

# A needs theory of governance

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## **Abstract**

New-institutional economics hypothesizes imperfect rationality, self-seeking preferences, monetary-related needs, and opportunism as features of human behavior that require specific institutional and organizational counteracting measures. Consistently, new-institutionalist models of governance highlight the efficiency and transaction costs minimizing features of control rights and governance. Differently, needs theory of governance, as here presented, hypothesizes imperfect rationality, multiple needs, and reciprocity, in which case opportunism is reduced to an exception to individual behavior. Consistently, it presents a theory that links production governance with the wellbeing of those partaking in production. Building on Maslow's human psychology, the governance model suggested in this paper is aimed at evidencing the self-actualization potential of control rights, organizational structures and practices. The application of Maslow's theory to the institutional structure of organizations suggests that the deepest organizational layers (control rights and governance) broadly correspond to the most basic needs in Maslow's theory (survival, security and belonging), while the outer layers (managerial models and employment relations) correspond to the fulfillment of the highest needs (self-esteem and self-actualization). Cooperative firms are used as an illustration of governance solutions consistent with needs theory in human psychology.

**Key words:** new-institutional economics; opportunism; governance; needs theory; human psychology; self-fulfillment; cooperative firms; inclusive governance.

# **A needs theory of governance**

## **INTRODUCTION**

This work presents a theory that links production governance with the wellbeing of the individuals partaking in production. Individual wellbeing is also the measure of governance performance introduced by the approach. However, a clear and structured theoretical linkage between governance and wellbeing is still under-researched. Therefore, the theory advanced here aims at providing a justification on why governance requires to be assessed in terms of its capacity to sustain individual wellbeing. Within human psychological approaches wellbeing and self-actualization tend to coincide.

More specifically, we reason on what institutions and processes support self-actualization. The question requires bringing together streams of theory from institutionalism on the one hand, and organizational psychology on the other. Mainstream governance explanations assess governance in terms of its ability to confine the costs related to information asymmetries and opportunism, otherwise known as transaction costs. The behavioral assumption is one of self-seeking individuals who would behave opportunistically if there is enough information asymmetry and if sanctions are lower than the benefit obtained through self-seeking behavior. Governance structures are casted by exclusive decision-making (which is argued to economize on internal costs) and supported by command-and-control mechanisms to enforce direction, order, and punish opportunism. A theory based on multiple individual motivations, differently, emphasizes multiple and coexisting individual needs – such as security, self-esteem, belonging, autonomy, creativeness – which cannot be coherently fulfilled through opportunistic behaviors at individual level, and use of authority at

organizational level<sup>1</sup>. Building on the nature of individual needs changes the mainstream behavioral assumption of governance theory and, as a consequence, the justification for exclusive governance structures supported by transaction cost theory. The perspective introduced here emphasizes that individual needs and their fulfillment demand to be nourished at organizational level by structures and practices that integrate production resources not yet by authority, but by reciprocity, cooperation and inclusive decision-making.

In our framework opportunism as “self-interest seeking with guile”, in Williamson’s words (1975: 255), represents just one possible (and deviant) behavioral trait. It can be understood as exception to a general rule, more than as the most fundamental feature of economic behavior. Within a similar line of enquiry, Hodgson (2004) warns against the exclusivity of the explanatory role of opportunism in Williamson’s approach to governance. Over and above control, he cites the furthering of education, corporate culture and trust between employees as fundamental functions of management. Following Minkler (1993), he also stresses the importance of the knowledge generation function of governance, more than of control. Foss and Weber (2016) state that the centrality of opportunism in transaction costs literature makes it difficult to explain why hierarchies are not always used. In their approach opportunism does not need to “take the front seat” in the new institutionalist theory of the firm. Limited rationality as separate source of transaction costs, and its interaction with different hierarchical forms represents a better explanatory factor of the way in which governance structures are implemented, and of how they steer the behavior of the relevant groups of stakeholders. Likewise, the needs perspective removes the centrality of opportunism and explains opportunism as a deviation from a behavioral pattern defined by positive reciprocity,

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<sup>1</sup> The hierarchical governance perspective, moreover, clashes with research results in social and organizational psychology, which evidenced the importance of intrinsic motivation and fulfilment at the individual level, and the dangers connected with motivational crowding out thereof (Cf. Frey, 1997 in economics and Deci and Ryan 2000 in organizational psychology).

cooperation and inclusion. In the theory suggested, opportunism is conceived as a potential obstacle to the accomplishment of cooperative behavior, and to the resilience of individual motivations, rather than as an ontological feature of all human beings (Ben-Ner & Jones, 1995).

Consistently with arguments earlier developed by Marshall (1916) in political economy, by Berlin (1967) and Bobbio (1995) in political philosophy, and more recently by evolutionary scholars (Nelson & Winter, 1982; Langlois, 1992; Loasby, 2006), our arguments emphasize that when the institutional levels of governance are explained using needs theory, the governing rules that most effectively contribute to fulfillment are those that balance two functions: (a) the creative, enabling, and dynamic component; (b) the binding, and static component (Commons, 1931). The creative function of governance is exemplified by inclusive and self-managed organizations, which enable principals to partake in shaping the direction of activities and in defining governance rules. In parallel, rules are also directed to foreclose opportunistic behavior and guarantee a high degree of fairness and compliance with collectively defined objectives.

The explanatory strategy proceeds as follows. First we review the new-institutional approach to governance, building on Williamson's layered institutional analysis (Williamson, 2000). We then address needs, drawing on Maslow's seminal work (Maslow, 1943, 1968). The following section presents the components of the needs theory of the firm and compares it with the new-institutional theory. Finally, we present our framework of analysis, which deepens the interaction between institutional layers and individual needs. Examples are drawn from cooperative firms and other inclusive forms of governance, which illustrate how the framework can be applied. We explain this choice by emphasizing that the in depth analysis of the relationship between organizational variability and needs fulfillment is beyond the scope of this paper. Future research will have the opportunity to better distinguish between different governance forms and the way in which they differently support or otherwise impact the gratification of needs.

## **NEW-INSTITUTIONALIST THEORY OF GOVERNANCE**

New-institutionalism represents one of the most influential schools in the understanding of opportunistic behaviors facing asset specificity, contrasting interests and asymmetric information (Williamson, 1973; Jensen & Meckling, 1976). This approach has been crucial for the study of resource allocation through markets and hierarchical governance forms, with applications that regard also non-conventional resources, as in the study of common pool resources (Ostrom, 1990).

New-institutionalism draws consistently on behavioral assumptions developed within agency theory, i.e. individuals are selfish utility maximizers.<sup>2</sup> This principle has been explicitly placed at the center of the principal-agent problem by Jensen and Meckling (1976). Self-seeking behavioral assumptions and individual preferences for deception are reflected also in the prevailing approach to “good governance”, which considers solutions to the principal-agent problem, implementing rules oriented to facilitate the board and regulators’ control over managers’ actions (Birchall, 2014). Good governance requires the existence of processes embodied in rules, and an incentive system that ensure the liability of managers to the main patron of the company (for a critique see Davis, Schoorman, & Donaldson, 1997; Gregory-Smith & Main, 2015). “Governance failure,” in this sense, occurs in the face of inadequate reactive measures to opportunism and corruption, greed and short-termism (OECD, 2004). The focus of the “good governance” approach is on the constraining role of institutions. Individual needs and motivations are mostly taken as exogenous to the explanatory framework.

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<sup>2</sup> In turn, agency theory accepts the assumptions of the orthodox theory of the firm, which posits profit maximization and self-seeking preferences as dominant behavioral patterns in business organizations.

Based on the same behavioral assumptions, Williamson (2000) designs a multi-level framework for the analysis of economic institutions, including the broader institutional context where individuals act and organizational governance is shaped. In his work, he identifies four interacting institutional levels: (1) the informal institutions defined by cultural norms and beliefs; (2) the formal institutions which define property; (3) contracts aligning governance structures and transactions; (4) rules pertaining resource allocation, such as the market mechanism, and incentives for employees. Consolidated values and beliefs, at level one, are reflected by the legal framework at level two. This defines the basic institutional structure of the economic organization, and requires compliance by individuals. Variation occurs at level three and four, where individuals and organizations can choose how to specify the rules governing the organization and the type of incentives offered to individuals.

Legal and internal rules together identify criteria for managing assets and for distributing returns. In-built rules, in particular, define the governance model of the organization. Governance enables by defining who can partake in decision making regarding aims and strategic direction, in coordination and in resource allocation. It also constrains by setting who is responsible for monitoring and foreclosing behaviors that would hamper the survival of the organization.

In new-institutionalist theory, organizational survival and prosperity is associated with efficiency. As a consequence, the enabling and constraining function of governance is to economize on transaction costs. To justify this function, new-institutionalists start from observing that organizations utilize assets (such as machineries, inventories, knowledge) and that contracts can be used to define specific rights on assets. Since the definition of contracts is costly, new-institutionalism maintains that ownership, which defines who owns the residual rights, is preferred to contracting when contracting costs are high and contracts are not suitable tools for protecting the interests of the owner of the asset (e.g. because of high information asymmetry, contract incompleteness and risk of opportunism, especially in the presence of asset specificity). Rules are,

therefore, justified on the ground of their ability to allocate strategic control on assets (ownership) to those who have the highest interest in containing opportunism. Resource coordination happens by means of a command-and-control structure and incentives are defined under the assumption that individuals mechanically respond to monetary rewards or punishments.

## **INDIVIDUAL NEEDS**

Dissatisfied with the idea that individuals are selfish agents whose behavior within the organization can be piloted primarily through monetary incentives, organizational scholars have changed the terms of the debate, by integrating insights from the human psychology school, initiated by Abraham Maslow. In human psychology, the analysis of what motivates individual action starts from the study of what human beings value, desire and need. These desires, for Maslow, are only in part culturally determined. Each individual's attitudes are in fact also defined by her own biology, from which innate or intrinsic predispositions derive. Maslow's work highlights that when individuals, by interacting with their environment, are prevented from moving towards the realization of their inner inclinations, they will be frustrated and unhappy, and their wellbeing will be compromised. The question, in his and subsequent research, is: how can individuals become what they strive to be? Under what conditions? Following this area of enquiry, much has been researched and written about what makes individuals happy and healthy.

Self-actualization, in particular, is what human psychology has identified as the aim towards which individuals strive. Building on Maslow's seminal work, self-actualization is what determines the becoming of a healthy human being. It can be ultimately thought as the flourishing of what the full potential of each person allows him/her to be (Maslow, 1968).<sup>3</sup> In this work we take Maslow's

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<sup>3</sup> Maslow has been widely revisited and criticized, especially for approaching needs through stages of individual development. However, his theory does not prevent from considering self-actualization as an integrated process. For a critical discussion of Maslow's theory, see Neher (1991).

perspective and argue that each individual will have biological predispositions that define her or his potential. This potential represents the inner self, which needs to be discovered and enabled, rather than repressed, by social and economic institutions. As Maslow specifies, discovery and creativity are primary functions, since without discovering and reinterpreting what we desire it would be difficult to start making steps towards our self-actualization. The discovery of what we wish for points at what our needs are (Maslow, 1998).

Some specifications on the nature of needs and self-actualization are required. Firstly, desires and needs are not linked by a straightforward equivalence. To explain this, consider Dewey's theory of moral enquiry, which suggests that the fact that something is "desired" does not make it also "desirable." What Dewey suggests is that the moral quality of a desire is open to question (Dewey, 1930). Bringing this insight into needs theory, the contention is that whether a desired object becomes desirable is a matter of its functionality to human needs and self-actualization. The functionality of a desire with respect to self-actualization needs to be discovered empirically. It is through life experience, or our ability to critically assess the consequences of the actions taken towards self-actualization, that we learn which of our desires are also desirable, valuable, or needed at a particular point in time. In this sense, this work takes the view that *a need is a desired object with moral quality, or in other words a desire which is functional to the pursuit of self-actualization.*

Secondly, the idea of self-actualization should not be misunderstood for selfishness. Amongst the human needs identified by Maslow are the needs for belonging, love and affection, for fairness and justice, for being accepted and feeling part of a collective. This suggests that individual self-actualization occurs only if it happens "with" and "to" others, as well as to the individual. In this sense, self-actualization is both private and public, it merges the individual and the collective level. Acting on private needs includes also acting collectively "with" others, or "on" the needs of others, so that self-actualization occurs "to others" as well. Think about individuals that fulfill their need

for belonging and even their need for creativity by engaging with the political realm, with community initiatives, or by volunteering in third sector organizations.

This cooperative element of self-actualization has been supported by behavioral studies, starting from the classic prisoner dilemma game. The emphasis is on the creative and mutually beneficial cooperation, as well as on the positive effects that cooperation generates on the collectivity more broadly. Cooperation, in fact, is a form of public good, since it benefits the co-operators as well as the collectivity more broadly. From this perspective, institutions can play a proactive role in supporting creative and socially beneficial cooperation, as opposed to atomistic self-centered attitudes. Cooperation, however, may stop if there is no trust amongst individuals, or if indifference or opportunism prevail. In these respects, institutions can play a constraining role, as in new-institutionalism, to prevent behaviors that hamper creative cooperation. Differently from new-institutionalism, however, incentives against opportunism do not take central stage in justifying economic institutions.

From his clinical studies, Maslow concludes that the movement towards self-actualization is a process that cannot stop at the fulfillment of basic needs, but must evolve to the recognition of needs of higher order, leading to self-actualizing psychological health and wellbeing. It offers a picture of human beings as individuals who “are”, but are also “in becoming,” as needs evolve following life experience and critical assessment. The role of the environment is to enable this process (albeit, as he notices, “limitations” coming from the environment can also be enabling, for example by encouraging the individual to put effort in developing her inclinations).

Moving on to an analysis of context, Maslow’s contribution in human psychology, alongside the seminal work of others such as Rogers with his theory of transformative listening (Rogers & Roethlisberger, 1952), and McGregor (1960) with his Theories X and Y, have long argued that organizations can be places for human development. Building on human psychology ideas, stewardship theory has provided an alternative to agency theory, changing the behavioral premises

of managers with respect to their principals (Davis, Schoorman, & Donaldson, 1997). Stewards, rather than agents, are managers who gain higher utility from cooperation rather than from defection. Thus, through cooperation, they benefit themselves and the principals. More generally, however, governance should provide answers not only to the preferences, needs and behaviors underpinning the relationship between top managers and shareholders, but for all the actors who partake in the organization.

Montuori and Purser (2014) have recently noticed that management has missed the self-actualizing side of organizations and that organizations should not militate against the individual and her wellbeing. The point of contention is the pursuit of organizational solutions that genuinely search for engagement and non-authoritarian relationships between managers and workers, for ways of engaging that unleash creative and mutually beneficial cooperation, rather than the exercise of supervisory power of superiors over subordinates (Sacchetti, Sacchetti, & Sugden, 2009; Sabatini, Modena, & Tortia, 2014).

However, despite advocating novel solutions, the claims of human psychology have not been supported by the study of alternative governance models. For Montuori and Purser, management has adopted a rhetoric of engagement and self-actualization by developing techniques and practices which did not critically discuss the nature of the enterprise. Management techniques have been used as tools to increase productivity rather than as tools to stimulate critical thinking and creativity, thus trivializing the idea of humanistic psychology. It is no surprise, then, that these “manipulative practices” have failed (ibid.).

The reason for this, in our view, is the existence of an institutional failure: a failure that human psychology has only intuited, and that management theory never addressed. The use of authority and exclusive decision-making are inconsistent with greater democracy, cooperation, use of creativity and, ultimately, self-actualization. Within the traditional hierarchical organization, the emancipatory role of solutions suggested by Maslow, McGregor or Rogers was impractical, simply

because the fundamental assumptions about the governance of the organization were not put under scrutiny. When human psychology is applied to organizations, reference is to “progressive” practices in organizational development such as coaching, personal development, or communication tools to allow workers to identify desirable behaviors and images of their ideal enterprise. The use of these “empowering” tools occurs and depends on the discretionality of management, i.e. it is subject to the orientation and will of a restricted group of decision makers within the organization. As a result, the application of human psychology has been through different fortunes, receiving attention during the 1960s and the 1970s, but decreasing after that, when firms turned to their bottom line in order to engage with the global competitiveness race. Reducing the pursuit of self-actualization to the use of management practices, therefore, is not a stable strategy, since it does not touch the idea of the enterprise at a more fundamental level. As in the dominant enterprise model the power to decide and control over strategic decisions and surplus distribution remains concentrated and aimed at pursuing the interest of the dominant stakeholders. Given these premises:

**Proposition 1:** The new-institutionalist theory of human behavior emerges, with limited modifications, out of orthodox economics theorizing. The theory presented here, conversely, follows the Maslowian tradition in human psychology.

## **MORAL DIMENSION OF ECONOMIC INSTITUTIONS**

The aim of thinking economic institutions in terms of human psychology, and needs theory in particular, is to understand and appreciate how different institutional solutions can contribute to self-actualization. However, economic institutions differ for in the type of values they embody, where conflicting values are at stake. At governance level, there is a variety of solutions. Governance, for example, can be partly interpreted as a set of mechanisms for the pursuit of

“security needs”, through rules regarding job security, pension, health insurance etc.... Governance structures and rules also address the need for belonging and cooperative use of creative intelligence, for instance by means of rules that engage individuals in the collective making of decisions. Likewise, mutual respect amongst individuals, clear and fair processes of interaction and professional growth can be interpreted as behavioral practices and rules that empower a certain degree of autonomy and creativity (Sacchetti & Tortia, 2013).

The application of Maslow’s view on what leads to self-actualization has a cathartic effect on the way organizations can think about their governance. It affects the same nature and aims of organizations, thus going beyond what management theory would consider in terms of progressive human resource practices. The very fact that the cooperative use of creative intelligence can be embedded in governance rules denotes openness to multiple solutions and change, including the possibility of changes in rules and practices. Change occurs thanks to the tensions that inevitably originate from experience. Such tensions can exist, to different extents, despite the level of specification of the legal framework or of internal rules. Both, in fact, can be progressively refined and redefined to acknowledge interaction between practical conditions and outcomes. Inside the organization, in particular, formal rules, but also routines and shared practices, are subject to variation and change. The open-ended nature of institutional evolution has to do, in this case, with the ever-changing features of what is deemed as needed and valued inside each single organization, and relates to the type of aims pursued. We refer here to the concept of ontogenetic evolution, more than phylogenetic evolution of the institutional set-up in which the organization is embedded (see Hodgson, 2006).

The evolution of institutions, however, is not “blind.” We build on Dewey’s theory of moral enquiry here, to suggest that there is a moral dimension to governance structures and rules specifically, and to economic institutions more broadly (Dewey, 1927). This is because the valued

ends and means embodied by economic institutions are selected amongst conflicting needs and values.

As an illustration, suppose that there is a choice from a set of needs and valued objectives  $N$  ( $n_1 \dots n_n$ ) and that for each need there is a consistent set of governance structures and rules  $G$  ( $g_1 \dots g_n$ ). What combination of objectives and governance will the firm choose? The definition of the objective (it could be, for example, the maximization of shareholder value in conventional corporations, or member welfare in cooperative enterprises) reflects, in general, what is valued by the decision-makers (through governance choices) and society (through its customs). Likewise, rules and governance structures are the means that support the pursuit of a need and related valued objectives. Needs and governance, in turn, are defined within the framework designed by some more fundamental rules, such as those concerning the distribution of control rights.

Within authoritarian structures decision making occurs by excluding other interested parties from the process of choice and, therefore, even to the detriment of others. At the opposite extreme the choice of institutions can be shaped around inclusive democratic structures and rules, privileging dialogic process over authority (Sacchetti, 2015). The more governance is consistent with what the individual needs and values, the higher the likelihood that behaviors are consistent with the governance rules, and the lower the probability of misbehavior and the need for control. If this happens, governance rules, and more broadly institutions, can be considered as the enablers of individual self-actualization. The economic institutions that are consistent with self-actualization are those that recognize that choices amongst conflicting needs requires inclusion and cooperation rather than authority, dialogic process rather than self-centered atomism. These inclusive features of institutions serve the purpose of enabling individuals to take part in the formulation of moral judgment on strategic decisions, partaking in the definition of the most needed and valued objectives and means.

Two elements can be identified in the formation of moral judgments. On the one hand, individual needs are identified by means of intelligent reflection, as the individual interacts with the environment, of which institutions are part. Institutions, at the same time, are determined collectively by extending the individual reflection to the public level, where multiple needs and perspectives are recognized by means of public enquiry (Dewey, 1927; Long, 1990; Sacchetti & Sugden, 2009). Enquiry gives voice and space to exercise their intelligence and creativity, to feedback to the initial institutional setting, and eventually change it to align it with experience and needs. Through the dialogic process, some of the limitations of bounded cognition are overcome. In parallel, when solutions to governance problems become acted upon, outcomes can be tested against their acceptability.

Dialogic situations bring multiple and possibly divergent solutions to unity, since the dialogic process builds on the willingness to reach consensus (Dewey, 1927), or on the willingness of participants to give and take, according to principles of reciprocity and cooperation. These principles are opposed to the type of competition and self-seeking behavior assumed by new-institutional theory, which occurs when actors behave disjointly, or even in opposition to each other. Rather, cooperation is a form of behavior which occurs when individuals act collectively for the pursuit of mutual benefit. The pre-condition of cooperative behavior is that individuals act according to the principle of reciprocity, meaning that positive or negative actions are matched by similar, albeit not equivalent, acts, at some point in time. Positive reciprocity, in turn, is supported by trust, or a positive expectation about other people's behavior.<sup>4</sup> Examples of these rules of

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<sup>4</sup> Also experimental results show that reciprocity and conditional co-operation are conducive to efficiency and wellbeing, while punishment of defectors tends to emerge endogenously to limit deviant behaviors (Fehr & Gächter, 2000a, 2005; Fehr, Gächter & Kirchsteiger, 1997).

behavior have become formalized in cooperative firms and in self-managed organizations more broadly (Borzaga & Tortia, 2016), as discussed in Section 5.

## **A NEEDS THEORY OF GOVERNANCE**

We outline a needs theory of governance to relate economic institutions with their capacity to respond to human needs and contribute to individuals' self-actualization. Each element of the needs theory of governance is outlined in Table 1 and compared with new-institutional theory. What a needs theory of governance highlights is that, besides bounded cognition and information asymmetries, the problem of self-actualization lays in the mismatch between individual needs on the one hand, and economic institutions on the other. Governance rules can be a means for actualizing and interpreting needs by use of a dialogic approach. Compared to new-institutional theory, the needs theory of governance suggests that improvements in contracts, incentives, information, and control are not sufficient conditions to solve deficits in individuals' self-actualization. Rather, the problem lays in the structure and method used to define the broad direction, the objectives, and the allocation of resources.

In the needs theory of governance, the human dimension becomes the aim rather than being the tool that serves organizational objectives, while contractual exchanges, most often with clients and suppliers, are instrumental to the pursuit of human development. Similarly, the organization is conceived as an ecosystem which is functional to the individual's self-actualization. From this perspective, in striving to fulfill her needs, the individual needs to preserve the organization as her living environment. This, among other aims, implies the need to keep the organization alive by guaranteeing financial and economic sustainability over the relevant time-span. Likewise, the ecosystem cannot survive by destroying its population (differently from biology, where the system can reach resilience by sacrificing its population). Later contributions have mostly focused on the individual and her features in isolation, albeit earlier authors in human psychology recognized the

fundamental interconnectedness between the individual and her environment. This implied the risk to accept from standard economic approaches that methodological individualism that they so much refused. Our need theory of governance does not atomize the individual, but considers her as part of a collective, or as part of a public sphere of choice where self-actualization is pursued with and for others, and not to the detriment of others. Consistently with Maslow as well as with McGregor's Y theory, the creative and cooperative individual, and her wellbeing, are the main concerns here. However, the basic unit of analysis in this model is the interconnections between individuals and institutions within the organizational context.

We take the perspective that once discovered, each need has to be backed by the institutional context, or otherwise it will dissipate. In other words, the resilience of individual motivations requires that individual needs are supported by appropriate institutional processes. The broader the spectrum of needs recognized by institutions, the greater the capability for individuals to reach self-actualization. The higher the match, the higher the individual capability and engagement with the process or set of activities that can lead to the valued end.

The central idea of the needs theory of governance is that individual needs interact with institutional levels and, specifically, with governance structures and rules. When the interaction between needs and institutional levels fulfill individual needs in accord with the organization's objectives, the outcomes promote self-actualization and wellbeing, thus unleashing motivational energy for furthering new activities. The interaction between needs and institutions is expected to be higher when individuals partake through a dialogic process to the definition of objectives and institutional solutions that are considered adequate to achieve those objectives (Degli Antoni, 2016). Therefore, the expectation is that institutions that favor inclusion of individuals in the dialogic process are more likely to contribute to the self-actualization of individuals. Conversely, needs theory of governance suggests that exclusion from the definition of objectives and institutions can only limitedly serve the purpose of self-actualization.

**Proposition 2:** New-institutional economics hypothesizes imperfect rationality, self-seeking preferences, monetary-related needs, and opportunism as fundamental features of human behavior. A needs theory of governance, instead, hypothesizes, imperfect rationality, multiple needs, cooperation and reciprocity, in which case opportunism is reduced to an exception of individual behavior.

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*Insert Table 1 about here*  
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Clearly, as the organization cannot act to the detriment of the individual and her self-actualization, likewise individuals should not act to the detriment of the organization. However, in terms of organizational survival, a non-secondary consequence of the mismatch between individual values and organizational rules would be the emergence of X-inefficiency, for example in terms of members' reduced involvement and commitment, or the rise of behaviors that resist organizational strategies (Leibenstein, 1966). The most widespread remedies proposed in both the orthodox and institutional literature range from increasing hierarchy to tightening control and pay for performance (Lazear & Shaw, 2007). All these cures are liable to increasing control and other organizational costs without guaranteeing expected efficiency (Frey & Osterloh, 1999; Akerlof & Kranton, 2000). On the contrary, when rules are co-decided and cooperation is the norm (while opportunism is the exception) coordination is based on dialogic processes, rather than on monitoring and control (Leibenstein, 1978). This is because rules based on cooperation, including incentives, privilege seeking understanding and consensus even in the presence of divergent interests, over focusing on the use of authority. The command-and-control model of governance is also more likely to generate strong biases on individual willingness and capability to use voice and creativity, thus further reducing self-actualization (Sacchetti & Tortia, 2013). The negative impact

of a model that incentivizes individuals to respond to authority rather than use of creative intelligence and cooperation would then reinforce controlling practices and engender a vicious circle of dissatisfaction and feeling of “not counting” (Deci & Ryan, 2000; Sacchetti, Sacchetti & Sugden, 2009). Moreover, where a cooperative attitude is absent or poor, the need for hierarchical relations is reinforced, debate is not enriched by critical enquiry and the conditions for the development of a dialogic process disappear.

John Commons (1931) argued in favor of the empowering role of institutions, being “collective action controlling, liberating and expanding individual action” (quoted in Mirowski, 1987: 1020). In this respect, structures and working rules manifest their dual role of limiting self-seeking opportunistic behavior on the one hand, and enabling the discovery of multiple needs and solutions on the other. It follows that, rather than being the tool of coercion used by management, incentive mixes represent an emergent property of complex organizations whose function is to improve coherence between organizational objectives and multiple individual needs (Bacchiaga & Borzaga, 2001). One simple example at hand is the role of salary in work relations. Whilst it is true, as Maslow (1998) suggested, that workers’ motivations cannot be reduced only to payment of a monthly check, research evidences that monetary rewards contribute also to needs of higher order.<sup>5</sup> From the firm’s point of view, salary reflects resource scarcity and the need to pay the worker on the basis of his/her productivity. From the worker’s viewpoint the salary is, first and foremost, a means of survival but, at the same time, it contributes to the individual’s autonomy and self-

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<sup>5</sup> Concerning “far goals” of the enterprise Maslow (1965/1998) stated: “I have seen very few of these managers or writers on organizational theory who have the courage to think in far terms, in value terms. Generally, they feel they’re being hard headed if they use as the criteria of management success or of healthy organization criteria of smaller labor turnover or less absenteeism or better morale or more profit and the like. But in so doing, they neglect the whole Eupsychian growth and self-actualization and personal development side of the enterprise” (p.49).

accomplishment, and it is even part of worker identity (Cf. Depedri, Tortia, & Carpita, 2012 for empirical evidence).

However, despite the double function of monetary incentives, needs of higher order require also different solutions. Whilst new-institutionalist approaches argue that monetary incentives are the main drivers of production efficiency, evidence suggests that monetary incentives should be adequately balanced with non-monetary ones, and match individual needs and motives that do not have a specific monetary equivalent (Borzaga & Tortia, 2006; Becchetti, Castriota, & Tortia, 2013; Pencavel, Pistaferri & Schivardi, 2006). This body of research suggests that not only self-actualization is desirable from the viewpoint of human psychology, but it is also beneficial for the survival of the organization.

**Proposition 3:** Williamson's (2000) layered institutional model is aimed at highlighting the efficiency and transaction costs minimizing features of control rights and governance.

Differently, and consistently with the needs theory of governance, our model is aimed at evidencing the self-actualization potential of control rights, governance, and organizational practices.

## **INSTITUTIONAL LAYERS AND SELF-ACTUALIZATION**

The overarching message coming out of our discussion of economic institutions and their impact on self-actualization has placed emphasis on the idea that linkages exist between fulfillment of needs and organizations governance. Illustrations of how this connection can be implemented in practice .come from the much discussed and varied forms of shared capitalism and employee-owned companies (Erdal, 2011). Likewise, cooperative firms' governance illustrates a mutualistic, and democratic governance orientation. Other illustrations come from new institutionalist studies by

Ostrom (1990) on the effects of governance rules on the sustainable use of common pool resources and the people living out of their use (such as water for agricultural activities, Alpine meadows, and fisheries).

The reversed pyramid in Figure 1 identifies the benchmark for assessing the combined action of control rights, governance structure and rules in enabling the full expression of individuals' inner needs. It emphasizes that self-actualization requires adequate institutional preconditions, that is the existence of a governance structure and rules that favor continuous adjustment to and mediation between organizational objectives and individual needs. Whilst in Williamson (2000) the analysis of institutional layers focuses on transaction cost minimization and efficiency, the needs theory of governance suggests that those same layers can be interpreted prevalently as answers to layered needs and, ultimately, self-actualization in a way similar to Maslow's ordering of human needs. Our contention is that basic needs in Maslow theory (survival, security and belonging) broadly correspond to the most fundamental layers in Williamson framework (control rights and governance), while the highest Maslowian needs (self-esteem and self-actualization) correspond to the outer layers in Williamson framework (managerial models and employment relations). At one and the same time, the basic institutional layers in Williamson also represent the precondition for the correct working of the upper institutional layers in terms of the ongoing organization of production and interaction with the external environment. In the latter case, higher order needs are achieved through self-esteem and the self-actualization. The pursuit of the final objectives of the organization, that is production and exchange, is thus intermingled with the self-fulfillment of the involved actors (Sacchetti, 2015). Indeed, self-actualization, for instance in terms of utilization of creative intelligence, is likely to take place mainly in the sphere of production and the organization of work, since, as Loasby (2006) notices, this layer intermingles with knowledge creation and use. Needs theory, in this sense, changes the main "function" of production institutions from efficiency to needs fulfillment.

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*Insert Figure 1 about here*  
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**Proposition 4:** The application of Maslow’s theory to governance suggests that the deepest organizational layers (control rights and governance) broadly correspond to the most basic needs, while the outer layers (managerial models and employment relations) correspond to the fulfillment of the highest needs.

Williamson (2000) represents the organization as a stratified entity, where the different layers interact through specific connectors: rules, individual norms of behavior, and strategies. At the first layer of the pyramid are the basic institutions, such as control and appropriation rights, which usually undergo a high degree of legal formalization (Layer 1). The process of evolution of control rights is likely to take place in the long run. At this level, control rights appear to interpret the need for “survival”, which is the hardest wired and most “prepotent” need in Maslow’s theory. This institutional layer makes individuals value ownership of assets as a way to inhibit the fear of death and to ensure offspring. It can also be interpreted as precondition for the fulfillment of higher order needs. Control rights are binding in defining who has access to decision-making and scarce resources; however they do not univocally define how resources are managed, outcomes distributed, and how production is carried out.

Resource allocation and distribution patterns pertain the governance structure and working rules, defined at Layer 2. Formal governance connects control rights at Level 1 with the working and final aims of the organization at Level 3. At Level two, we observe the means through which the aim of the organization is pursued. In the case of cooperative forms of governance the organizational aim coincides with the aims of the self-organized principals. Likewise, governance rules are at least partially defined on an ongoing basis by the self-organized principals as a way to

reflect their needs and evolve based on their experience and critical appraisal of results (Ostrom, 1990). By building on what self-organized principals need, and by using the resources available for firm survival in accordance with control rights, formal governance and self-regulation address Maslowian second layer needs such as the “security” and “belonging” of individuals partaking in the organization. Security needs and belonging can be exemplified by the sustainability of the natural resource in self-managed common pool resources, or by job stability in worker cooperatives; quality and accessibility of services in users’ cooperatives; stable, long term access to credit for small producers and low risk financial investments for families in credit cooperatives and credit unions. Likewise, higher needs in cooperative firms are fulfilled by means of democratic governance, which provides the preconditions for processes of inclusion and critical assessment. These are aimed at defining and adjusting rules that reflect the evolving, shared needs of members and lead, through increased welfare, to the fulfillment of higher order needs.

The definition of rules determines also the criteria for assessing, internally, individual behavior. The achievement of a fair environment is crucial in enabling engagement with the democratic process, as the latter would work only when relations inside the firm are based on trust and reciprocating behaviors, under the assumption that each individual position is not independent from the position and behavior of the other members. In this sense, the constraining feature of rules is not meant to impair individual potential, but to ensure that an individual’s right to participate and share results is respected and compatible with other members’ rights. Rules that inhibit inclusion, from this perspective, would be perceived as unfair and have the undesirable effect of undermining motives directly related to intrinsic values and belonging, the third layer in Maslow’s scale, thus violating a fundamental condition for self-actualization. Self-actualization, the highest achievement in Maslow’s theory, arises when individuals can stimulate and use their creative intelligence for the benefit of self and others. The third layer in the reverse pyramid in Figure 1 captures actual

outcomes in terms of members' self-actualization, which is accomplished in the context of production, the outer organizational layer in Williamson (2000) framework.

## CONCLUSIONS

The need theory of governance has been presented with the aim of connecting human psychology and economic institutions. Need theory of governance has been used in this work as a critical, interpretative, as well as descriptive analytical tool, which can be used to interpret governance solutions.

Conclusions emphasize that, when governance is explained by focusing on needs and the self-actualization of individuals, opportunism as spelled out in most orthodox economic theorizing ceases being the dominant dimension of human behavior. Opportunism is, instead, left with a distortional role, which needs to be kept under control, while needs and their related motives become the fundamental driving force of governance choices. Governance is interpreted as an institutional solution that is geared to fulfill human needs, thus contributing to their self-actualization and wellbeing. The governance structure and rules that contribute to such outcomes must balance two features: the creative and the binding. If, on the one hand, the definition of rules leaves space for the expression of specific values and enables principals to creatively shape the organization's governance, on the other hand rules are also directed to foreclose opportunistic behavior and guarantee a high degree of compliance with collectively defined objectives. Conclusions also reinforce that attained outcomes can be explained only by considering the interconnections between needs and institutional layers, between the individual and her ecosystem. In a non-authoritarian setting, governance structure and rules are designed to promote dialogic process and enquiry at all levels of production activities, over time.

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**TABLE 1****The need theory and the new-institutional theory of governance compared**

<b>Components</b>	<b>Needs theory of governance</b>	<b>New-institutional theory of governance</b>
1. Units	Individuals/Organizations, interconnectedness	Organizations/individuals
2. Objective(s)	Self-actualization, involving multiple needs (monetary and non-monetary)	Minimization of transaction costs/maximization, monetary
3. Rationality	Bounded, governance failure	Bounded, market failure
4. Needs	Multiple, evolving	Monetary
5. Institutions	Enable multiple and evolving needs and related motives	Constraining, cost minimization
6. Behavior	Self-actualizing creativity and mutually beneficial cooperation. Reciprocity. Opportunism as exception	Self-seeking, opportunism
7. Decision-making	Amongst peers; transformative, dialogic process, moral enquiry	Agent/principal; authority
8. Empowerment	Important, endogenous, self-actualizing.	Not important, or not to be trusted
9. Incentives	Monetary and non-monetary	Monetary
10. Compliance with rules	Discretionary (self-defined rules)	Discretionary (respond to externally defined incentives, mechanical)

**FIGURE 1**

**Institutional layers and self-actualization in cooperative firms**

