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Controversy: Do Corporations Have Any Responsibility Beyond Making a Profit?

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In 1970[1] Milton Friedman published a short but extremely controversial essay in which he denied that corporate executives had any moral duty to relax the conditions of profit maximization on behalf of the wider interests of society. They are under a strict contractual duty to act for the owners of the company (the stockholders). For executives (or, indeed, owners) to use company resources to advance social goals (such as affirmative action in the workplace, social justice remuneration, and rigorous environmental constraints that exceed the requirements of positive law) would be for them to usurp the political function. Some would go further and insist that such action is a form of theft.[2] The social-responsibility thesis is a covert attempt to bring about socialism. Friedman's view, however, has been broadly accepted by all pro-capitalist writers, albeit with some modifications. For example, it is maintained that the passive stockholder is not a conventional resource owner; he or she is not allowed to enter the plant of a company randomly or have access to its secret information. Shareholders are more accurately understood as partners in a contract with the firm—a contract that entitles them to a return on their investment. It does not authorize company expenditure on morally worthy projects that might be against the interests of the stockholder; furthermore, the courts have been reluctant to uphold actions that do not have stockholder interests as their object.[3] The real justification for the capitalist system is utilitarian: It demonstrably increases social well-being by providing jobs for willing workers and products at competitive prices. However, any departure from these goals involves not just a lowering of utility but also a breach of property and contract rights. But the relationship between utility and rights is never explored in this theory.

Nevertheless, the animus against capitalism has not eased with the fall of communism. In fact, the attacks on free enterprise have become more sinister because the critics do not offer a wholesale replacement of the market but only modest suggestions for its reform. The major argument is that capitalism is not a self-justifying system (derived from the morality of freedom) but requires validation from a morality *external* to it: hence the rise of business ethics. Furthermore, to gain moral and legal approval, business, *contra* Friedman, must be socially responsible in a way that exceeds conventional morality. One reason is that the state has conferred certain privileges on the corporation such as entity status, permanent life, and, most important, limited liability, without which it could not exist.[4] These gifts, which privilege the corporation against other agents in society or other business personnel such as partners, must be earned by firms through actions not required of ordinary citizens.

However, it is not difficult to show that business creates its own morality within a world of conventions that develop spontaneously and precede positive law. Even if it were a world inhabited by egoists (or, at least, by conventional utility-maximizers), it would itself create a framework of law and morality that protects property and contracts, without which a business could not survive. In repeated plays of the Prisoners' Dilemma game, rational agents will observe these rules for their own advantage (as David Hume[5] observed, of the two farmers who do not like each other yet find cooperation to be to their mutual advantage). Business agents find their self-interested actions across national and cultural boundaries to be coordinated precisely because the foundational rules of business are indifferent to religion and national origin, as Voltaire[6] noted with his admiring comments on the nascent London stock market. It was a venue in which Jews, Christians, and Muslims could trade peacefully, and the only "sin" was bankruptcy. It is rare that business activities are "one-shot" dilemma games (played only once) in which rule-breakers cannot be detected and punished by other participants. Although some types of damage to the environment by self-interested egoists who trade or produce only once might be different and require coercive regulation, even here it is likely that a regime of rigorously enforced property rights would preclude the need for too much state legislation. Most of business could regulate itself, even in the anonymous world of modern financial markets where people meet only via computer screen. In the absence of coercive regulation, new players to the game would be inducted into its conventions. Many of the spectacular business scandals that occur in these markets are the result of over-zealous prosecutors and the myriad of competition-destroying rules. Rules that require companies to go beyond profit will not develop spontaneously because they are seldom related to the activity of business itself.

Corporate Rights Reducible to Individual Rights

It can be shown, I think, that under common law systems, business corporations do not have any rights that are not reducible to *individual* rights.[7] The so-called special privileges of the corporate form can, and did, emerge from individuals pooling their resources and creating an artificial collective entity by contract. It is true that the early corporations in Britain were grants of privilege by the Crown (the same thing happened early on in the United States), and they were accompanied by specific social duties; however, since the nineteenth century, corporations have been merely recognized by authorities, not created by them. What legislation did exist in the United States, for example, was merely permissive. The concept of limited liability originated in the mists of history and court decisions, and legislative acts have merely acknowledged and formalized it, but this concept is not essential to a corporation, for no one is obliged to trade with persons who seek its protection. Corporations are now recognized as profit-making organizations, and their employees, under Anglo-American law, have a strict fiduciary duty to act in the interests of stockholders. That duty still remains, despite some statutory and judge-made depredations of the original function and purpose of the corporation.

The argument of most writers on business ethics, however, is that the corporation is not derived from individual but from social premises; it operates only with society's permission. It is trivially true that the corporation is a kind of collective entity that advances the common goals of its members. It is also correct to assert that its wealth and independence function as significant limits to the otherwise all-pervading power of the state.[8] But none of this implies that the corporation is, as John Kenneth Galbraith once contended, immune from the corrective processes of the market. The very fact that a significant number of today's top American corporations are less than twenty years old and that major companies have been liquidated or taken over in recent years should be enough to convince the skeptic that corporations operate in a highly uncertain and competitive world. It is true, as Ronald Coase pointed out in 1937,[9] that the worker, on joining the corporation, loses a certain amount of market freedom since the firm operates on the basis of bilateral and non-specific contracts, and not individually negotiated multilateral agreements of pure market society. But they are still voluntary arrangements from which a person is free to leave at will. Indeed, the rise of the Internet and the phenomenon of individuals using sophisticated technology and working from home, are both changing the nature of the corporate form, if not quite signaling its demise. Business forms change as transaction costs change, thus firms only emerge because pure market production methods involved significantly high transaction costs. Indeed, as market economies progress, they are becoming more individualistic and, consequently, the case for corporate social responsibility is becoming even less plausible.

Corporations and the Demand for Social Responsibility

For the foreseeable future, corporations will continue to exist, which means that the demands for social responsibility will likewise persist. But these demands come up against the laws of economics, which dictate very different social policies from those of orthodox business ethics. One assumes that the critics of contemporary business are eager to preserve a competitive market; indeed, they are inveterate critics of monopoly and other market imperfections. But what they do not acknowledge is that the corporation can only be charitable and socially responsible the *less* competitive the market is. Furthermore, in an efficient market, good deeds for some workers normally harm the interests of others. For example, in the early 1970s[10] Coca-Cola was a pioneer in social responsibility by running a private-enterprise welfare scheme for its immigrant workers who experienced poor conditions in Florida (though these workers were still better off than natives in the countries from which they came). But the welfare scheme, though virtuous, raised costs and caused unemployment within the company, which remained undetected. It is only the monopolist who has sufficient surplus to engage in charitable causes, but many ethicists expect all business personnel to do so. It is noticeable that the recently privatized water company monopolies in Britain are among the market leaders in business ethics. Not only can such companies afford to be generous because of an obviously less than perfect market, but they fear that if they are not, they will be subject to excessive regulation. Does the social responsibility thesis, then, encourage the formation of monopolies? In most cases of corporate beneficence, it is not easy to see whether corporate beneficence is genuinely moral (i.e., if it was willingly approved by the shareholders) or merely prudent.

In fact, those who stress the social responsibility of business require the corporation's executives, not to mention the stockholders, to perform *supererogatory* duties, i.e., obligations that go beyond promise-keeping and observation of the elementary rules of justice and property. These duties properly belong to private persons, and, where they are genuine expressions of morality, they normally involve the agent in a (typically financial) sacrifice. But corporate executives, especially if they do not hold stock in the company, will assume these responsibilities. Business ethics is a more pleasing, less onerous activity, than working for the stockholders, but it is no more than a form of rent-seeking by executives. Companies are also active in business ethics to ward off profit-reducing regulation, which would be considered hypocritical by the genuine moralist. Mr. Robert Reich,[11] the former United States Labor Secretary, has said that companies fulfilling social duties will be rewarded with favorable tax and regulatory treatment. Given the low esteem that business is usually given in capitalist economies, it is not surprising that ethics should appear as a form of tactical behavior.

The Threat to Commerce of Stakeholder Communitarianism

Each of the preceding examples of corporate social responsibility has been around for a long time, and, despite the threat to property and contract they pose, commerce has adjusted itself to them. However, in recent years there has emerged from the same school a much more serious threat to commerce. This is the *stakeholder* movement, and if its moralistic exhortations were ever put into law, the emasculation of property they entail could make the free market almost unworkable in America and Britain. To critics of Anglo-American capitalism, the superficial allure of stakeholderism is heightened by the fact that it appears to be a feature of the rival, and successful, economic systems of Germany and Japan. Indeed, these economies seem to embody those communitarian features that theorists of corporate responsibility find irresistible.

The word *stakeholder* is a not very subtle play on the word *stockholder*, which originally referred to a form of ownership, but now has come to represent nearly the antithesis of ownership rights. In an implicit refutation of Anglo-American capitalism's commitment to property rights, the prominent stakeholder theorists Evan and Freeman insist: "The reason for paying returns to owners is not that they 'own' the firm but that their support is necessary for the survival of the firm, and that they have a legitimate claim on the firm."[12] The shareholders are simply one of a number of groups that might make claims on company resources. The potentially rivalrous stakeholders would include workers, suppliers, residents in the community where the firm is situated and, indeed, any group that might have a connection with it, however tenuous. Though Evan and Freeman claim to be Kantians, given their theory, however, the shareholders would be used as means to the ends of others in an un-Kantian way.

It is clear from stakeholder theory that owners would have no special position in the organization, and, for this reason, it is unlikely that rationality would prevail in the decisions made by stakeholders. A host of considerations other than profit would be relevant to things such as plant relocation, remuneration, severance (if it were allowed), and takeovers (if they were ever permitted). The problem is that there is no ordering principle equivalent to the price mechanism that could be used by stakeholders in the typical decisions affecting corporations. If the stakeholder idea were taken seriously, decision-making in a corporation would resemble that of a parliamentary assembly: the board room would be a battleground for warring pressure groups. It is no coincidence that stakeholder theorists refer to the groups influencing corporate decisions as *constituencies*.

Stakeholder theory, however, made a significant contribution to the debate about corporate takeovers. The standard collectivist argument is that the company is not the property of its stockholders and, therefore, the choices the stockholders make should not be the only consideration in questions about the company's future. The clearest difference between Anglo-American capitalism and its Japanese and German rivals is that hostile bids are scarcely known in the latter two economies. Here the company is, in effect, "owned" by stakeholder groups (trade unions, banks, managers, and so on), so that in Germany, for example, even though stockholders have the final say in such matters (despite the obligatory presence of trade unions on supervisory boards), no one owner can vote more than 5 percent of his stock no matter how much he might own. This dilutes the force of ownership. But individualist Anglo-American capitalism, with its concern for stockholder value, could not function in such a world. In the absence of a takeover threat, managers would become rent-seekers and divert income to themselves that should go to the stockholders. Who would ever invest in a company that was effectively owned by a coalition of stakeholders? It might be true that "owners" in Japan and Germany can enforce discipline on management without the takeover threat, or that the communitarian spirit in those countries prevents anti-social egoism, but it is unlikely that these social characteristics will survive globalization and the anonymity to commerce that it inevitably brings. In fact, the 5 percent voting rule in Germany is scheduled for repeal later this year.

The arguments presented here are not merely utilitarian, for the idea of stakeholderism is disruptive of the moral relationship that should obtain between legitimate owners and employees. It is not merely property rights that become insecure in such a world, for what contractual relationships would ever be secure if they were under the constant threat of political-style decisions? Even if a company were solely concerned with pursuing the good (if that were to be imagined), it could not be successfully organized on stakeholder principles, for without some kind of ordering principles, it would be permanently harassed by rival notions of the good. Even here, the business would require executive action, which can occur only in a system where executives are ultimately responsible to stockholders rather than to a coalition of interest groups. The latter paralyzes sound fiscal decision-making.

Conclusion

On simple utilitarian grounds, Anglo-American capitalism is proving to be superior to its rivals. The German social market[13] is under great pressure at the moment, and the country's companies are increasingly threatened by foreign predators. (At the time of writing, Mannesmann, a major mobile telephone company, is being threatened by the British company, Vodafone, with the most expensive hostile bid in history. Vodafone's potential success might very well mean the end of the German model.) Indeed, because of the debilitating and uncompetitive effect of communitarian capitalism, Germans are investing heavily overseas. The laws of economics eventually triumph over the most elegant of ethical theories; capital always flows to places where the returns are highest. But there is nothing particularly moral about this model; neither German commentators nor capitalists have any objection to their companies making hostile bids for businesses in other countries. This suggests that the model has more to do with nationalism than either rational economics or a universal ethic.

The much-admired Japanese economy has been mired in recession for over a decade, but its anti-individualist bias and alleged corporate responsibility have masked for decades a type of immorality that would have been exposed quickly by the open economies of Wall Street and London. In Japan, small shareholders are treated poorly; they are paid derisory dividends and are excluded from any serious role in the management of companies. Criminals seem to be more influential in corporate governance than regular stockholders are.[14]

For decades, Anglo-American capitalism has been as modest about its commercial success as it has been about the moral achievements of its business personnel. The current demand for the social responsibility of the corporation seems to be based on inadequate knowledge of how this system (or that of its rivals) works. Nonetheless, the long period of sustained rise in stock values indicates that the shareholder value is a potent force in the United States (and increasingly so in Britain). There are plenty of opportunities for making individual moral choices in those economic systems, which were displayed through a staggering number of individual donations from company personnel to worthy causes, even during the greedy 1980s. Without the competitiveness and flexibility of capitalism, it is doubtful that market economies could have created sufficient wealth to sustain such benevolence. Profit is essential for the sort of ethics favored by business moralists. Believers in the extensive social responsibility of business end up socializing morality and, therefore, removing that element of individual responsibility necessary for all ethical conduct.

Notes

1. Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits," *New York Times Magazine* (1 September 1970). Reprinted in *Ethical Theory and Business*, ed. Tom L. Beauchamp and Norman E. Bowie (Englewood Cliffs, N.J.: Prentice-Hall, 1993).
2. Elaine Sternberg, *Just Business* (London: Little, Brown, Ltd., 1994), 30.
3. In the United States, the leading court cases are *Dodge v. Ford* (1919) and *A. P. Smith Manufacturing Co. v. Barlow* (1953).
4. The implication is that capitalism would be reduced to single proprietorships or partnerships.
5. David Hume, *A Treatise of Human Nature*, ed. H. Aiken (New York: Macmillan, 1948), 612.
6. See David Boaz, ed., *Libertarianism: A Primer* (New York: Free Press, 1997), 38.
7. See Norman P. Barry, *Business Ethics* (London: Macmillan, 1998), chap. 3.
8. Michael Novak, arguing from a Catholic perspective, has continually stressed this point.
9. Ronald H. Coase, "The Nature of the Firm," *Economica* 4 (1937): 386–405.
10. Henry Manne, *The Modern Corporation and Social Responsibility* (Washington, D.C.: American Enterprise Institute, 1972), 29.
11. Robert Reich, "The New Meaning of Corporate Social Responsibility," *California Management Review* 40, 2 (Winter 1998): 8–17.
12. William R. Evan and R. Edward Freeman, "A Stakeholder Theory of the Firm: Kantian Capitalism," in *Ethical Theory and Business*, ed. Tom L. Beauchamp and Norman E. Bowie (Englewood Cliffs, N.J.: Prentice-Hall, 1993), 82. For a critique, see Barry, *Business Ethics*, chap. 4.
13. See Norman P. Barry, "The Social Market Economy," *Social Philosophy and Policy* 10 (1993): 1–25.
14. Barry, *Business Ethics*, 174–75.