprising, on one side, the state of being "the salt of social life" and, on the other side, "a road to hell". It's worth taking this matter further, since it helps us to realize how organizations can last through enduring arrangements, albeit being prone to come down with illnesses, even risking survival or going bust eventually.

[9] Coleman (1973b).

The study of conflicts of interests and the rewards expected by economic agents who pursue personal goals into alignment with those of their organizations has brought about a fertile subject matter for the last fifty years[10]. Take for instance Demsky's paper (2003, page 51), where he chose the following explanation:

> A conflict of interest arises when an executive, an officeholder or even an organization encounters a situation where official action or influence has the potential to benefit private interest.

Although agreeing with Demsky's statement we feel, however, that the notion of conflict of interest should be more encompassing than the one he offered. I have argued elsewhere that such notion must include clashes of interest among different stakeholders (Apreda 2002b, 2005).

Let us assume two parties, **A** and **B**, which interact between them in a persistent way along certain span of time; they could be human persons, or corporate actors, including groups (departments within organizations, even institutions in the government, foreign countries and markets, to give some relevant examples). Now, let us avail ourselves of an operational definition within the compass of this paper.

Definition 2 Conflict of Interest

*By a **conflict of interest** between **A** and **B** is meant the following process:*

- *The set of **A**'s preferences, either in wants, needs, purposes, and courses of action grow in opposition to those in **B**'s own set.*
- *Both sets of preferences cannot be mutually met or fulfilled.*

[10] The groundwork on this subject matter was laid on, among others, by Jensen, Smith, Fama and Williamson. Some of their main contributions related to conflicts of interests are listed in References at the end of this paper.

- *The accomplishment of both actors' preferences turns out to be at odds with available resources.*

We must notice that the expression "set of preferences" embraces a wide-ranging semantics. If we took into account agent **A**, for instance, his set of preferences would contain the following building blocks:

– **A**'s information set, which includes his data base, as well as knowledge (learning from information) and skills (practical procedures to deal with information);
– **A**'s goals, perceptions, opinions, beliefs, assumptions about how the world functions;
– **A**'s capacity to interpret, assess, and choose between inputs listed in a) and b), pertaining his transaction with agent **B**.

In point of fact, social actors show themselves as forward-looking and end-seeker creatures. Pursuing this logic, therefore, both **A** and **B** are likely to clash over their preferences, any time they are not able to attain them simultaneously. Whatever the ultimate option will be, it worth pointing out that such choice is not only grounded on objective preferences but also subjective ones, like tastes, opinions, and assessment skills. As Zaller (1991, page 1215) cutely asserted:

> Every opinion is a marriage of information and values – information to generate a mental picture of what is at stake, and values to make a judgment about it.

3.1 POSITIVE AND NEGATIVE CONFLICTS OF INTEREST

When **A** and **B** found themselves in a conflict of interest, such state of affairs may be tracked down onto basic disagreements, among them the following:

– which are the desirable goals and the affordable means;
– where is the starting point as from which **A** and **B** can negotiate;

– how to carry out the decision-making process;
– to what extent their preferences are compatible;
– who is to decide which are the scarce resources at hand and how each party is entitled to their ultimate allocation.

A considerated analysis of these issues will require, firstly, to make a clear distinction between positive and negative conflicts of interest; secondly, to deal with the far-reaching notion of conflict systems.

By **positive conflicts of interest** we are going to understand those coming up in well-defined playing fields, with enforceable rules that take place in competitive surroundings, allowing clear mechanisms for settling disputes, and whereby the counterparts understand there are superior goals that stand higher than their own. As Selsnick (1948, page 26) pointed out: "*It is necessary to view formal organizations as cooperative systems*."

Several examples spring to our mind: sports, suppliers' biddings, the working of real markets, internal discrepancies in the life of organizations, marketing and institutional campaigns, entrance tests to universities, electoral contests in representative democracies, as well artistic or academic competition striving for scholarships, appointments or rewards.

In contradistinction to positive conflicts of interest, we say that conflicts of interest become **negative** when they unfold through a pattern like the next one:

a) **A** and **B** realize there is a conflict of interest between them;
b) one party grows aware that certain events or courses of action, would bring benefit to her but to the detriment of her counterpart;
c) the time comes when one of the actors makes up her mind to not follow the rules of the game by the book, hence pursuing her own personal agenda in disregard of her counterpart's claims, benefits, or entitlements.

In the background of this subject matter, there has been a nurturing debate running along two main lines of argument. Oliver Williamson (1996) stands out as a staunch supporter of the first line; in fact, he regarded b) and c) as defining characteristics of what he termed "opportunistic behavior with guile". In opposition, and leading the second group, we find Herbert Simon (1947) who believed that cooperation, bounded rationality, and learning may help curbing conflicts of interest [11].

Be that as it may, by negative conflicts of interests we are going to mean those arising out of purposive and rational attempts from both counterparts to flout one or more among the defining features of positive conflicts of interests. Therefore, we should wonder how negative conflicts of interests evolve and become material[12]. The answer rests at the root of many issues ingrained in the field of Corporate Governance, namely the failure to hold up healthy internal political coalitions, the inherent frailty of business relationships with customers or suppliers, the hazardous trade off between short- and long-term plans for any sustainable process of growth and, last but not least, the consequential explanations advanced by Williamson and Simon.

From the foregoing discussion, we can infer that there is a deep relationship between actors and events. For instance, it is worthwhile dwelling for a moment on a complementary perspective strongly endorsed by the sociologist James Coleman (1973b, page 1):

> There are actors and events, and actors are related to events in two ways: control of actors over events, and consequences of events for actors. Further, actors are purposive, in that they exercise control to achieve outcomes beneficial to them. Thus we can think of the actor's control over events as his resources, and the differential benefits he receives from an event's outcome as his interests. Then an event is any occurrence over which some actor has some

[11] The story of this compelling debate is told in Auguier and March (2001).

[12] Although "material" is a catchword, there is a meaning that has proved suitable for corporate governance. In accordance with the Black's Law Dictionary, by material is understood *something of such nature that knowledge of the item would affect a person´s decision-making process.*

control and in which some actor has interest. An actor is any person who has interests in events, some resources, and the ability to use those resources to implement his interests.

CLINICAL VIEWPOINTS AND GUIDELINES (2)

1. Although conflicts of interest become staples in the life of organizations, they do not necessarily convey risks or threats to healthy governances. In point of fact, positive conflicts of interest nurture organizations and internal cooperation.
2. A first step towards managing negative conflicts of interest consists in querying whether they are sporadic or persistent along time.
3. It seems advisable to carry out the following stress testing so as to cope with negative conflicts of interest:

- which are the desirable goals and the affordable means;
- where is the starting point as from which **A** and **B** can negotiate;
- how to carry out the decision-making process;
- to what extent their preferences are compatible;
- who is to decide which are the scarce resources at hand and how each party is entitled to their ultimate allocation;
- is there a contesting agenda that could threaten the organization's own agenda?

4. ORGANIZATIONS AS CONFLICT SYSTEMS

Let us move on to frame the concept of purpose-built systems and, afterwards, to handle the basic features they exhibit in down-to-earth organizations.

a) Purpose-built systems

The mainstream definition of purpose-built systems makes them to consist of a set of components that are linked by explicit relationships in the pursuit of one or more goals. However, we are going to narrow down such a broad meaning, by primarily focusing on organizations in the flesh.

Components

Persons or corporate actors (groups or individuals) qualify as elementary components of this construct. Their purposeful activities become consequential either when regarded from the levels of single or collective action. The fabric of this structure lies on patterns of behavior, which arrange themselves through roles to be performed by single actors as well as the workings of groups of stakeholders within or without any organization.

Relationships

Interactions among components make sense within the context of transactional environments, either external markets or internal arrangements that bring about transactions within organizations. They furnish social rules of the game by which economic agents carry out their actions eventually, evolving and turning into a network of linkages among different stakeholders.

Goals

They derive from purposes and tasks that are set up by laws, the regulatory environment, the company's internal by-laws or, as it has recently been proposed, by means of the Statute of Governance in each organization[13].

b) Conflict systems

In an insightful paper published in the early 1960s, James March introduced the idea of conflict-systems, which helped him to shape a perspective from which organizations in the private sector could be looked upon as political coalitions. Not surprisingly, this work was published in *The Journal of Politics*[14] since the whole proposal intended to have far-reaching implications in political analysis as well[15].

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[13] The statute of governance has been comprehensively presented and developed in Apreda (2011a).

[14] James March (1962), The Business Firm as a Political Coalition, *The Journal of Politics, volume 24, number 4,* pp. 662-678.

[15] On this regard, see my book on Public Governance (Apreda, 2007b).

Taking advantage of March's contribution, we set forth a definition of conflict-system that may come in handy to organizations from the viewpoint of purposive systems.

Definition 3 Conflict-Systems

By a ***conflict-system*** *is meant any organization or social arrangement in which*

- *components in the system persistently make choices among alternative states or conditions including economic constraints on available resources;*
- *conflicts arise from the fact that most preferred states of the system are not attainable at the same time and with the mutual agreements of their components;*
- *assumptions, relationships, agendas, goals, and means, are contestable;*
- *distinctive groups of stakeholders may build up coalitions to confront their agendas and, still worse, ending up as factions ingrained in the organization.*

Whereas the first two requirements closely follow those depicted in March's paper, I have introduced two additional predicates: on the one side, bringing awareness to the overwhelming fact that antagonistic issues may be contested; on the other, pointing out that opportunistic behavior could thrive on and spoil, through agenda-setting and factions, the whole governance of organizations[16].

Deeply related to March's standpoint, Jervis (1997) pointed out that in the analysis of organizational interactions and structures, we have to focus on the following characteristics:

- Elementary components can be so deeply related that changes stemming from a group of them bring about changes in other groups of components within the system.
- The whole arrangement of components, relationships, and goals, conveys some patterns of behavior that are different from the ones we could make out of single

[16] More background in Apreda (2011b).

components. In other words, the whole cannot be explained by the summation of its building parts.

- Stakeholders do not attempt only one course of action at a time. On the contrary, they follow up manifold activities simultaneously.
- Frequently, actions disclose unintended consequences, even disrupting well-established relationships within the system itself.

Therefore, components within any system breed conflicting views about their relationships with expected goals and set preferences, what adds up to stumbling blocks that must be carefully handled in the prevention or treatment of governance risks.

c) Coalition building

The main outcome of March’s paper stems from his viewpoint that any organization can be regarded as an evolving **political coalition**, and it brings forth a sensible answer to manifold problems outgrowing out of conflict systems. In that context, the senior management and the board of directors perform the role of political brokers which would entail, among other things, two ensuing processes:

> The composition of the firm is not given; it is negotiated. The goals of the firm are not given; they are bargained. (page 672)

From the fact that there is a set of potential participants in any firm who make claims on the system, March regards such demands as the required price to participate in the coalition. This subject deserves a further development indeed, since as soon as we look upon an organization like a network of coalitions the focus naturally shifts towards the political nature of the organization itself. It’s worth noticing that Coase (1937, 1988), well ahead of his time, hinted that transactions within the firm are ruled by power relationships and not the mechanism of prices ruled by markets.

Conflicts of interests can be tracked down into confronting agendas. Organizations can be assimilated to conflict systems because they are political structures to all intents and purposes. What is at the root of stakeholders' claims can be summed up by a bid for authority, influence, control and power[17]. It was Pranger (1965, page 217) who showed the overlapping between political systems and organizations this way:

> Organization theory is political theory in which traditional considerations regarding citizenship and leadership have been transfigured but not transubstantiated into modern acts, scenes, agents, agencies and purposes.

In concluding this section, we should beware of the fact that parties enter a coalition bringing their own particular agendas, and they must design a new one to embrace only those stakes over which they are ready to agree with. In the widest meaning available, the whole business firm is a coalition and the CEO becomes a political broker. As long as stakeholders voice their demands, they add up to their participation into coalitions.

CLINICAL VIEWPOINTS AND GUIDELINES (3)

1. As organizations grow like conflict-systems, the starting point of analysis should rest on the components, relationships and goals of such system.
2. Any organization becomes dysfunctional not only because their components, relationships, and goals may go awry, but also because of the failure of those factors to keep up their expected roles.
3. Coalition building is always a purposeful activity and brings about different agendas from the main actors in the coalition.
4. Agenda setting in the context of coalition building may entail interesting and rewarding developments that foster better governance.
5. Agenda setting in the context of coalition building may be at departure of the agenda of the organizations, which means that a faction may be in the making.

[17] A clear and elegant description of this manifold topic is provided by Robert Dahl (1991)

6. Coping with factions might lead to refurbishing the governance so as to uproot the discontent, or to fight the faction to the last consequences.

5. THE CLINICAL APPROACH TO CONFLICTS OF INTERESTS

Throughout this section, diagnosis for widespread governance risks will be described and suitable therapeutic courses of action supplied [18]. Under no circumstances, our methodology seeks to be the only one available or the best one to be chosen eventually.

5.1 CONFLICTS AMONG STOCKHOLDERS

By way of introduction, let us address some typical conflicts of interest among stockholders.

a) In a family-owned company, when children of the founding father and, later, the cousins are appointed to the organization as executives or directors, their agendas with regard to dividends distribution will clash eventually with the one of the founders. The old guard can be in favor of retaining earnings to self-finance the company, while the newcomers want to pocket as much as possible because they intend not only to profit from short-term goals but also to set aside money for their future interests.

b) Several examples bear witness that a group of minority shareholders may build up a faction and make life miserable to the remaining shareholders. In some cases, the latter could attempt a repurchase of stock to get rid of the former, offering a premium price by means of a private tender.

c) Sometimes, and mainly in countries that do not follow the Anglo-Saxon governance paradigm, new issues of stock allow for differential voting rights to incoming

[18] Governance risks have been introduced in the corporate governance field of learning and practice by Apreda (2011a, 2012a).

stockholders. For instance, the old guard would be profiting from the rule “one share equals five votes”, while granting newcomers the rule “a share equals one vote”. This construct enables the incumbent players to hold the floor in assemblies with much less shares than their opponents and carry the day when they make decisions on dividend policies, repurchase of old shares, and long-term strategic issues[19].

Figure 2

CLINICAL REPORT ON CONFLICTS OF INTEREST AMONG STOCKHOLDERS

Main actors and governance issues	Diagnosis and therapy
Owners **Governance categories:** *ownership structure* *owners rights*	**DIAGNOSIS** The Founding Person has not handled the succession issue yet. There are likely contestable minorities that could enter in coalition building or factions, mainly through conflicts of interest between the first generation (the founder´s sons and daughters) and the second one (the cousins). Some stockholders claim that the structure of ownership and control has fallen behind the time. **THERAPY** Set up a Shareholders Agreement which comprises the succession issue, mechanisms for the entrance and exit of family members, provisions for buying-selling stock between the company and departing members, dividend policies, differential voting rights, and preferred stock issuance. Appoint independent directors, even dissident directors[20]. Draw out and make enforceable a Statute of Governance. Appoint a truly professional and independent CEO. Design voting trusts[21].

d) Conflicts of majorities and minorities are usually dispelled in the Latin or Germanic Governance paradigms by means of organizational forms named “pyramids” by which the family holds the political power albeit not the bulk of dividends that flow towards minorities.

[19] The governance of non-listed companies (most of them family-owned) is surveyed in Mc Cahery and Vermeulen (2010).

[20] See section 5.2 for more background on this topic.

[21] Further information in point e), this section.

For example, if the pyramid followed the rule "one share-one vote", and the family as block holder had 51% of the company A's stock, and the latter the 51% of the company's B stock, and this one the 51% of a third company C, then 100 million dollars of dividends coming out of the last one would be apportioned the following way:

49 millions to C's minority, and 51 millions to B;
25 millions to B's minority, and 26 millions to A;
12,74 millions to A's minority, and 13,26 millions to the family.

Therefore, the family relinquishes 86,74 millions in dividends on behalf of minorities, keeping only 13,26 millions, but controls all the pyramid members, which amounts to political power by and large (appointing directors and managers for the whole construct, holding discretionary authority in transfer-pricing and perks, having the last say in strategic decisions and the business plan pertaining each component in the pyramid).

e) Coalitions between subgroups of shareholders are characteristic of family-owned organizations, as Gianfrate and Zanetti (2007, page 30) found out among Italian listed companies:

> Almost 40% of listed companies in 2005 were controlled by coalitions of shareholders. They are kept together by agreeing to vote together, which are called **voting trusts or voting syndicates**. They bind themselves to vote in a certain way within shareholders' meetings or within corporate board's meetings.

f) A powerful resource for managing conflicts among shareholders in companies all over the world, as far as the equity is in the hands of a few powerful stockholders, consists in binding them together by means of the ***Shareholders Agreement***, whereby they commit future patterns of behavior in a host of relevant issues like the succession problem (of the founding father or mother), the dividend policy, the exit and entrance requirement for outgoing or incoming stockholders, the rights of refusal or preference in favor of standing shareholders, and the duties of representative directors in the board.

5.2 CONFLICTS BETWEEN THE BOARD OF DIRECTORS WITH STOCKHOLDERS AND MANAGERS

At the foundations of any board of directors we find that their members must comply with the so-called fiduciary duties on behalf of owners and the company itself: loyalty, good faith, and diligence. In the real world, however, this is easier said than done, as Enron stands to witness.

The first stage in the life of organizations shows a small board comprising the founding fathers, brothers and sisters, as well spouses. It is not surprising, then, that the first occurrence of conflicts of interest spring out from colliding family members belonging to the board in the pursuit of a controlling agenda. A second stage grows out of the first generation that brings sons and daughters, as well as their marital partners, to executive jobs or board positions. This seems a period when coalitions either in the board or the Executive Council[22] are built as a matter of course.

As time passes by, not only family newcomers join the firm, but also professional managers who do not belong to the family, bringing about the well-known process of "separation of ownership and control". At this juncture, some directors could stand up for the owners' interests whereas others would rather take the managers' side[23].

To draw out an accurate picture of any down-to-earth board of directors, we must give heed to a new development in the last two decades that has been advocating for independent and dissident directors.

a) Two reasons make the notion of an independent director pervasive and fuzzy. Firstly, the best procedure for getting a definition has been, so far, a regulatory

[22] The Executive Council is the arrangement by which senior managers regularly hold meetings to deal with day-to-day issues in the going concern.

[23] The latter is the likely setting whenever new directors, external to the family, are nominated by the CEO's office.

approach that defines what it should be understood by “non-independent” director. This amounts, in practice, to listing a set of circumstances by which the regulator regards them as impediments for being independent. Secondly, as Professor Macey (2008) has asserted, even when the company meets the regulatory demands, independence is not granted as a matter of course.

Figure 3

CLINICAL REPORT ON CONFLICTS OF INTEREST AMONG DIRECTORS, STOCKHOLDERS AND MANAGERS

<table>
<tr><th>Main actors and governance issues</th><th>Diagnosis and therapy</th></tr>
<tr><td>Directors

Governance categories

Directors as trustees
Fiduciary duties
Allocation of control rights</td><td rowspan="2">DIAGNOSIS

Self-dealing becomes widespread in the company.
Directors carry out their fiduciary duties with leniency and shirking.
The board turns out to be the rubber stamp for the CEO’s office.

THERAPY

Set up a Board of Directors Protocol.
Foster the appointment of independent and dissident directors.
Install an Audit Committee with independent and dissident directors in a majority.
Design a Nomination and Compensation Committee, with independent and dissident directors in a majority, excluding any executive director.</td></tr>
<tr><td>Owners

Managers</td></tr>
</table>

b) For practitioners and scholars alike, the bred of dissident directors features an innovation fostered by private equity and hedge funds. They are stockholders, external to the family, and they do not arrive to the company recommended by the CEO’s office. They buy stock and intend to enhance the company’s decision-making. In doing so, their agendas support value creation, tight-budget constraints, and they pursue an active auditing of management performance.

5.3 CONFLICTS BETWEEN STOCKHOLDERS AND MANAGERS

There are two time-honored conflicts of interests between these two big players[24]: namely confronting agendas and divergent risk-perception.

Confronting agendas

It is not surprising that senior managers usually absorb so much power within organizations. One of the most invoked explanations rests on the separation of ownership and control. But there is another factor to take into account, often neglected in current discussions[25], which could be briefed this way: **managers are power brokers**. Managers run the company on a daily basis. In point of fact, their jobs involve entering into permanent transactions with all the relevant stakeholders of their company. They continuously negotiate with customers, suppliers, employees, unions, the government, creditors, directors, and shareholders. They bid for power, and they get it.

To what extent could we expect managers to contend the company's agenda? If conflicts of interest were positive, there would be an advisable remedial procedure: firstly, by giving the managers compensation packages strongly linked to value creation but, secondly, also appointing truly independent and dissident directors as overseers. If the conflict were negative, then stockholders must curb managers' power; otherwise, the managers' agenda could disrupt the company's governance or, even worse, feed the seeds of a takeover engineered through a coalition with outside investors.

Selznick (1948, page 34) elaborated on a powerful therapeutic device against this kind of conflict interest, under the label of cooptation:

> A mechanism of organizational adjustment is what we may term cooptation […] Cooptation is the process of absorbing new elements into the leadership or policy-determination structure of any organization as a means of averting threats to its stability or existence.

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[24] They are not the only ones, albeit they become so pervading and relevant that must be highlighted.

[25] This feature has been researched by Apreda (2011b, 2007a)

Figure 4

CLINICAL REPORT ON CONFLICTS OF INTEREST BETWEEN STOCKHOLDERS AND MANAGERS

Main problem: confronting agendas

<table>
<tr><th>Main actors
and governance issues</th><th>Diagnosis and Therapy</th></tr>
<tr><td>Owners

Governance categories
ownership structure
owners rights</td><td rowspan="3">DIAGNOSIS

Managers want to have a say in the fundamental agenda and clash with owners on strategic decision-making.
Managers set forth reorganization plans at variance with owners ideas.
There is a likely chance that coalition building between managers and some directors becomes a fact of life.
Managers could start a coalition with green-mailers, or be in pursuit of a hostile takeover.

THERAPY

Stress testing should be carried out to get the governance overhauled, including changing the Statute of Governance or the company´s internal by-laws.
Make a Stockholder-Management Agreement to be embedded into the Statue of Governance
Appoint independent directors or, even better, dissident directors.
Decide whether managers should be co-opted by owners, appointing some of them to the board.
Appoint a truly professional and independent CEO.
Design a package of remunerations and incentives tied to performance and value creation.
Sharpen up the governance architecture, by means of internally enacted by-laws intended to enhance accountability and transparency.</td></tr>
<tr><td>Managers

Governance categories
managers’ fiduciary duties
their decision rights
their performance and incentives</td></tr>
<tr><td>Conflicts of interest

Governance categories
conflicts of interest
a) among owners, directors, managers, and creditors
b) with other stakeholders</td></tr>
</table>

Divergent risk-perception

This is a topical problem in companies where the managers are professionals that do not belong to the family. If the company had grown up beyond the founding stage, then conflicting visions of how to run the business will be arising in the end.

Figure 5

**CLINICAL REPORT ON CONFLICTS OF INTEREST
BETWEEN STOCKHOLDERS AND MANAGERS**

Problem: divergent risk-perception

<table>
<tr><th>Main actors
and governance issues</th><th>Diagnosis and Therapy</th></tr>
<tr><td>Owners

Governance categories
ownership structure
owners rights</td><td rowspan="4">DIAGNOSIS

There is a mounting opposition to owners’ strategic directions.
Managers frequently reject risky projects.
Owners stand against external sources of funding.
Owners frequently disagree about their managers’ provisions for non-current assets.
Managers try to set up a global risk-control system.
There are likely chances that managers intend to profit from perks consumption and rent-seeking.
It seems that owners favor soft-budget constraints on behalf of the dominant family interests.
Stockholders disapprove the precautionary style of managers as regards compliance risks.

THERAPY

Stress-tests should be carried out to get the governance overhauled, including changing the Statute of Governance or the internal by-laws.
Independent directors should be appointed.
Decide whether managers be co-opted by owners, appointing some of them to the board.
Factions must immediately be forestalled or fired.
Set up compensation packages tied to medium- and long-term performance, contingent to value creation.
Establish a Risk-Management Committee within the board, with majority of independent directors, but including the CEO as a member of such committee.
Appoint a truly professional and independent CEO.
Establish a compliance managerial function.
Let private equity representatives enter into the Board as dissident directors.</td></tr>
<tr><td>Managers

Governance categories
managers’ fiduciary duties
their decision rights
their performance and incentives</td></tr>
<tr><td>Directors

Governance categories
the board of directors or trustees
their fiduciary duties
the allocation of their control rights</td></tr>
<tr><td>Conflicts of interest

Governance categories
conflicts of interest
a) among owners, directors, managers, and creditors
b) with other stakeholders</td></tr>
</table>

Which is the main attitude of owners towards risk? In most cases, they are risk-seekers. Both Western business and law-traditions foster such perception of the risk as a good worthy of being pursued. For instance, we can’t help thinking in the logic behind the limited-liability feature attached to the most dynamic organizations and the fact that most stockholders can actually diversify their portfolios with shares from other companies. All in all, stockholders can bear risks since they are concerned with their companies for long-term investment horizons. Therefore, they are always in favor of carrying out not only safe investment projects, but hazardous ones as well.

But managers, mainly the professional ones without family attachments towards the company, exhibit an opposite viewpoint of how much risk they will be able to bare with eventually. One good reason for their risk-aversion can be found in their tenures; another, their reputation in the labor market. In order for managers to create economic value and pay off debts, they must become staunch supporters of tight-budget constraints[26].

5.4 CONFLICTS BETWEEN THE COMPANY AND CREDITORS

The most worrying concern that face creditors any time they lend money to a company relies on the recovery of the capital invested, and the periodic collection of interest payments that ultimately reward them. Although any company that fails to meet its liabilities risks would default in the end, creditors' expectations center around reliability and trust from the side of debtors. Ultimately, at the core of the relationship in which they engage themselves, creditors and companies have different risk bearings and perceptions.

As for risk bearing, albeit the company is liable towards creditors, their owners only have a limited liability on the company's indebtedness. Besides, shareholders bear not only upside but also downside risks. Then, when an investor in those shares sells them at a higher price than the one he paid in the past, the risk position turns out beneficial. And if the reverse happened, the investor would sell at a loss, whereby the initial risk position turns out to be unfavorable and detrimental.

[26] If managers failed to meet these goals, they would be looking for trouble and governance risks would increase (Apreda, 2012a).

Figure 6

CLINICAL REPORT ON CONFLICTS OF INTEREST BETWEEN THE COMPANY AND CREDITORS

Main actors and governance issues	**Diagnosis and Therapy**
Owners **Directors** **Managers**	**DIAGNOSIS** Owners frequently reject external sources of funding. Managers are prevented from setting up a global risk-control system. It seems that owners favor soft-budget constraints on behalf of their interests. Stockholders disapprove the precautionary style of managers towards compliance risks.
Creditors **Governance categories** *creditors' property rights* *protective covenants*	
Conflicts of interest **Governance categories** *conflicts of interest* *a) among owners,* *directors, managers, and creditors* *b) with other stakeholders*	**THERAPY** Debt financial engineering must comprise contractual covenants to safeguard ownership rights of creditors[27]. Appoint dissident or independent directors. If debt is to be issued in global markets, try public placements and appoint a trustee on behalf of creditors. Establish Creditor-Company Agreements.
Overlooking and compliance **Governance categories** *institutional constraints* *the role of regulators and gatekeepers* *compliance*	

But let us assume that the creditor is a bondholder in the secondary market. It can sell at higher prices, but not much higher than the nominal face value by which the issuer committed to the paying back of the principal. Therefore, upwards movements are bounded by the face value. However, he may sell the bond at much lower prices than the acquisition value. So, the risk position for the bondholder is not symmetric: prices are bounded when they rise, and unbounded when they go bust. Even worse, whereas

[27] Smith and Warnes (1979) seems a good primer to this subject.

shareholders can diversify their portfolios, bondholders' face a downward risk exacerbated when they build up a bond portfolio[28].

The best treatment for this essential conflict of interest between companies and creditors hinges upon the embedding of covenants on behalf of the latter in debt contracts, either when lenders are banks, institutional investors, global portfolios, or single investors. Covenants are protective devices that strengthen and grant property rights claimed by creditors at the end of the day. They constrain companies to fulfill their commitments, and if the latter failed in the compliance of covenants, debt contracts would trigger off a default provision.

5.5 CONFLICTS BETWEEN THE COMPANY AND OTHER STAKEHOLDERS

For the sake of illustration, let us scrutinize some deviant behavior, widely supported by massive evidence, which is carried out by organizations to the disadvantage of other stakeholders. Before going to actual examples, it would be better to bring forward a pair of statements conventionally held as if they were true, when they are ultimately wrong and misleading.

Statement 1 *The actual purpose of any company is to make money.*

A much more misleading rendering would tell us that any company must do only those things which give benefits to their owners.

It is straightforward to absolutely destroy the pretense of such statement because if it were true, which would be the difference between a good company when contrasted with Enron or with a drug-cartel? Therefore, the statement above must be reshaped to all

[28] Broadly speaking, this is true unless the portfolio has been devised with immunization provisions, like a a bundle of zero-coupon bonds scheduled and held till maturity.

intents and purposes. I advocate even that the following new statement might be taken up as a principle of governance to be embedded into the company's Statute of Governance[29].

New Statement 1 *The actual purpose of any company is to make money in the context of corporate social responsibility towards stakeholders, and the full compliance of the law.*

Closely related to the foregoing statement and widely endorsed by many corporations, we come across to another contriving assertion.

Statement 2 *As a direct consequence of Statement 1, the corporation should not care whether it produces externalities to the disadvantage of people (including children, disabled, or paupers), communities, countries, and environmental resources. In point of fact, externalities amounts to the cost of running business.*

Companies produce and release externalities that damage the health of people (even killing them), deplete natural resources, disrupt the balance between people and their environments, pollute cities and country sides, rivers and seas, lakes and valleys. Who shouldn't concern with this criminal negligence[30]? The former statement must be reshaped as a matter of course; for instance, in this way:

New Statement 2 *Externalities harmful to stakeholders, and produced by companies, convey a behavior grounded on the contempt of law, and an utter disregard of corporate social responsibility.*

Now we can apply the clinical approach to governance by choosing some conflicts of interests embracing relationships between companies and customers.

[29] Further analysis on the Statute of Governance can be found in Apreda (2011a).

[30] An impressive evidence on this matter is found in Bakan (2004).

Figure 7

CLINICAL REPORT ON CONFLICTS OF INTEREST BETWEEN THE COMPANY AND CUSTOMERS

<table>
<tr><th>Main actors
and governance issues</th><th>Diagnosis and Therapy</th></tr>
<tr><td>Owners

Directors

Managers</td><td rowspan="3">DIAGNOSIS

Does the company meet regulations and corporate social responsibility standards?
Does the company deceive customers and misrepresent contents or properties of the goods that place in the market?
Does the company show disregard of customers' health, welfare, freedom of choice, expectations, or contractual commitments?
Does manipulative marketing resources, like nagging, undercovering, or artificial obsolescence become standard practice?
Maintenance, spare parts supply, core and ancillary services are deteriorating.
Misleading and abusive financial arrangements.
The company releases private information from customers to outside information services.
The company bears strong criticism about how externalities are shifted to customers.
Average customers voice that "they do not know what is inside and whether the attached information is reliable or has been checked out by any regulatory agency.

THERAPY

Enhance customers' rights as a governance principle or practices in the Statute of Governance, and enforce sound practices stemming from that principle, mainly one about how the company will handle externalities.
Devolution and recalling procedures must be clearly stated.
Improve the compliance function performance.
Request from the Audit Committee the fulfillment of commitments on Corporate Social Responsibility protocol, and the granting of transparency and accountability on behalf of customers.
Include a whole section in the Annual Report on this subject.</td></tr>
<tr><td>Conflicts of interest

Governance categories
conflicts of interest
a) among owners, directors, managers, and creditors
b) with other stakeholders</td></tr>
<tr><td>Overlooking and compliance

Governance categories
institutional constraints
the role of regulators and gatekeepers
compliance</td></tr>
</table>

CONCLUSIONS

This paper has set forth a clinical approach to foster better governance in organizations, by piecing together the following issues:

- Conflicts of interest are staples in the down-to-earth running of organizations, by which the latter turn out to be conflict-systems eventually.
- Conflict systems turn out to be the bedrock of manifold negative conflicts of interest.
- Following such line of enquiry, a collection of clinical viewpoints and guidelines have been chosen and framed as a tool kit for decision-making.
- Both clinical viewpoints and guidelines come in handy to cope with those conflicts of interest that arise from antagonisms and contesting claims to be found among stockholders, directors, managers, creditors, and other stakeholders.

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