CENTRE FOR CIVIL SOCIETY

ViewPoint 1

Do Corporations Have Social Responsibility?

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Centre for Civil Society

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Introduction

The public discourse on corporate governance is abuzz with phrases such as “corporate social responsibility,” “business ethics,” “ethical investment,” and “triple bottom line.” Corporations are under increasing pressure to be more responsible, ethical, environmentally conscious, and concerned with sustainable development. They are asked to consider not just shareholders but all stakeholders—employees, suppliers, customers, the communities in which they operate, and the ecosystem from which they extract resources.

In the post-communist world, the practical necessity of private business is almost universally accepted; demands for nationalization, new public sector units are outside the bounds of accepted policy discourse. Adam Smith, through the metaphor of Invisible Hand, lucidly explained the social value of the pursuit of self-interest. In a system of private property and free competition, individuals’ pursuit of self-interest leads, as if guided by an Invisible Hand, to the attainment of social welfare. But the morality of capitalism remains universally suspect. The bourgeoisie is unable or unwilling to stand upright morally.

Businessmen are regarded as useful, but not honorable—a necessary evil. They are needed for material life; but their moral status is always suspect. They are tolerated but never honored. Contrast this treatment of businessmen with that of politicians.

Thoroughly corrupt politicians are relieved of moral condemnation by trite assertions like: “politicians come from the same society that we have created.” “We ourselves elect them; they reflect popular will.” No one can cast a stone on the politician. We are all equally guilty for political corruption. Corrupt politicians are a reflection of the failing values of the society. We should feel responsible that they exist in our midst.

How about corrupt businessmen? Is their existence ever seen as a sign of moral degradation of the society? Are they a reflection of us? No one seems to hold society responsible for the existence of corrupt businessmen. It is hard to imagine that they could be from us. They are judged to be a different species altogether.

While criticizing the corrupt politicians, one is reminded that there are good politicians too. It seems that one good politician can provide cover for all the corrupt ones.

No one excuses bad businessmen by remembering good businessmen. One bad businessman undoes all the good ones. We are satisfied if a few politicians are honest but dissatisfied unless all businessmen are perfect. Actually a distinction between corrupt and non-corrupt businessmen is hardly ever made. They are all treated alike. They exploit workers, gouge customers, and ruin the environment. We rationalize corrupt politicians but refuse to consider the possibility of an honest businessman.

Constant complaints about corruption in politics bring the reply that one should join politics and unless one does so one has no moral right to complain. What is the reply to complaints about corrupt businessmen? Surely not to join business! Even business management students take pride in declaring that they would like to work for a non-profit organization.

Our literature, plays, and films reflect this moral indignation of businessmen. Businessmen are the commonest villains. This is also true in the so-called capitalist societies. Several classics can be immediately listed where businessmen are portrayed as bad characters. A long search would be required to find a work let alone a classic that shows a businessman as the hero. It is assumed that success in business requires no higher virtue; mechanics and management of success are studied but not mercantile values.

More than two centuries after the Industrial Revolution, after unimaginable prosperity created by capitalism, our instincts favour aristocratic or peasant virtues and disdain bourgeois virtues. Even the existence of bourgeois virtues is hardly ever recognized. Professor D N McCloskey (1994, p.179) describes each class and its virtues thus:

Aristocrat, Patrician Virtues:	Honor; Loyalty; Courage; Pride of being
Peasant, Plebeian Virtues:	Duty; Reverence; Humility; Benevolence; Fairness; Charity; Pride of service
Bourgeois, Mercantile Virtues:	Enterprise; Honesty; Thrift; Trustworthiness; Responsibility; Prudence; Pride of action

We cherish the values of the soldier, worker, and the artist, but not of the merchant. In reality, commerce has the most civilizing influence It gives us "polite, accommodating, energetic, enterprising, risk-taking, and trustworthy people" (McCloskey, p. 181). Bourgeois virtues have made civilization possible.

Today only charity brings any moral recognition to businessmen. They are commended not for the money they make but for the money they give away. Unfortunately, businessmen themselves have accepted this moral condemnation—the unearned guilt. They are more proud of their philanthropic activities than their productive work. They seem to be trying to wash away they sin of earning wealth by giving it away. They fund poverty alleviation programmes, forgetting that their factories and shops are the most effective and sustainable means of poverty alleviation.

However there is nothing particularly morally hazardous about business. Any human activity that involves choices between right and wrong has its moral hazards. Businessmen may face larger number of moral dilemmas in their activities, but they could scarcely be more than those faced by bureaucrats or politicians, or for that matter, by professionals like doctors and lawyers. What is required then is not some special ethics for businessmen but an ethics to guide every one of us in all our endeavors. Business morality is simply personal morality, no more, no less.

The commercial civilisation evolves us into better beings—in the standard of living, etiquette, and in moral behavior. The Invisible Hand of capitalism also produces the Invisible Heart.

I do not argue with that businessmen are inherently superior,

McCloskey, D N. 1994. "Bourgeois Virtue." *The American Scholar*. Spring 1998.

morally or otherwise. It is the system under which they operate that over time makes them more honest, reliable, and innovative. Unfettered competition imbibes them with mercantile values. Wealth earned through voluntary transactions in a marketplace is moral, not when acquired with the use of force. Greed of one businessman helps to turn the greed of another into an asset, a virtue.

The two essays in this monograph demonstrate the morality of free enterprise and demolish the fashionable demands on business under the cloak of "business ethics" and "corporate social responsibility" by detailing their inherent contradictions and perverse unintended consequences. A reading list at the end provides information to follow these issues further.

The first essay by Nobel Laureate Milton Friedman was written in 1970, at the beginning of the "social responsibility" assault on business. It is quintessential Friedman, the title says it all: *The Social Responsibility of Business Is to Increase Its Profits*. Professor Alexei Marcoux then details flaws of the recent stakeholder approach to business ethics. The approach demands that profits of corporations must be shared by all stakeholders, and not be appropriated by shareholders alone. Surprisingly though, stakeholder theorists are silent about the sharing of losses. Why would one invest in equity if the gains are given to all but the losses are only for them to bear? Stakeholder politics—attempts to manage conflicting claims of various stakeholders in every major business decision—in corporate boardrooms and annual meetings would turn managers into politicians. As Marcoux quips: "If a camel is a horse designed by a committee, then what misshapen beast is a firm shaped by the strategic interactions of its stakeholder representatives?"

Businessmen must acquire moral certitude, understand the bourgeois virtues they practice. They should not appease promoters of business ethics and corporate social responsibility and undermine the great commercial civilization they have helped create.

The slogan "Jai Jawan! Jai Kisan! Jai Vigyan!" must also include, "Jai Vyapar!"

September 30, 2001 **PARTH J SHAH**

The Social Responsibility of Business Is to Increase Its Profits

Milton Friedman*

When I hear businessmen speak eloquently about the "social responsibilities of business in a free-enterprise system," I am reminded of the wonderful line about the Frenchman who discovered at the age of 70 that he had been speaking prose all his life. The businessmen believe that they are defending free enterprise when they declaim that business is not concerned "merely" with profit but also with promoting desirable "social" ends; that business has a "social conscience" and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers. In fact they are–or would be if they or anyone else took them seriously–preaching pure and unadulterated socialism. Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades.

The discussion of the "social responsibilities of business" are notable for their analytical looseness and lack of rigor. What does it

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mean to say that "business" has responsibilities? Only people can have responsibilities. A corporation is an artificial person and in this sense may have artificial responsibilities, but "business" as a whole cannot be said to have responsibilities, even in this vague sense. The first step toward clarity to examining the doctrine of the social responsibility of business is to ask precisely what it implies for whom.

Presumably, the individuals who are to be responsible are businessmen, which means individual proprietors or corporate executives. Most of the discussion of social responsibility is directed at corporations, so in what follows I shall mostly neglect the individual proprietors and speak of corporate executives.

In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom. Of course, in some cases his employers may have a different objective. A group of persons might establish a corporation for an eleemosynary purpose-for example, a hospital or a school. The manager of such a corporation will not have money profit as his objectives but the rendering of certain services.

In either case, the key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them.

Needless to say, this does not mean that it is easy to judge how well he is performing his task. But at least the criterion of performance is straightforward, and the persons among whom a voluntary contractual arrangement exists are clearly defined.

Of course, the corporate executive is also a person in his own right. As a person, he may have many other responsibilities that he recognizes or assumes voluntary-to his family, his conscience, his feelings of charity, his church, his clubs, his city, his country. He may feel impelled by these responsibilities to devote part of his income to causes he regards as worthy, to refuse work for particular corporations, even to leave his job, for example, to join his country's armed forces. If we wish, we may refer to some of these responsibilities as "social responsibilities." But in these respects he is acting as a principal, not an agent; he is spending his own money or time or energy, not the money of his employers or the time or energy he has contracted to devote to their purposes. If these are "social responsibilities," they are the social responsibilities of individuals, not of business.

What does it mean to say that the corporate executive has a "social responsibility" in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers. For example, that he is to refrain from increasing the price of the product in order to contribute to the social objective of preventing inflation, even though a price increase would be in the best interests of the corporation. Or that he is to make expenditures on reducing pollution beyond the amount that is in the best interests of the corporation or that is required by law to contribute to the social objective of improving the environment. Or that, at the expense of corporate profits, he is to hire "hardcore" unemployed instead of better qualified available workmen to contribute to the social objective of reducing poverty.

In each of these cases, the corporate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his "social responsibility" reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending customer's money. Insofar as his actions lower the wages of some employees, he is spending their money.

The stockholders or the customers or the employees could separately spend their own money on the particular action if they wished to do so. The executive is exercising a distinct "social responsibility," rather than serving as an agent of the stockholders or the customers or the employees, only if he spends the money in a different way than they would have spent it.

But if he does this, he is in effect imposing taxes, on the one hand, and deciding how the tax proceeds shall be spent, on the other.

This process raises political questions on two levels: principle and consequences. On the level of political principle, the imposition of taxes and the expenditure of tax proceeds are governmental functions. We have established elaborate constitutional, parliamentary and judicial provisions to control these functions, to assure that taxes are imposed so far as possible in accordance with the preferences and desires of the public–after all, "taxation without representation" was one of the battle cries of the American Revolution. We have a system of checks and balances to separate the legislative function imposing taxes and enacting expenditures from the executive function of collecting taxes and administering expenditure programs and from the judicial function of mediating disputes and interpreting the law.

Here the businessman–self-selected or appointed directly or indirectly by stockholders–is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose, and he is to spend the proceeds–all this guided only by general exhortations from on high to restrain inflation, improve the environment, fight poverty and so on and on.

The whole justification for permitting the corporate executive to be selected by the stockholders is that the executive is an agent serving the interests of his principal. This justification disappears when the corporate executive imposes taxes and spends the proceeds for "social" purposes. He becomes in effect a public employee, a civil servant, even though he remains in name an employee of a private enterprise. On grounds of political principle, it is intolerable that such civil servants–insofar as their actions in the name of social responsibility are real and not just window dressing–should be selected as they are now. If they are to be civil servants, then they must be elected through a political process. If they are to impose taxes and makeexpenditures to foster "social" objectives, then political machinery must be set up to make the assessment of taxes and to determine through a political process the objectives to be served.

This is the basic reason why the doctrine of "social responsibility" involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses.

On the grounds of consequences, can the corporate executive in fact discharge his alleged "social responsibilities?" On the one hand, suppose he could get away with spending the stockholders' or customers' or employees' money. How is he to know how to spend it? He is told that he must contribute to fighting inflation. How is he to know what action of his will contribute to that end? He is presumably an expert in running his company–in producing a product or selling it or financing it. But nothing about his selection makes him an expert on inflation. Will his holding down the price of his product reduce inflationary pressure? Or, by leaving more spending power in the hands of his customers, simply divert it elsewhere? Or, by forcing him to produce less because of the lower price, will it simply contribute to shortages? Even if he could answer these questions, how much cost is he justified in imposing on his stockholders, customers, and employees for this social purpose? What is his appropriate share and what is the appropriate share of others?

And, whether he wants to or not, can he get away with spending his stockholders', customers' or employees' money? Will not the stockholders fire him? (Either the present ones or those who take over when his actions in the name of social responsibility have reduced the corporation's profits and the price of its stock.) His customers and his employees can desert him for other producers and employers less scrupulous in exercising their social responsibilities.

This facet of "social responsibility" doctrine is brought into sharp relief when the doctrine is used to justify wage restraint by trade unions. The conflict of interest is naked and clear when union officials are asked to subordinate the interest of their members to some more general purpose. If union officials try to enforce wage restraint, the consequence is likely to be wildcat strikes, rank-and-file revolts and the emergence of strong competitors for their jobs. We thus have the ironic phenomenon that union leaders—at least in the US—have objected to Government interference with the market far more consistently and courageously than have business leaders.

The difficulty of exercising "social responsibility" illustrates, of course, the great virtue of private competitive enterprise—it forces people to be responsible for their own actions and makes it difficult for them to "exploit" other people for either selfish or unselfish purposes. They can do good—but only at their own expense.

Many a reader who has followed the argument this far may be tempted to remonstrate that it is all well and good to speak of Government's having the responsibility to impose taxes and determine expenditures for such "social" purposes as controlling pollution or training the hard-core unemployed, but that the problems are too urgent to wait on the slow course of political processes, that the exercise of social responsibility by businessmen is a quicker and surer way to solve pressing current problems.

Aside from the question of fact—I share Adam Smith's skepticism about the benefits that can be expected from "those who affect to trade for the public good"–this argument much be rejected on grounds of principle. What it amounts to is an assertion that those who favor the taxes and expenditures in question have failed to persuade a majority of their fellow citizens to be of like mind and that they are seeking to attain by undemocratic procedures what they cannot attain by democratic procedures. In a free society it is hard for "evil" people to do "evil," especially since one man's good is another's evil.

I have, for simplicity, concentrated on the special case of the corporate executive, except only for the brief digression on trade unions. But precisely the same argument applies to the newer phenomenon of calling upon stockholders to require corporations to exercise social responsibility (the recent General Motors' crusade for example). In most of these cases, what is in effect involved is some stockholders trying to get other stockholders (or customers or employees) to contribute against their will to "social" causes favored by the activists. Insofar as they succeed, they are again imposing taxes and spending the proceeds.

The situation of the individual proprietor is somewhat different. If he acts to reduce the returns of his enterprise in order to exercise his "social responsibility," he is spending his own money, not someone else's. If he wishes to spend his money on such purposes, that is his right, and I cannot see that there is any objection to his doing so. In the process, he, too, may impose costs on employees and customers. However, because he is far less likely than a large corporation or union to have monopolistic power, any such side effects will tend to be minor.

Of course, in practice the doctrine of social responsibility is frequently a cloak for actions that are justified on other grounds rather than a reason for those actions.

To illustrate, it may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government. That may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects. Or it may be that, given the laws about the deductibility of corporate charitable contributions, the stockholders can contribute more to charities they favor by having the corporation make the gift than by doing it themselves, since they can in that way contribute an amount that would otherwise have been paid as corporate taxes.

In each of these and many similar cases, there is a strong temptation to rationalize these actions as an exercise of "social responsibility." In the present climate of opinion, with its widespread aversion to "capitalism," "profits," and "soulless corporation" and so on, this is one way for a corporation to generate goodwill as a by-product of expenditures that are entirely justified in its own self-interest.

It would be inconsistent of me to call on corporate executives to refrain from this hypocritical window-dressing because it harms the foundations of a free society. That would be to call on them to exercise a "social responsibility!" If our institutions, and the attitudes of the public make it in their self-interest to cloak their actions in this way, I cannot summon much indignation to denounce them. At, the same time, I can express admiration for those individual proprietors or owners of closely held corporations or stockholders of more broadly held corporations who disdain such tactics as approaching fraud.

Whether blameworthy or not, the use of the cloak of social responsibility, and the nonsense spoken in its name by influential and prestigious businessmen, does clearly harm the foundations of a free society. I have been impressed time and again by the schizophrenic character of many businessmen. They are capable of being extremely far-sighted and clearheaded in matters that are internal to their businesses. They are incredibly short-sighted and muddle-headed in matters that are outside their businesses but affect the possible survival of business in general. This short-sightedness is strikingly exemplified in the calls from many businessmen for wage and price guidelines or controls or income policies. There is nothing that could do more in a brief period to destroy a market system and replace it by a centrally controlled system than effective governmental control of prices and wages.

The short-sightedness is also exemplified in speeches by businessmen on social responsibility. This may gain them kudos in the short run. But it helps to strengthen the already too prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces. Once this view is adopted, the external forces that curb the market will not be the social consciences, however highly developed, of the pontificating executives; it will be the iron fist of Government bureaucrats. Here, as with price and wage controls, businessmen seem to me to reveal a suicidal impulse.

The political principle that underlies the market mechanism is unanimity. In an ideal free market resting on private property, no individual can coerce any other, all cooperation is voluntary, all parties to such cooperation benefit or they need not participate. There are no values, no "social" responsibilities in any sense other than the shared values and responsibilities of individuals. Society is a collection of individuals and of the various groups they voluntarily form.

The political principle that underlies the political mechanism is conformity. The individual must serve a more general social interest–whether that be determined by a church or a dictator or a majority. The individual may have a vote and say in what is to be done, but if he is overruled, he must conform. It is appropriate for some to require others to contribute to a general social purpose whether they wish to or not.

Unfortunately, unanimity is not always feasible. There are some respects in which conformity appears unavoidable, so I do not see how one can avoid the use of the political mechanism altogether.

But the doctrine of "social responsibility" taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly collectivist doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means. That is why, in my book *Capitalism and Freedom*, I have called it a "fundamentally subversive doctrine" in a free society, and I have said that in such a society, "there is one and only one social responsibility of business–to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

Business Ethics Gone Wrong

Alexei M Marcoux*

Business ethics courses are offered (and often, for business majors, required) in ever-increasing numbers. The ranks of the academy swell with professors whose principal vocation is teaching and writing in business ethics. Although deriving and explaining the ethical norms that support and lubricate a well-functioning market economy are worthwhile tasks, the intellectual fashion in business ethics is quite a different matter. For among business ethicists there is a consensus favoring the stakeholder theory of the firm-a theory that seeks to redefine and reorient the purpose and the activities of the firm. Far from providing an ethical foundation for capitalism, these business ethicists seek to change it dramatically.

SHAREHOLDERS AND STAKEHOLDERS

Stakeholder theory is most closely associated with R Edward Freeman, Olsson Professor of Applied Ethics at the University of Virginia's Darden School. The theory holds that managers ought to serve the interests of all those who have a "stake" in (that is, affect or are

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affected by) the firm. Stakeholders include shareholders, employees, suppliers, customers, and the communities in which the firm operates-a collection that Freeman terms the "big five." The very purpose of the firm, according to this view, is to serve and coordinate the interests of its various stakeholders. It is the moral obligation of the firm's managers to strike an appropriate balance among the big five interests in directing the activities of the firm.

This understanding of the firm's purpose and its management's obligations diverges sharply from the understanding advanced in the shareholder theory of the firm. According to shareholder theorists such as Nobel laureate economist Milton Friedman, managers ought to serve the interests of the firm's owners, the shareholders. Social obligations of the firm are limited to making good on contracts, obeying the law, and adhering to ordinary moral expectations. In short, obligations to nonshareholders stand as sideconstraints on the pursuit of shareholder interests. This is the view that informs American corporate law and that Friedman defends in his 1970 New York Times Magazine essay, "The Social Responsibility of Business Is to Increase Its Profits."

CORPORATE SOCIAL RESPONSIBILITY AND STAKEHOLDER THEORY

Stakeholder theory seeks to overthrow the shareholder orientation of the firm. It is an outgrowth of the corporate social responsibility (CSR) movement to which Friedman's essay responds. According to CSR, the firm is obligated to "give something back" to those that make its success possible. The image of the firm presented in CSR is that of a free rider, unjustly and uncooperatively enriching itself to the detriment of the community. Socially responsible deeds (such as patronizing the arts or mitigating unemployment) are necessary to redeem firms and transform them into good citizens.

One wonders, however, why firms are obligated to give something back to those to whom they routinely give so much already. Rather than enslave their employees, firms typically pay them wages and benefits in return for their labor. Rather than steal from their customers, firms typically deliver goods and services in return for the revenues that customers provide. Rather than free ride on public provisions, firms typically pay taxes and obey the law. Moreover, these compensations are ones to which the affected parties or (in the case of communities and unionized employees) their agents freely agree. For what reasons, then, is one to conclude that those compensations are inadequate or unjust, necessitating that firms give something more to those whom they have already compensated?

Stakeholder theory constitutes at least something of an advance over CSR. Whereas CSR is fundamentally antagonistic to capitalist enterprise, viewing both firm and manager as social parasites in need of a strong reformative hand, stakeholder theory takes a different tack. Rather than offer stakeholder theory as a means of overthrowing capitalist enterprise, stakeholder theorists profess to offer theirs as a strategy for improving it. As Robert Phillips of the University of San Diego writes, "One of the goals of the stakeholder theory is to maintain the benefits of the free market while minimizing the potential ethical problems created by capitalism."

On the theory that "you'll catch more flies with honey than with vinegar," stakeholder theorists ostensibly praise corporate leaders and maintain that firms are social institutions and their managers are community leaders. Given appropriate latitude, firms and managers are disposed to serve the social good. Corporate law and the market for corporate control, however, preclude firms and managers from following their inclinations and serving their social missions. Stakeholder theory seeks to free both firm and manager from their exclusive attention to the narrow, parochial concerns of shareholders so that they can focus on a broader set of interests.

But although the diagnosis of the problem with capitalist enterprise is (at least, on the face of it) different from that advanced in CSR, the stakeholder theorists' remedy is largely the same: the elevation of nonshareholding interests to the level of shareholder interests in formulating business strategy and policy. The stakeholder-oriented manager is admonished to weigh and balance stakeholder interests, trading off one against another in settling on a course of action. Stakeholder theorists seek a reorientation of the corporate law toward the interests of stakeholders and the insulation of managers from the market for corporate control.

PROBLEMS

Whatever the appeal of the stakeholder theory's inclusiveness of and sensitivity to the myriad interests that affect and are affected by firms, there are several powerful reasons to resist the theory's adoption and embodiment in a reformed corporate law.

Equity Capital. Because it undermines shareholder property rights, stakeholder-oriented management denigrates and discourages equity investment. In the stakeholder-oriented firm, equity investors bear the same downside risks that they bear in the traditionally governed, shareholder-oriented firm. The upside potential of their investment, however, is diminished significantly; for in distributing the fruits of the firm's success, equity investor interests are only some among many to be considered and served. In short, when the firm loses, shareholders lose; when the firm wins, shareholders might lose anyway if other interests are deemed to be more weighty and important.

Stakeholder-oriented management effectively eliminates issuing shares as a means of financing the firm's growth and new ventures. By diminishing the orientation of the firm toward shareholder interests, stakeholder-oriented management will presumably lead investors to discount sharply the value they attach to shareholdings. So stakeholder-oriented management essentially entails a near-exclusive reliance on debt as the fuel of expansion.

But the problems do not stop there. Debtholders, whether banks or bondholders, typically use equity holdings, returns to equity, and appreciation in the market price for shares as signals of financial health, and hence as mechanisms for pricing debt capital. Widespread or legally mandatory adoption of stakeholder-oriented management threatens to undermine well-established, stable, and efficient market norms for pricing capital in favor of a regime under which capital is more costly for firms to acquire because investment (whether in the form of equity or debt) is an inherently riskier proposition. That, in turn, threatens prospects for economic growth, stable employment, and the liquidity of financial markets. In short, stakeholder-oriented management promises poorer, static, risk-averse firms and hence a poorer, static, risk-averse economy. Stakeholder-oriented management is contrary to the interests of the very stakeholders it is intended to help.

Managerial Accountability. People recoil in horror at corporate officers' and directors' salaries, perks, and other bonuses that at times bear no relation to the performance of the firms they manage. This sorry state of affairs results from the confluence of a number of recent trends in corporate law that make it more difficult for shareholders to discipline self-serving managers:

- The decline of the ultra vires doctrine (under which shareholders could sue managers for embarking on projects contrary to the corporate purpose).
- The emergence of so-called corporate constituency statutes (which permit managers to consider and appeal to a broader range of interests in determining how and whether to fend off a takeover bid-and thereby hamper the smooth operation of the market for corporate control).
- The expansive reading given to the business judgment rule (which shields some managerial actions from substantive review by courts) by the Supreme Court of Delaware-where many firms are incorporated.

But whatever the impediments to disciplining self-serving managers under current law and public policy, they pale in comparison with those promised by stakeholder-oriented management (and a stakeholder-oriented corporate law). Whereas under the current corporate law much self-serving managerial behavior is recognizably self-serving but shielded from substantive review, under stakeholder-oriented corporate law such behavior would be considerably more difficult even to detect, as well as to deter.

It would be more difficult to detect because all but the most egregious of self-serving managerial behavior will coincide with the interests of some stakeholding group, and hence the self-serving manager may point to the benefited and burdened stakeholders and argue that, in his estimation, this was the optimal way to balance competing stakeholder interests. Absent a powerful principle of balanced distribution of the benefits of the firm (something stakeholder theorists have been notoriously slow to sketch), stakeholder theorists must acquiesce in self-serving managerial action that can plausibly be said to accomplish some sort of balance among competing stakeholder interests. That point is made with admirable clarity by Frank Easterbrook and Daniel Fischel in their 1991 book, The Economic Structure of Corporate Law: “A manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other.”

Self-serving managerial action would be more difficult to deter under stakeholder-oriented corporate law because stakeholder theory anticipates that good-faith stakeholder-oriented managerial actions will serve some interests and frustrate others in pursuit of an overall balance of interests. Therefore, stakeholder-oriented corporate law must provide protections to managers at least as extensive as those afforded under current business judgment rule doctrine-lest managers be the perpetual object of derivative lawsuits brought by shareholders, employees, customers, suppliers, or communities who believe that their interests were unfairly or improperly weighed and balanced. Between the ability of managers to justify their self-serving behavior in terms of the balanced pursuit of stakeholder interests, on the one hand, and the protections that a stakeholder-oriented corporate law must afford to managers if firms are to be managed at all, on the other hand, the accountability of managers for their actions must necessarily suffer.

<u>Interest-Group Politics.</u> Because stake-holder-oriented management anticipates the weighing and the balancing-and hence often the frustrating-of competing interests, it promises to make the

boardroom (populated, per Freeman, by representatives of all stakeholding groups) the site of wasteful, inefficient interest-group politicking. That is, the corporate boardroom will be transformed from a forum in which economically rational strategies are adopted in pursuit of added value into one in which legislative and bureaucratic political maneuvering will be the order of the day. Surprisingly, stakeholder theorists recognize and, apparently, welcome this. In a 1998 issue of Business Ethics Quarterly, com-munitarian thinker Amitai Etzioni is comforted by the thought that there "is no reason to expect that the politics of corporate communities would be any different from other democratic systems."

One can scarcely imagine how firms, whose resources are far more limited than are those of governments (and unsupported by the taxing power), can remain viable if their decision procedures are characterized by the strategic bargaining, logrolling, and other wasteful tactics that are the hallmark of democratic politics. If a camel is a horse designed by a committee, then what misshapen beast is a firm shaped by the strategic interactions of its stakeholder representatives?

SMALL VICTORIES

The market economy, the liberty it safeguards, and the prosperity it secures are threatened not, as in the recent past, by firebrands who seek to abolish it, but by more modest tinkerers who seek to "improve" it in the name of myriad social concerns. Defending the market economy from this attack requires more than cataloging the defects of alternative economic systems and the merits of markets. It requires a principled defense of the shareholder-oriented firm-the basic productive institution on which the market economy is constructed.

Despite its worrisome implications, stakeholder-oriented management and its accompanying rhetoric encounter little systematic opposition in philosophy departments, business schools, or board-rooms. The costs of complacency about that state of affairs are potentially high. For although they have so far failed to bring wholesale change to the corporation and the law that governs it, stakeholder-oriented activists have won important piecemeal victories. The passage of corporate constituency statutes in several states has weakened the market for corporate control and, hence, the property rights of shareholders. Federal plant-closing legislation has legitimized among policymakers the idea that firm managers ought to be responsive to a multiplicity of interests. Corporate mission statements in which stakeholders and their interests feature prominently-whether adopted earnestly or as cover for self-serving managers-serve to further legitimize the subordination of shareholder interests to other concerns. If the market economy and its cornerstone, the shareholder-oriented firm, are in no danger of being dealt a decisive blow, they at least risk death by a thousand cuts.

BUSINESS ETHICS RECONSIDERED

Too often the free-market response to the changes sought by stakeholder-oriented business ethicists has been to denigrate the role of ethics in business-as if stakeholder-oriented reforms are the inevitable consequence of injecting concern for ethics into business. But the partisans of stakeholder theory are not spokespeople for ethics; they are spokespeople only for a particular conception of ethics-and a particularly flawed conception, at that. The manifold failings of stakeholder theory should not be taken to reflect poorly on the project of business ethics; rather, they reflect poorly on stakeholder theory itself.

Defenders of the free market, limited government, and the rule of law must articulate an alternative business ethics, one that recognizes and provides reasoned argument for the moral merit of the shareholder-oriented firm. Norms of honesty, integrity, and fair play, rather than an albatross around the neck of the free market, are a central, if neglected, part of the story of the success of the shareholder-oriented firm. In short, shareholder-oriented firms are not merely wealth-enhancing, they are good.

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CENTRE FOR CIVIL SOCIETY

The Centre for Civil Society is an independent, nonprofit, research and educational organisation devoted to improving the quality of life for all people of India by reviving and reinvigorating civil society. The motivation behind the Centre is the poignant paradox of intelligent and industrious people of India living in the state of destitution and despondency. But we don't run primary schools, or health clinics, or garbage collection programs. We do it differently: we try to change people's ideas, opinions, mode of thinking, the mindset by research, seminars, and publications.

We champion limited government, rule of law, free trade, and competitive markets. These principles promote civil society—peace, harmony, and prosperity.

The Centre was inaugurated on August 15, 1997, signifying the necessity for achieving economic, social, and cultural independence from the Indian state after attaining political independence from an alien state.

WHAT IS CIVIL SOCIETY?

Civil society is an evolving network of associations and institutions of family and community, of production and trade, and of piety and compassion. Individuals enter into these relationships as much by consent as by obligation but never under coercion. Civil society is premised on individual freedom and responsibility, and on limited and accountable government. It protects the individual from the intrusive state, and connects the individual to the larger social and economic order. Civil society is what keeps individualism from becoming atomistic and communitarianism from becoming collectivist. Political society, on the other hand, is distinguished by its legalised power of coercion. Its primary purpose should be to protect, and not to undermine, civil society by upholding individual rights and the rule of law.

RELATIONSHIP BETWEEN CIVIL & POLITICAL SOCIETY

The "principle of subsidiarity" demarcates the proper arenas for civil and political society, and for local, state, and central government within the political society. The principle suggests that the state should undertake those tasks that people cannot undertake for themselves through voluntary associations of civil society. The functions thus assigned to the state must be entrusted first to local governments. The functions that local governments cannot perform should be given to state governments and only those that state governments are unable to undertake should be delegated to the central government. The rampant growth of the political society—the institutions of government—since independence has hindered the flourishing of civil society in India. It is only by rethinking and reconfiguring the political society that India will be able to achieve economic prosperity, social peace and cohesion, and genuine political democracy. The focus on civil society enables one to work from both directions; it provides a "mortar" program of building or rebuilding the institutions of civil society and a "hammer" program of readjusting the size and scope of the political society. Both programs are equally critical and must be pursued simultaneously. Weeds of the political society must be uprooted and seeds of a civil society must be sown.

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In accordance with its purpose, the Centre accepts support only from individuals and institutions of civil society.

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- Law, Liberty, and Livelihood
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- Protecting and Creating Jobs: De-regulation of Labour Markets
- Government as Manager or Supervisor of Financial Markets?
- India in the Global Market: Liberalisation of Trade
- Corporatisation and Privatisation of Public Sector Units

PUBLICATIONS

- *Economic Freedom & Development* by Wolfgang Kasper
- *Free Your Mind: A Beginners Guide to Political Economy* by Sauvik Chakraverti. Rs. 100
- *Profiles in Courage: Dissent on Indian Socialism* edited by Parth J Shah. Rs. 350
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- *Friedman on India* edited by Parth J Shah. Rs 75
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- *How Markets Work: Disequilibrium, Entrepreneurship and Discovery* by Israel Kirzner. Rs 50
- *Agenda for Change* edited by Bibek Debroy & Parth J Shah. (out of print)
- *Self-Regulation in the Civil Society* edited by Ashok V Desai. Rs. 100

ViewPoint Series:

- *Do Corporates Have Social Responsibility?* edited by Parth J Shah. Rs. 30
- *Population Causes Prosperity* by Sauvik Chakraverti. Rs. 30
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- *Swaminomics* by Swaminathan S. Anklesaria Aiyar
- *Terracotta Reader* edited by Parth J Shah
- *New Public Management: A Primer* by Sauvik Chakraverti and Parth J Shah

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- Economics in One Lesson Seminar
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- Indian Financial Sector After a Decade of Reforms
- Corporate Social Responsibility?
- Should We Ban Quacks?
- Liberalisation and Livelihood
- Economics Curriculum in Schools
- Education Policy: Choice and Competition

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To provide a platform for self-development and deeper understanding of the principles and policies of liberalism, gradutes of our seminars come together to form Friends of Freedom (FoF). Young professionals and others interested in liberal values also become members.

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- BALCO: With the help of advocates Parag Tripathi and Suranya Aiyar, the Centre filed an intervention PIL in the Bharat Aluminium Company (BALCO) privatisation case to support that the privatisation of public sector companies is in the public interest; its opposition serves only parochial interests.

- VIP Security: To stop the harassment and inconvenience under the guise of VIP Security to ordinary citizens of Delhi in using roads.

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A bill pending in the Parliament is analysed, clause by clause and an alternate bill is drafted. The changes are then discussed with interested Members of Parliament, formally and informally.

SWAMINOMICS

The Centre has created www.swaminomics.org and www.swaminomics.com to house the popular Sunday column "Swaminomics" in *Times of India* by Swaminathan S Anklesaria Aiyar.

RESOURCE CENTRE

The Centre maintains a library of several thousand books, publications of a large number of public policy research institutes and computers with internet access. It is open to the public for use but borrowing privileges require membership. The Centre plans to open similar resource centres throughout India.

About the Editor

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