

Two extreme views: Managing for Share- or Stakeholders?¹

Julian Fink
julian.fink@uni-bayreuth.de

(1) Another sceptical challenge?

Consider first a misguided *sceptical* argument against business ethics. Suppose Jack says that managers are subject to ethical obligations. There are things they ought to and ought not to do. Jill challenges Jack in asking the following: 'So managers are subject to ethical obligations. What precisely are they? What is it that managers ought and ought not to do?' Suppose Jack replies: 'I don't really know what it is *precisely* that managers ought to do. However, I know that they ought and ought not to do something'. Can Jill then legitimately challenge Jack's position by charging him with *inconsistency*? That is, is Jack inconsistent in asserting that there are moral obligations without having a determined view about what they are?

(2) Share- vs. stakeholder ethics

(2.1) Friedman's view: ethics = constraint profit maximisation

(2.1.1) In *Capitalism and Freedom*, Milton Friedman makes the following remark. Consider a society based on private property rights. In such a society, Friedman claims,

... 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 Few trends could so undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.²

What is the precise view Friedman defends here? First, Friedman speaks about 'social responsibility'. It is safe to translate this into a moral view, i.e., a view about what is morally permissible, or what ought to be case – from the moral point of view. Second, he talks about 'corporate officials' (aka 'corporate officers'), i.e. the highest ranking officials with executive powers, commonly known as 'managers'. Third, Friedman (loosely) talks about 'rules of the game'; let's think of this as 'the law'.

¹ This lecture is primarily based on chap. 2 of Sanbu's 'Just Business: Arguments in Business Ethics'.

² Friedman, *Capitalism and Freedom*, 1983: 133.

Given these clarifications, let's characterise Friedman's view a bit further. Note first that Friedman's view is – perhaps surprisingly – neither an expression of *amoralism* nor of *moral scepticism*. Friedman does not deny objective morality. Nor does he tell us to be indifferent towards moral considerations. Quite the contrary: Friedman's view is in fact a deeply moral one. Managers have a moral obligation. Their obligation is to manage corporations *profitably*.

Furthermore: Friedman does not say that managers ought to be *egoistic* (i.e. maximise their *own* benefits). Nor should managers do whatever they want. Again, his view is that '... it is not only permissible to manage businesses solely to maximise profits; it is morally required to do so' (Sandbu, p. 17).

Second, though Friedman emphasises 'increasing profit' as what is morally required, there is a more fundamental consideration behind his view. Consider this quote:

A group of person may establish a corporation for a purpose – for example, a hospital or a school. The manager of such a corporation will not have money profit as his objective but the rendering of certain services... the key point is... the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them.³

Consequently, the manager's obligation is not to maximise profits *per se*. Instead, managers are under the obligation to fulfil the shareholders' interests and desires. A correct name for Friedman's view would thus be *shareholder primacy*; an attempt of rendering his view precise could read as follows:

Friedman's shareholder-primacy view. For all acts *A*, if *A* is an act of a manger *M qua* manager, then *M* is morally required to *A* if and only if (i) *A* is instrumental to fulfilling the desires of the *M*'s shareholders and (ii) the fact that *M* does *A* is not illegal.

How could one justify this shareholder-primacy view? Three strategies seem possible.

One is to emphasise the *social role* of managers. What matters for the moral evaluation of a manager is the *aim* of a managerial position. Put simply, the aim of a managerial position is to serve the owners of the corporation and to fulfil their interests. This aim of the manger's social role entails the 'shareholder-primacy view', or so one may argue.

The second possible defence stems from *consequentialism*. Suppose consequentialism says, roughly, that whether you ought or ought not to perform an act *A* depends solely on *A*'s consequences. It does therefore not

³ Friedman, 'The Social Responsibility of Business is to Increase its Profits', 1970.

depend on intrinsic features of *A*. Suppose this is correct. Imagine that a manager leaves the path of profit maximising. For example: he or she refrains from firing unproductive employees for the sake of keeping unemployment low. But suppose, as a consequence, this would hurt, rather than improve societies well-being by, for instance, diminishing technological innovation and limiting the growth of productivity. Let us assume this harms society more than what is gained through the prevention of unemployment. Then it would not be right – from a consequentialist perspective – to keep unproductive employees employed and to leave the path of profit maximisation.

So, in general, the consequentialist defence of the shareholder supremacy view can be expressed as follows. Suppose that the public good and well-being is promoted more effectively if managers in fact ignore ‘social responsibility’ and moral concerns and concentrate on maximising profits. Given the correctness of consequentialism, this explains why a manager in fact satisfies a moral obligation by focusing on profit maximisation. But surely, this defence is sound only if (i) the public good and well being is in fact promoted by profit-maximising behaviour and (ii) if moral obligation is portrayed correctly in consequentialist terms.

The third justification of Friedman’s shareholder-primacy view is a ‘rights-based’ one. Consider the view upon which an act is morally impermissible if it violates a legitimate right of a person. No doubt, as the *owners* of corporations, shareholders have certain *property rights*: they are entitled to use, transfer, and generate income from their property. Consequently, one may argue, that these rights may give rise to the managers duty to act in the shareholders’ interests.

Here is how to construct the argument. First, the owners (shareholders) invest their assets into a company for a certain purpose. Let us assume they do so in order to create interest and dividends, i.e. to generate profit. Then managers are hired by the owners to handle (i.e. manage) their investment and to execute the shareholders’ interests. Consequently, a manager would infringe a right of the shareholders at least partly if they were to act against the shareholders interests; it is simply not their money. It is morally wrong to use other people’s money for purposes not in accordance with their will. Thus – expressed radically – engaging in ‘corporate social responsibility’ – when not increasing profits – thus infringes a right, in an immoral fashion, resembling theft, in fact.

Compare an analogous argument concerning *promising* (cf. Sanbu, p. 19).

(2.1.2) However, upon reflection, it seems that Friedman’s pure shareholder-primacy view must be rejected. It seems untenable to think that a manager is morally required to do *whatever* his principal and shareholder wants. Compare a Mafia boss, for instance, who owns a company and wants his competitors to be eliminated (physically). This does not seem to generate an obligation for the agents of that company to fulfil this wish. Consequently, to give us a plausible account of ethics, the shareholder-primacy view needs to be qualified. There

need to be some ethical constraint that exists *independently* of shareholder interests.

Friedman himself admits a qualification: The managers' 'responsibility is to conduct the business in accordance with [shareholders'] desires, which generally will be to make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom.' However, this remark seems to make Friedman's view circular. Roughly, it now says that a manager is morally permitted to *A* if and only if (i) *A-ing* serves the shareholders interests and (ii) *A is morally permitted*. This is a circular view; it cannot inform us what managers are morally permitted or required to do.

(2.2) From share- to stakeholders ethics

(2.2.1) *Shareholder primacy* says that business should be managed to benefit *shareholders*. The 'stakeholders view' says that businesses should be managed to benefit *stakeholders*. But who are *stakeholders*?

Defined generally, a stakeholder is an individual (or a group) who are factually or potentially affected by the activities of a corporation. In a real world scenario, who are they? Consider an incomplete list: shareholders (investors), employees, customers, suppliers, unions, the government, communities *etc.*

Here is the essence of the 'stakeholder approach' in R. Edward Freeman's words, a major proponent of this view.

Corporations shall be managed in the interests of its stakeholders, defined as employees, financier, customers, employees [*sic*], and communities.⁴

In consequence, the stakeholder approach does not, *prima facie*, give priority to a particular group of stakeholders (i.e. shareholders). Instead, ethical management consists in management keeping the relationships and the benefits for the diversity of stakeholders in balance.

How can this view be defended? And why is it supposed to be more plausible than shareholder primacy?

Recall the right-based defence of the shareholder-primacy view. Shareholders have a right to ensure that their managers act in their interests. This right stems – as suggested before – from the agent-principal relationship between managers and shareholders. Shareholders employ their managers as their agents, thereby creating formal informal contracts. These contractual relations give rise to the managers' obligation to maximise profits.

⁴ Freeman, 'A Stakeholder Theory of Modern Corporation'.

Consequently, *shares* distribute rights and obligations among shareholders and managers. But cannot the same be said for *stakes*? Take a local community who permits a business to operate in their vicinity, i.e. to built factories, streets, and other facilities. In part, the community will be affected negatively by the operation. This gives rise to a right of compensation: for instance, the local community has rights to benefit from the companies operation and to expect that the newly established business will behave like good 'corporate citizen' (consider the analogy of the legitimate expectations a community could have towards a natural person joining a community). The community has a right to not to be exposed to uncontrollable hazards like toxic pollution or exploitation of local workforce. Freeman, for instance, goes as far as saying that

[w]hen the firm mismanages its relationship with the local community, it is in the same position as a citizen who commits a crime. It has violated the implicit social contract with the community and should expect to be distrusted and ostracized. It should not be surprised if punitive measures are invoked.⁵

Surely, a similar rights-based view could explain the special duties of management towards customers and employees *etc.*

(2.2.2) Is the stakeholder approach a plausible alternative to the shareholder-primacy view? Perhaps it appears plausible at first sight. Corporations should not only benefit an already privileged group in society (i.e. owners or capital means, investors).

However, the stakeholder approach also faces a variety of problems. First, consider the 'identification problem'. Who belongs to the group of a company's stakeholders? – all *potentially* affected? Then this definition stretches very far. It may include the media, Greenpeace *etc*? To act ethically, does a manager really have manage in the interests of these groups?

Second, what precisely does it mean to manage in the interests of stakeholders? Obviously, the different groups have different interests. Suppose stakeholder theory is saying that mangers should *maximise* the benefits to all stakeholder groups (much as shareholder primacy says that maximize the shareholder's interests). However, this view leads to impossible imperatives, as one cannot maximise more than one objective simultaneously. Similarity, suppose we conceive of managers as *agents* of stakeholders as their principals, and this relationship creates duties for managers. No doubt, this would mean that managers face an array of *conflicting* duties; i.e. duties that they cannot fulfil simultaneously. Contemporary stakeholder theory does not say much as to how to resolve these conflicts.

⁵ Ibid.

How could one defend the stakeholder view? In other words, why do stakeholders matter morally when it comes to ethical management? Two general strategies seem possible: (i) managing in the interest of multiple stakeholders is the best means to achieve something else, e.g. profit maximisation. If this is correct, business should be managed in the interest of stakeholders for *instrumental* moral reasons. Alternatively, perhaps there is an argument that (ii) managing in the interest of stakeholders is right for the sake of the stakeholders (i.e. for *intrinsic* moral reasons).