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Author(s): Joseph Heath

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BUSINESS ETHICS WITHOUT STAKEHOLDERS

Joseph Heath

Abstract: One of the most influential ideas in the field of business ethics has been the suggestion that ethical conduct in a business context should be analyzed in terms of a set of fiduciary obligations toward various “stakeholder” groups. Moral problems, according to this view, involve reconciling such obligations in cases where stakeholder groups have conflicting interests. The question posed in this paper is whether the stakeholder paradigm represents the most fruitful way of articulating the moral problems that arise in business. By way of contrast, I outline two other possible approaches to business ethics: one, a more minimal conception, anchored in the notion of a fiduciary obligation toward shareholders; and the other, a broader conception, focused on the concept of market failure. I then argue that the latter offers a more satisfactory framework for the articulation of the social responsibilities of business.

Over the past two decades, the “stakeholder paradigm” has served as the basis for one of the most powerful currents of thinking in the field of business ethics. Of course, stakeholder vocabulary is used even more widely in areas where it is not necessarily intended to have any moral implications (e.g., in strategic management).¹ In business ethics, however, the stakeholder approach is associated with a very characteristic style of normative analysis, viz. one that interprets ethical conduct in a business context in terms of a set of moral obligations toward stakeholder groups (or one that helps “to broaden management’s vision of its roles and responsibilities to include interests and claims of non-stockholding groups”²). Seen in this light, the primary moral dilemmas that arise in a business context involve reconciling these obligations in cases where stakeholder interests conflict. Thus ethicists who are impressed by the stakeholder paradigm have become highly adept at translating any moral problem that arises in the workplace into the language of conflicting stakeholder claims.³

The question that I would like to pose in this paper is whether the stakeholder paradigm represents the most fruitful approach to the study of business ethics. The vocabulary of stakeholder obligations has become so ubiquitous that in many contexts it is simply taken for granted. Yet the stakeholder approach is one that comes freighted with very substantive—and controversial—normative assumptions.

Naturally, there are many who have criticized the stakeholder paradigm as part of a broader skeptical critique of business ethics in general, one which denies that firms have any “social responsibilities” beyond the maximization of profit.⁴ This is not my intention here. I will argue that firms do have important social responsibilities, ones that extend far beyond mere conformity to the law. The question is whether the stakeholder paradigm represents the best framework for articulating the logic and structure of these obligations.

In order to serve as a point of contrast, I would like to provide an outline of two other possible approaches to the study of business ethics: one, a more minimal conception, anchored in the notion of fiduciary obligations toward shareholders, and the other, a broader conception, focused on the regulatory environment in which firms operate.⁵ I will then attempt to show that the latter, which I refer to as a “market failures” approach, offers a more satisfactory framework for articulating the concerns that underlie traditional appeals for increased corporate social responsibility.

Business Ethics as Professional Ethics

There is one point that all three of the approaches that I will be presenting here have in common. All three conceive of business ethics as a species of professional ethics.⁶ In the same way that medical ethics concerns, first and foremost, ethical questions that arise from the professional role of doctors, and legal ethics deals with questions that arise from the professional practice of lawyers, business ethics deals with questions that arise out of the professional role of managers. This is a narrower sense of the term “business ethics” than one sometimes encounters, but as we shall see, there are some advantages to be had from focusing on this somewhat constrained set of issues.

In each case, the assumption is that a professional role itself imposes its own set of obligations upon the person, which are not necessarily part of general morality (although they may be sanctioned by, or derived from, general morality). For example, both doctors and lawyers have a special obligation to protect client confidentiality, an obligation that arises out of their professional role. In other words, this obligation is one that is imposed upon each of them, not *qua* individual, but *qua* doctor, or *qua* lawyer. According to this conception, business ethics is concerned with the special obligations that arise out of the managerial role, and which are imposed upon the manager *qua* manager.

The reason that it is helpful to conceive of business ethics as a set of moral obligations arising out of the professional role of the manager is that it serves to head off the commonly expressed accusation that business ethics is just blue sky dreaming, or a wish list of things that ethicists would like corporations to do, many of which will turn out to be unrealistic in practice. According to the “professional ethics” view, business ethics represents an attempt to articulate a code of conduct that is *already implicit* both in the structure of corporate law and in the best practices

of working managers. This helps to allay the suspicion that business ethics is some alien code, which ethicists seek to impose upon corporations from the outside.

Not everyone accepts the “professional ethics” view. There is an influential strain of thinking in business ethics that treats moral obligations as perfectly invariant across persons. (This tendency is perhaps summed up best in the title of John C. Maxwell’s recent book, *There is No Such Thing as “Business” Ethics: There’s Only One Rule for Making Decisions*.⁷) Thus some theorists begin by specifying an undifferentiated moral code (whether it be Kantian, utilitarian, Christian, Aristotelian, or what have you); they then treat business ethics as a subject concerned primarily with reconciling pressures that arise in a business context with the obligations that are imposed by this general morality (e.g., the Bible says “thou shalt not bear false witness,” so what do you do when the boss asks you to lie to a client?).⁸ From this perspective, the managerial role shows up, not as a source of positive moral obligations, but primarily as a source of social pressures that may conflict with morality.

Absent from this perspective is any clear conception of the role that the professions play in a modern economic system (or of the way that a professional “ethos” can give rise to a system of distinctive moral constraints⁹). The primary difference between having a job and practicing a profession involves the element of trust and fiduciary responsibility associated with the latter. In some situations, it is possible for parties in an employment relation to specify all the terms of the contract, to monitor performance completely, and to institute a system of incentives that guarantees perfect compliance. Stacking boxes in a warehouse is an example of an employment relation of this type. These are jobs, and in them, employees are not usually thought to have any special responsibilities beyond those specified in the contract, i.e., the terms of employment. Employees in these sorts of jobs are normally paid by the hour, and have a fixed workday, in recognition of the market-like structure of the transaction.

Things become more complicated, however, when it is impossible to specify the terms of an employment contract completely, imperfect observability of effort makes monitoring difficult, or information asymmetries make the design of a perfect system of performance incentives impossible. In such cases it is impossible to eliminate moral hazard, and so the purchaser of labor services must rely in large measure upon the voluntary cooperation of the seller in order to secure adequate work effort.¹⁰ Thus a certain amount of trust, or moral constraint, is required in these relationships. Contracts usually specify goals and obligations in very general terms, and the person supplying the services is expected to use his or her own judgment to decide how best these terms should be satisfied. The purchaser often lacks not only the information and skills to determine the best course on her own, but is often incapable of even verifying that the supplier has done so after the fact. This is the condition that Oliver Williamson refers to as “information impactedness,” and it represents the primary force driving professionalization.¹¹

In certain cases, reputation effects are enough to motivate good faith work effort for individuals in these roles. For example, most people have no ability to evaluate the claims and recommendations made by their auto mechanic, and the cost of getting a second opinion can be prohibitive (in both time and money). Thus they have no choice but to trust the mechanic. But as a result, reputation and “word-of-mouth” plays an important role in the market for automobile repairs. The market for contractors, plumbers, and hair stylists has a similar structure. These groups are not generally thought of as professionals, because the market still does a tolerable job of overcoming the important information asymmetries.

It is not an accident that these cases all involve purchases that consumers make frequently, where there is significant opportunity for repeat business. In markets where larger, more infrequent purchases are made, or where information asymmetries are even greater, it is much more difficult for purchasers of services to impose discipline upon suppliers through reputation mechanisms. As a result, suppliers who deploy highly specialized knowledge must work harder to secure the trust of potential clients, simply because the client may never have the opportunity to verify the quality or value of the services received. In some cases, the trust requirements are sufficiently high that these suppliers will form their own membership association, in order to impose an internal “code of conduct” more stringent than the requirements of general labor and contract law. The most well-known examples are the “bar” for lawyers, along with the various medical licensing boards for doctors. These sorts of associations are especially important in professions where the only people competent to evaluate a particular individual’s performance are other members of that same profession.

Economists sometimes suggest that the function of these organizations is merely to cartelize a particular segment of the labor market. This is a good example of the “naïve cynicism” often exhibited in this field—where the automatic identification of pecuniary incentives as the dominant motive leads to sociologically naïve analyses of particular institutions. These associations also play an important socializing role, helping to instill genuine respect for a set of moral obligations that are often specific to the profession.¹² For example, many engineers in Canada wear an iron ring on their little finger, which is conferred during a ceremony called “The Ritual of the Calling of an Engineer” (developed in 1925 by Rudyard Kipling). The ring is a symbol of the Pont de Québec Bridge, which collapsed in 1907 as it was nearing completion, killing seventy-six people. A subsequent Royal Commission declared that errors committed by the bridge’s principal engineers were the primary cause of the tragedy. Initially, the rings were said to have been made with iron from the collapsed bridge. In the present day, the rings are intended simply to serve as a reminder to working engineers that the lives of many people depend upon their efforts. Engineers have more than just an obligation to put in a day’s work for a day’s pay, they must also consider the impact that their actions will have upon the eventual users of the structures or products they design. Many engineering students

describe the ceremony as genuinely moving, and find that the ring serves as a constant reminder of their professional ethical obligations.

The existence of a professional association, a certification system, a common body of accepted knowledge, and a shared ethics code, are sometimes treated as the distinguishing marks of a genuine profession.¹³ This involves some confusion of cause and effect. What makes the complex body of knowledge important is that it generates an information asymmetry, which creates a moral hazard problem that threatens to undermine any market transaction involving such specialists. Thus specialists must work hard to cultivate trust among potential purchasers of their services. A certification system, along with a professional association that imposes a stringent code of conduct, is one way of achieving this objective. There may be cases, however, in which a certification system is difficult to devise, or a professional association difficult to organize. Such is the case, traditionally, with managers (especially during the era when most were promoted up from the shop floor). Nevertheless, the *economic role* that managers occupy is a professional one, precisely because of the information impactedness in the domain of services they provide. The nature of the managerial role is such that they *need* to be both trusted and trustworthy. This is reflected in the fact that most systems of corporate law treat senior managers as fiduciaries of the firm.¹⁴ Thus the mere fact that managers do not belong to professional associations does not mean that they are not professionals, or more importantly, that there is not a distinctive set of ethical obligations that arise out of their occupational role. The fact that they are in a position of trust is what matters.¹⁵

Thinking of business ethics in terms of “professional ethics for managers” is an attractive perspective, insofar as it offers some relatively clear criteria for the evaluation of different “theories” or “paradigms” within the field. Managers who take social responsibility seriously already have some very firm intuitions about what constitutes ethical and unethical conduct. The question is whether the vocabulary and the principles that business ethicists develop offer a more or less perspicuous and coherent articulation of these intuitions—whether their theories help us to achieve greater clarity, or whether they sow confusion. This is the standard that I shall be employing in this paper. Thus my criticism of the stakeholder approach to business ethics is not that it is false or incoherent. I shall merely try to show that the vocabulary, and the theory that underlies it, is *inherently misleading*, and thus does not promote useful ways of thinking about corporate social responsibility.¹⁶

The Shareholder Model

The managerial role arises as a consequence of the so-called separation of ownership and control in the modern corporation. In the early stages of development, most corporations are run by the founders, who are also generally the principal owners. At a later point, the owners may choose to employ managers to assist them in running the firm, or to take over that role entirely. In the same way that individuals

employ lawyers in order to advance their interests in a legal context, owners hire managers in order to advance their interests in a business context. Of course, as the firm becomes more mature, this relationship becomes significantly more complex (leading many to argue that the shareholders in a publicly-traded corporation cannot be regarded as its “owners” in any coherent sense). Nevertheless, the fact that shareholders are residual claimants in a standard business corporation means that their interests are not protected by an explicit contract. As a result, there is a set of fiduciary principles governing the relationship between managers and shareholders.¹⁷ Because the fiduciary relationship imposes upon managers a very broad “duty of loyalty” and “duty of care” toward shareholders—concepts with explicit moral overtones—this particular relationship might be thought to serve as a natural point of departure for the development of a theory of business ethics (in the same way that duties toward the patient form the core of professional ethics for doctors, duties toward the client the core of professional ethics for lawyers, etc.)

Yet despite the fact that moral obligations toward shareholders are such a striking feature of the managerial role, in the business ethics literature they are the subject of considerable controversy, and are often downplayed or dismissed. (Marjorie Kelly, the editor of *Business Ethics* magazine, set the tone for one end of this discussion with the title of her article, “Why All the Fuss About Stockholders?”)¹⁸ There are several reasons for this relative neglect of the shareholder, some worse than others. In popular debates, there is a tendency when talking about “the corporation” simply to conflate the two groups (managers and owners), or to assume that there is a greater identity of interests between them than is usually the case. The standard microeconomics curriculum encourages this, by starting out with the assumption that individuals maximize utility, but then aggregating consumers together into “households” and suppliers into “firms”—each of which is thought to maximize some joint utility function—without explaining the transition (this gets reserved for more advanced courses). Even though it is understood that “the firm” is something of a black box in this analysis, the result is still an unhelpful blurring of the distinction between the pursuit of self-interest on the part of individuals and the maximization of profit on the part of firms, and thus a tendency to overestimate the extent to which the latter flows naturally from the former. As a result, it is easy to underestimate the potential for moral hazard in the relationship between managers and shareholders.

The recent scandals at Enron, Parmalat, Tyco, WorldCom, Hollinger, and elsewhere, have shown that shareholders neglect these difficulties at their own peril. In each of the major scandals, managers were able to enrich themselves primarily at the expense of shareholders. (It may be helpful to recall that at its peak, Enron had 19,000 employees and a market capitalization of \$77 billion. Thus for each employee who had to look for a new job as a result of the subsequent bankruptcy of the firm, shareholders lost at least \$4 million.) The fact that most of these scandals involved illegal conduct should not distract us from the fact that each illegal act was surrounded by a very broad penumbral region of unethical conduct. For example,

it was never decided specifically whether the \$2.1 million dollar party thrown by Tyco CEO Dennis Kozlowski for his wife's birthday, half paid out of company funds, constituted fraud or theft, but it most certainly represented a violation of his moral obligation to shareholders.

It is a mistake to believe that self-interest alone, combined with a few performance incentives, is able to achieve a harmony of interest between managers and shareholders. In this respect, a lot of the work done by economists (and game theorists) on the "theory of the firm" has been quite misleading. The overriding objective of many economists has been to extend the methodological tools—and in particular, the action theory—used in the analysis of markets to model the internal structure of organizations.¹⁹ Thus "principal-agent" theory has focused almost entirely upon the use of external incentives as a mechanism for overcoming collective action and control problems within the firm. In so doing, economists have dramatically underplayed the role that trust, values, social norms, and other aspects of "corporate culture" play in determining organizational behavior.²⁰ Thus they have wasted considerable time and energy devising increasingly baroque performance pay schemes, while neglecting more obvious managerial strategies, such as encouraging employee loyalty to the firm, or cultivating a direct concern for customer satisfaction.²¹

It is precisely because of the importance of these internal (i.e., moral) incentives, along with the enormous potential for abuse, that U.S. corporate law essentially imposes a fiduciary relationship between senior managers and shareholders. It is helpful to recall, for example, the words of an influential U.S. court judgment, concerning the obligations of managers:

He who is in such a fiduciary position cannot serve himself first and his cestuis second. He cannot manipulate the affairs of his corporation to their detriment and in disregard of the standards of common decency and honesty. He cannot by the intervention of a corporate entity violate the ancient precept against serving two masters. He cannot by the use of the corporate device avail himself of privileges normally permitted outsiders in a race of creditors. He cannot utilize his inside information and his strategic position for his own preferment. He cannot violate rules of fair play by doing indirectly through the corporation what he could not do directly. He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors, no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements, for that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the cestuis. Where there is a violation of those principles, equity will undo the wrong or intervene to prevent its consummation.²²

The obligations enumerated here are sufficiently broad that one could only imagine legal prosecution in cases of the most egregious violation. Thus a very robust theory of business ethics could be developed based simply on the injunction to respect the spirit of this judgment, along with the fiduciary obligations that it outlines toward shareholders. Yet despite this fact, far too little has been said on

this subject. The dominant assumption has been that shareholders are able to take care of themselves. Many introductory business ethics textbooks cover topics like whistle-blowing, truth in advertising, pollution, discrimination, and health and safety issues, yet neglect to discuss more common ethical challenges that employees encounter in their day-to-day affairs, such as the temptation to abuse expense accounts.²³ Strictly speaking, society should be no more willing to tolerate such abuses when carried out by business executives (wasting shareholders' money) than when carried out by politicians or civil servants (wasting taxpayers' money). The reality, needless to say, is quite different. Thus a simple duty of loyalty toward shareholders precludes a lot of the everyday immorality that goes on in firms (but which attracts attention only when it reaches spectacular proportions, as with the recent spate of corporate scandals).

Thus the tendency to overestimate the degree of alignment of managerial and shareholder interests leads to more general failure to appreciate the extent to which shareholders are *vulnerable* in their relations with managers (just as patients are vulnerable in their relations with doctors, or clients are vulnerable in their dealings with lawyers). There is, however, also a more principled reason that obligations toward shareholders tend to get downplayed. There is a widespread perception that the fiduciary relationship between the manager and the shareholder cannot serve as a source of genuine moral obligation. Even though I am morally obliged to keep my promises, if I promise my friend that I will rob a bank that does not mean that I am then morally obliged to rob a bank.²⁴ The same applies to fiduciary relations. Consider the following argument, due to Arthur Applbaum.²⁵ Imagine a Hobbesian state of nature, in which everyone treats everyone else abysmally. Such conduct is immoral. Now imagine that, in this state of nature, each person solemnly swears to stop pursuing his own interests, and to begin pursuing the interests of the person next to him. What changes? From the moral point of view, nothing much. It is still the war of all against all, except that now it is being carried out by proxy. Certainly the mere fact that each person is acting "altruistically"—advancing the interests of her neighbor, rather than her own—is not enough to transform this into a morally acceptable state of affairs. If it could, then the simple act of promising would permit unlimited "laundering" of immoral acts into moral ones.

Thus the discussion of the fiduciary responsibilities of managers quickly turns into a discussion of the moral legitimacy of the goals being pursued by shareholders. This in turn must lead to a discussion of the moral status of *profit* (since this is the interest of shareholders that managers are generally understood to be advancing). It is here that the "ethical" status of business ethics begins to seem problematic. Indeed, Milton Friedman's well-known article "The Social Responsibility of Business Is to Increase its Profits," which presents the ethical obligation to maximize the returns of shareholders as the cornerstone of a conception of business ethics, usually shows up in business ethics textbooks, not as the point of departure for further development of the theory, but rather as an example of an instructively mistaken point of view.²⁶ The problem is that "profit" is associated, in many people's

minds, with “self-interest.”²⁷ “Ethics,” on the other hand, is usually associated with behavior that is “altruistic,” in some sense of the term. More precisely, morality can be understood as a “principled constraint on the pursuit of self-interest.”²⁸ If this is the case, then substituting “profit” for “self-interest” yields the conclusion that business ethics must represent some sort of principled constraint on the pursuit of profit—not an injunction to maximize it.²⁹

In the case of doctors, who must do everything in their power to promote the health of their patients, it is easy to see that health is a good thing, and so efforts to promote it in others must also be good. This is more difficult to see in the case of managers and wealth, especially in cases when increasing the wealth of shareholders can only be achieved at the expense of others. Yet managers who take their responsibilities toward shareholders seriously are often put in a situation where they must effect pure distributive transfers—often regressive ones between workers and shareholders. Here it becomes difficult to see what is so ethical about business ethics.

Thus in order to see managerial obligations toward shareholders as genuine moral obligations, one cannot merely point to their fiduciary status, one must also come up with some justification for the role that profit-taking plays in a capitalist economy. There are two general strategies for doing so. The first, which might be thought of as broadly Lockean, defends profits as the product of a legitimate exercise of the shareholder’s property rights, under conditions of freedom of contract. According to this view, the shareholder is entitled to these profits for the same reason that the creditor is entitled to repayment with interest, or that the worker is entitled to her wages. This is not very compelling, however, because the Lockean theory is one that defines the individual’s legal rights, but makes no pretence of accounting for her moral obligations. Thus, for example, the Lockean thinks that we have no legal obligation to give anything to charity, and our property rights protect us from any seizure of our assets for such purposes. But this does not mean that we have no moral obligation to give to charity. Ordinary morality tells us that wealth is not an overriding value, and so there would appear to be many cases where the profit motive is trumped by other considerations. This makes it unethical for shareholders to pursue profits in particular ways, and thus unethical for managers to assist them in carrying out such strategies.

The more promising defense of profit is the Paretian one, which points to the efficiency properties of the market economy as a way of justifying the profit orientation of firms. According to this view, the point of the market economy is not to respect individual property rights, but rather to ensure the smooth operation of the price system. The profit orientation is valued, not because individuals have a right to pursue certain interests, but rather because it generates the competition necessary to push prices toward the levels at which markets clear.³⁰ When markets clear, it means that all resources will have been put to their best use, by flowing to the individuals who derive the most relative satisfaction from their consumption. The spirit of the Paretian approach is best expressed in the “invisible hand” theorem

of welfare economics, which shows that the equilibrium of a perfectly competitive market will be Pareto-optimal (i.e., it will be impossible to improve anyone's conditions without worsening someone else's).³¹

Yet this framework still seems to be, in many ways, not "ethical enough" to satisfy many people's intuitions.³² It offers a seal of approval, for instance, to a wide range of so-called sharp practices in market transactions (which, despite being legal, nevertheless offend our intuitive moral sensibilities). And while it has been pointed out many times that firms seldom profit in the long run from abusing employees, cheating customers, or taking advantage of suppliers, it nevertheless remains true that *in certain cases* it can be profitable to do so. In other words, it is simply not the case that the interests of shareholders always line up with those of workers, customers, suppliers, and other groups with an interest in the firm's decisions. There are genuine conflicts that arise, and it is not obvious that the ethical course of action for managers in every instance is to take the side of shareholders, respecting no constraints beyond those imposed by law. But if this is so, the question becomes how far one should go, as a manager, in advancing the interests of the principal, and when one should start showing more concern for others who are affected by one's actions. Yet even to pose the question in this way is to reveal the limitations of any theoretical approach to business ethics that takes obligations to shareholders as the *sole* criterion of ethical conduct in business.

The Stakeholder Model

The shareholder approach to business ethics suffers, first and foremost, from the taint of moral laxity. It does not seem to impose *enough* obligations upon managers to satisfy the moral intuitions of many people. In particular, it suggests that, as R. Edward Freeman puts it, "management can pursue market transactions with suppliers and customers in an unconstrained manner."³³ Thus the suggestion has been made that managers have moral obligations, not just to shareholders, but to other groups as well. Freeman introduced the term "stakeholders" as a "generalization of the notion of stockholders," in order to refer to "groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by, corporate actions."³⁴ He went on to make the suggestion that managers have *fiduciary* obligations toward multiple stakeholder groups.

This overall approach has proven to be remarkably influential, and it is not difficult to see why. After all, we understand quite clearly what it means for managers to have fiduciary obligations toward shareholders. By construing relations with "stakeholders" on analogy, Freeman provided an intuitively accessible framework for articulating the sorts of moral obligations that the shareholder model elides. (In the same way, the term "social capital" has become popular, precisely because people understand what capital is, and so construing social capital on analogy with real capital provides an intuitively accessible framework for thinking about collective action.)

Of course, the term “stakeholder” has been picked up and used quite widely, even by those who do not share Freeman’s views on the structure of managerial obligations. For example, so-called strategic stakeholder theory argues that managers must exercise moral restraint in stakeholder relations *as a way of discharging their fiduciary obligations toward shareholders* (i.e., “ethics pays”). Freeman, on the other hand, claims that managers must exercise moral restraint in dealings with stakeholders *because managers have direct fiduciary obligations toward those stakeholders*. Shareholders, according to this view, are just one stakeholder group among many. Managers have fiduciary obligations toward shareholders only because shareholders are stakeholders, and managers have fiduciary obligations toward *all* stakeholders.³⁵

Thus Kenneth Goodpaster identifies the key characteristic of Freeman’s theory when he refers to it as the “multi-fiduciary stakeholder” theory.³⁶ What matters is the idea that managers have fiduciary obligations toward multiple groups—regardless of whether these groups are called stakeholders or something else. Thus the two components of the theory are separable—one need not conceive of stakeholder relations as fiduciary relations. Nevertheless, stakeholder vocabulary is often used as a way of expressing tacit commitment to the multi-fiduciary view. As a result, some of the obvious weaknesses of the position tend to be overlooked. As Goodpaster observes, the fact that managers have moral obligations with respect to customers, employees, and other groups, does not mean that these obligations must take a fiduciary form. There is some danger of being seduced by the metaphor, leading one to think that the status of stakeholders is much closer to that of shareholders than it in fact is. For example, the manager might have an obligation to respect certain *rights* of customers, without also having a fiduciary duty to advance their *interests*.

If managers really are to be regarded as fiduciaries of stakeholder groups, it raises immediate difficulties with respect to questions of corporate governance. Freeman suggests that the manager must become like “King Solomon,” adjudicating the rival claims of various stakeholder groups. Yet giving managers the legal freedom to balance these claims as they see fit would create extraordinary agency risks. On the one hand, managers would need to be protected from being fired by shareholders upset over the performance of their investments.³⁷ But even more significantly, it would become almost impossible for members of any stakeholder group to evaluate the performance of management. It is difficult enough for shareholders to determine whether managers are actually maximizing profits, given available resources. But when profits can be traded off against myriad other objectives, such as maintaining employment, sustaining supplier relationships, and protecting the environment, while managers have the discretion to balance these objectives as they see fit, then there is really no alternative but to trust the word of managers when they say that they are doing the best they can. The history of state-owned enterprises shows that the “multiple objectives” problem can completely undermine managerial discipline, and lead to firms behaving in a *less* socially responsible manner than those that are explicitly committed to maximizing shareholder value.³⁸

Setting aside these practical difficulties, the plausibility of multi-fiduciary stakeholder theory also depends quite heavily upon how broadly the term “stakeholder” is understood. This so-called identification problem has attracted considerable attention.³⁹ Freeman distinguishes between a “narrow definition” of the term, which refers to groups that are “vital to the success and survival of the firm,” and a “wide definition,” which refers to any group “who can affect or is affected by the achievement of the organization’s objectives.”⁴⁰ The former includes employees, customers, suppliers, but also, in most formulations of the theory, the local community. The wide definition, on the other hand, is so wide that it becomes equivalent to “all of society.” (For example, every pricing decision made by the firm contributes to the national inflation rate, which in turn affects every member of society. So if a stakeholder is anyone affected by the corporation, then everyone is a stakeholder in everything.) Yet the idea that managers are fiduciaries for “all of society” simply collapses business ethics into general ethics (i.e., general utilitarianism, Kantianism, Christian ethics, or what have you). Thus theorists who believe that the managerial role imposes special obligations upon the individual have tended to stick to the narrower definition of the stakeholder.

From the moral point of view, however, there seems to be no reason for the firm to pay special attention to stakeholders in the narrow sense of the term. There are plenty of good *strategic* reasons for managers to worry most about those whose contribution is vital to the success of the firm, but it is difficult to see what *moral* ones there could be. The groups that are conventionally classified as stakeholders in the narrow sense are not necessarily those with the most at stake in a particular decision, in terms of their potential welfare losses. In fact, if one looks at the standard list of stakeholder groups (customers, suppliers, employees and the local community), it tends rather to be those who are the best organized, or who have the most immediate relationship to the firm, or who are best positioned to make their voices heard. Thus stakeholder theory often has a “squeaky wheel” bias.⁴¹ For example, when General Motors considers closing down a plant in Detroit and moving it to Mexico, a standard multi-fiduciary stakeholder theory would insist that managers take into account the impact of their decision, not just upon their workers in Detroit, but also upon other members of the community whose livelihood depends upon their wages. Thus the “local community” in Detroit where the plant is located would normally be counted as a “stakeholder.” But what about the “local community” in Mexico, where the plant *would* be located? And what about the people there who *would* be getting jobs?⁴² Presumably they also have a lot at stake (possibly even more, in terms of welfare, given the relative poverty of the society in which they live). The fact that General Motors has built up a relationship over time with the people in Detroit may well count for something, but it cannot justify *ignoring* the interests of the people in Mexico. From the moral point of view, a potential relationship can be just as important as an actual one.⁴³ The only real difference between the groups is that potential employees do not know who they are, and so are unable to organize themselves to articulate their interests or express grievances. But it is difficult to see

why—from a moral, rather than a strategic point of view—this should give managers the freedom to leave potential employees, or potential “local communities,” off the list of groups that the firm has an obligation to.

Because stakeholder theory focuses on the relationship between the manager and different “groups” within society, it tends to privilege the interests of those who are well-organized over those who are poorly organized, simply because it is the former who are able to present themselves as a coherent body with a common set of interests. To see this bias in action, one need only look at the difference in the way that different stakeholder theorists conceive of “social responsibility” and the way that *governments* have traditionally approached it.⁴⁴ In this context, it is useful to recall that the widespread nationalization of industry that occurred in Western Europe after the Second World War was motivated, in large part, by the desire of democratic governments to make corporations behave in a more socially responsible manner. The thought was that corporations behaved irresponsibly because owners put their private interests ahead of the public good. By transferring ownership to the state, the people as a whole would become the owners, and so the corporation would no longer have an incentive to pursue anything other than the public good.

Needless to say, this initiative did not have precisely the results that were anticipated. The interesting point, however, lies in the agenda that various governments initially laid out for these firms. First and foremost, state-owned enterprises were expected to play an important role in assisting the state to implement macroeconomic stabilization policies: attenuating the business cycle by making countercyclical investments; maintaining excess employment during recessionary periods; and following self-imposed wage and price controls when necessary, in order to control inflation. Similarly, state-owned enterprises were expected to serve the national interest in various ways, either by providing goods at discounted prices when supplying domestic industry, serving as a guaranteed market for domestically produced goods, or by assisting in the “incubation” of industries intended to bolster international competitiveness. They were of course also expected to act as model employers with respect to their workers, to refrain from polluting, to promote regional development, and so forth. While there is significant overlap between the latter set of objectives and the traditional concerns of many stakeholder theorists, there are also some striking differences. In particular, one can search the stakeholder literature long and hard without finding any mention of the way that firms can contribute to macroeconomic stability. The reason, I would suggest, is that there are no organized or clearly identifiable “stakeholder” groups in this case. After all, how does one identify those who are harmed by inflation? It is, by and large, an extremely diffuse group of individuals. As a result, business ethicists working within the stakeholder paradigm have had a tendency simply to ignore them. For example, I am not aware of anyone having suggested that managers should refrain from granting inflationary wage increases to workers (i.e., increases that are not funded by productivity gains). Governments, on the other hand, have traditionally

been concerned with these questions, precisely because they do have a mandate to defend the welfare of all citizens, and to promote the public interest.

As a result, if one interprets the term “stakeholder” in the narrow sense, it introduces an unacceptable element of arbitrariness into business ethics. If one expands the definition, such that anyone affected by the firm’s actions will be considered a stakeholder, multi-fiduciary stakeholder theory amounts to the claim that the manager should be motivated by general considerations of social justice. This risks rendering the stakeholder vocabulary nonsensical, since the concept of a “fiduciary” relation is inherently contrastive. Being a loyal fiduciary involves showing *partiality* toward the interests of one group, not an impartial concern for the interests of all. Furthermore, if the manager is obliged to show impartial concern, the question then becomes, is he or she the person best equipped, or best positioned, to be making these judgments? As Friedman pointed out long ago, normative issues at this level of generality seem to be a more appropriate topic for public policy and democratic deliberation.⁴⁵ It is simply not obvious that the *manager’s* obligations should be determined by these concerns.

Part of the unwillingness to accept this line of reasoning stems from a rejection of the idea that there might be an institutional “division of moral labor,” such that not everyone is morally responsible for everything at all times. Many of the most subtle and difficult questions in professional ethics involves dealing with the way that obligations are divided up and parceled out to different individuals occupying different institutional roles. This is especially tricky in cases where the institution has an adversarial structure.⁴⁶ For example, the role of a defense attorney in a criminal trial is to advance the interests of her client by mounting a vigorous defense. Naturally, the overall goal of the procedure is to see that “justice” is served. But that does not make the defense attorney *directly* accountable to what she thinks is “just” in any particular case. Her job is to defend her client (and in fact, mounting a less-than-vigorous defense, because she happens to believe that her client is guilty, constitutes a serious violation of professional ethics). The victim of the crime is no doubt a “stakeholder” in these proceedings, but that does not mean that the defense attorney has a fiduciary obligation toward this individual. Both as a human being and as an officer of the court, she no doubt has ethical obligations toward victims of crime. But *qua* defense attorney, her obligation in many cases will be to disregard this everyday moral constraint. Justice arises through the interaction of her role-specific obligations with those of the crown prosecutor (or district attorney) and the judge. Of course, this is not to say that defense attorneys should do *anything* to secure the acquittal of their clients, or should not respect certain constraints in dealing with victims. There are clearly ethical and unethical ways to proceed. The point is that the vocabulary of fiduciary obligation does not provide a useful way of formulating these constraints. Furthermore, the idea that attorneys should seek to promote justice by balancing the interests of all affected parties is in tension with the role-differentiation that is a central component of the adversarial trial procedure.

Turning to business ethics, the first thing to note is that market transactions also have an adversarial structure (insofar as prices are competitively determined). One can see the problems that this creates for multi-fiduciary stakeholder theory by considering the attempts that have been made to classify “competitors” amongst the relevant stakeholder groups (or more often, the way that “competitors” are tacitly excluded without discussion).⁴⁷ After all, competitors are clearly affected by many of the decisions taken by the firm. Furthermore, since competitors have the power to drive the firm into bankruptcy, their behavior is often vital to its success or failure. Yet it seems obvious that managers do not have any fiduciary obligations toward rival corporations. After all, the price mechanism functions only because of an unresolved collective action problem between firms. No company sets out with the intention of selling goods at a price that clears the market. Often no one even knows what that price is. It is only when firms compete with one another, undercutting each other’s prices in order to increase their market share, that the selling price will be driven down to market-clearing levels. This is a classic form of non-cooperative behavior, since it is not normally profit-maximizing overall for firms to sell at this price level. They do it only because they are stuck in a collective action problem.

Thus there is a significant difference between market transactions and the administered transactions that occur within the organizational hierarchy of the firm. The former, because they are mediated through the price system, have an intrinsically adversarial element, since prices are supposed to be determined through competition (and considerable legal effort is invested in the task of keeping things that way). Since many of the socially desirable outcomes of the market economy are a consequence of the operation of the price mechanism, it is not clear that individual firms, much less managers, should be held directly accountable to them. Yet the possibility of such differentiated roles is tacitly denied by the wide version of stakeholder theory, which demands that the manager be ethically responsible for balancing the interests of everyone who is affected by the firm’s actions, regardless of whether they are in a competitive or a cooperative relationship.

The Market Failures Model

Despite these difficulties, the stakeholder paradigm still exercises an extraordinary grip over the imagination of many business ethicists.⁴⁸ It is all too often assumed that the stakeholder theory and the shareholder theory exhaust the logical space of alternatives. As a result, theorists like Marjorie Kelly and Max Clarkson have sought to defend stakeholder theory by mounting increasingly spirited attacks on the idea that managers have any particular obligations to shareholders. The cornerstone of this “nothing special about shareholders” defense is the claim that shareholders are not really “owners” of the firm in any meaningful sense.⁴⁹ Thus Clarkson cites with approval the fact that “serious questions are being raised about the belief, widely held in North America, that the purpose of the corporation in society is to maximize

profits and financial value for the primary benefit of its shareholders, who are also assumed, mistakenly, to be the corporation's owners."⁵⁰

It is perhaps worth noting that this particular strategy for defending the stakeholder paradigm has the unhelpful effect of making business ethics extremely unintuitive for those who actually work in a standard corporate environment, where the understanding that shareholders own the firm is still widespread. In particular, the downgrading of shareholder claims creates an enormous tension with corporate law, which remains very much committed to the idea that shareholders have a special status within the firm, and that managers owe them fiduciary duties.⁵¹ Of course, it is always possible for the law to be unethical. Nevertheless, this problem is more serious than it would at first appear. If one could produce a sound argument for the conclusion that managers have fiduciary obligations toward various stakeholder groups, one would also have produced a strong *prima facie* argument for the legal enforcement of these obligations. Thus stakeholder theorists have invested some effort in attempting to show that corporate law has in fact been evolving in the direction of increased recognition of stakeholder claims.⁵² And it is here, I think, that one can see where the most instructive misunderstanding arises.

There can be no doubt that the development of the welfare state in the twentieth century has coincided with increased regulation of the market. Health and safety in the workplace, the minimum wage, unionization procedures, product warranties, "truth in advertising" and product labeling, toxic emission controls, environmental impact studies, even the size and location of commercial signage—have all become subject to increasingly strict controls. Furthermore, it is clear that all of these regulations respond, in one way or another, to the type of issues that have traditionally been of concern to business ethicists. Each regulation amounts to a legal prohibition of a form of corporate conduct that was at one time merely unethical. The question is how we should understand these developments. Freeman argues that the growth in regulation *constitutes an increased legal recognition of stakeholder claims*.⁵³ This is, I will argue, a serious misunderstanding. The growth of regulation over the course of the twentieth century goes hand-in-hand with the increased positive economic role of the state in supplying public goods. Both represent strategies aimed at *correcting market failure*. As a result, I think that the concept of market failure provides a much more satisfactory framework for understanding the growth of regulation—and thus the increased legal entrenchment of the social responsibilities of business—than that of stakeholder claim recognition.

Setting aside Germany's "co-determination" arrangements, the closest one can find to an explicit recognition of stakeholder claims is the spread of statutes that allow boards of directors to consider the impact that a hostile takeover would have on non-shareholder groups in determining whether resistance to such takeovers would be "reasonable." These "other constituency" statutes, adopted in many U.S. states (although not Delaware), typically permit (and occasionally require) "officers and directors to consider the impact of their decisions on constituencies besides shareholders."⁵⁴ Thomas Donaldson and Lee Preston describe this as a

“trend toward stakeholder law.”⁵⁵ It is significant, however, that these statutes do not impose fiduciary duties, and were largely motivated by a desire on the part of legislators to make hostile control transactions more difficult, based upon a perception that takeovers generate significant social costs. Thus “other constituency” statutes have a lot in common with enabling statutes for “poison pill” and “shark repellent” defenses. I would argue that they are therefore better understood as an attempt to curtail a (perceived) market failure in the stock market than as a legal recognition of stakeholder claims.

The politics of “other constituency” statutes is a complex issue, however, which I do not want to get into here. My primary concern is to illustrate the style of analysis suggested by the market failures perspective. A market failure represents a situation in which the competitive market fails to produce a Pareto-efficient outcome (or for our purposes, let us say, fails *egregiously* to produce an efficient outcome). There are two primary institutional responses to market failure. The first involves the creation of the corporation itself, which is based upon the substitution of an organizational hierarchy and a set of administered transactions for a competitive market. The central characteristic of the firm, as Ronald Coase observed in his classic work, is the internal elimination of market transactions and the “supersession of the price mechanism.”⁵⁶ In more contemporary terms, we would say that the corporation substitutes a set of principal-agent relations for the non-cooperative relations of marketplace competition. However, because of the limitations of external incentive schemes, these agency relations can often be organized only through some combination of moral and prudential constraint.⁵⁷ Thus the central focus of business ethics, in an *intrafirm* context, involves promoting cooperative behavior within these agency relationships (as Allen Buchanan has argued, in my view persuasively⁵⁸). First and foremost among these obligations will be the fiduciary duty that managers have as the agents of shareholders. Thus when dealing with relationships or transactions “inside” the organizational hierarchy of the firm, the market failures approach to business ethics follows the shareholder-focused view quite closely. With respect to individuals who are “outside” the firm, on the other hand, it is quite different.

The second primary institutional response to market failure is less drastic than the first; it involves preservation of the market transaction, but subject to some more extensive set of legal, typically regulatory, constraints. To see the rationale for this strategy, it is helpful to recall that the point of permitting profit-maximizing behavior among firms in the first place is to promote price competition, along with all the beneficial “upstream” and “downstream” effects of such competition, such as technical innovation, quality improvement, etc. Under conditions of “perfect competition,” lower price, improved quality and product innovation would be the *only* way that firms could compete with one another. We can refer to these as the set of *preferred* competitive strategies. Unfortunately, in the real world, the so-called Pareto conditions that specify the terms of perfect competition are never met. In order for competition to generate an efficient allocation of goods and services,

there must be an absence of externalities (e.g., a complete set of property rights), symmetric information between buyers and sellers, a complete set of insurance markets, and rational, utility-maximizing agents with dynamically consistent preferences. Because of the practical impossibility of satisfying these constraints, firms are often able to make a profit using *non-preferred* competitive strategies, such as producing pollution, or selling products with hidden quality defects.⁵⁹ This is what generates market failure. The basic rules for marketplace competition laid down by the state—including the system of property rights—are designed to limit these possibilities, in order to bring real-world competition closer to the ideal (or to bring *outcomes* closer to those that would be achieved under the ideal, in cases where a functional competition cannot be organized). This is the motivation that underlies not only direct state provision of public goods, such as roads, but also state regulation of negative externalities, such as pollution.⁶⁰

Unfortunately, the law is a somewhat blunt instrument. In many cases, the state simply lacks the information needed to implement the measures needed to improve upon a marketplace outcome (sometimes because the information does not exist, but often because the state has no way of extracting it truthfully from the relevant parties). Even when the information can be obtained, there are significant administrative costs associated with record-keeping and compliance monitoring, not to mention the costs incurred by firms in an effort to evade compliance. Thus the deadweight losses imposed through use of the legal mechanism can easily outweigh whatever efficiency gains might have been achieved through the intervention. This often makes legal regulation unfeasible or unwise.

It is at this point that ethical constraints become germane. As we have seen, profit is not intrinsically good. The profit-seeking orientation of the private firm is valued only because of the role that it plays in sustaining the price system, and thus the contribution that it makes to the efficiency properties of the market economy as a whole. Ideally, the only way that a firm could make a profit would be by employing one of the preferred strategies. However, for strictly practical reasons, it is often impossible to create a system of laws that prohibits the non-preferred ones. Thus according to the market failures perspective, specifically ethical conduct in an *extrafirm* business context (i.e., when dealing with external parties) consists in refraining from using non-preferred strategies to maximize profit, even when doing so would be legally permissible. Put more simply, the ethical firm does not seek to profit from market failure. In many cases, doing so will be illegal—precisely because the state has tried, through increased regulation, to eliminate the use of non-preferred competitive strategies. Ethical constraint becomes relevant in the rather large penumbral region of strategies that are not illegal, and yet at the same time are not among the preferred.

Corporations, for instance, are often in a position where they can produce advertising that will be quite likely to mislead the consumer, but which stops short of outright falsity. In a perfect world, advertising would provide nothing more than truthful information about the qualities and prices of goods. However, the vagaries

of interpretation make it impossible to prohibit anything but the most flagrant forms of misinformation. Thus misleading advertising stands to false advertising as deception does to fraud. It is something that would be illegal, were it not for practical limitations on the scope of the legal mechanism. Profiting from such actions is therefore morally objectionable, not because it violates some duty of loyalty to the customer (as stakeholder theory would have it), but because it undermines the social benefits that justify the profit orientation in the first place. (In a sense, the invisible hand no longer works to transform private vice into public virtue in this case, and so we are left merely with vice.)

In this respect, the market failures approach to business ethics is a version of what Bruce Langtry calls “tinged stockholder theory,” which holds that “firms ought to be run to maximize the interests of stockholders, subject not only to legal constraints but also to moral or social obligations.”⁶¹ Indeed, it has been well understood for a long time that a shareholder-focused model with a set of deontic constraints (or “side constraints”) on the set of permissible profit-maximizing strategies represents a plausible alternative to the stakeholder model.⁶² What distinguishes the market failures approach from other such proposals is the specific account of how these constraints should be derived. Rather than trying to derive them from general morality (as Langtry does by focusing on the “moral rights” of individuals affected by the firm, or as Goodpaster does even more explicitly through appeal to the “moral obligations owed by any member of society to others”), the market failures approach takes its guidance from the policy objectives that underlie the regulatory environment in which firms compete, and more generally, from the conditions that must be satisfied in order for the market economy as a whole to achieve efficiency in the production and allocation of goods and services. Furthermore, by focusing on the distinction between administered transactions and market transactions, it is able to offer a principled basis for the difference in structure between the intrafirm obligations owed to shareholders and the extrafirm obligations owed to other groups affected by the actions of the corporation.

When one adopts this market failures perspective, there is no reason to think that a conception of business ethics that continues to place primary emphasis upon the fiduciary responsibility toward shareholders cannot deal with the ethical obligations that have traditionally been described under the heading of “corporate social responsibility.” What so often upsets people about corporate behavior—and what gives profit-seeking a bad name—is the exploitation of one or another form of market imperfection. People generally have no problem with companies that make money by providing good service, quality goods, low prices, and so forth. For example, if all companies fully internalized all costs, and charged consumers the full price that the production of their goods imposed upon society, I believe it would be impossible to make the case for any further “social responsibility” with respect to the environment. Thus the market failures approach to business ethics is able to retain the intuitively familiar idea that managers have fiduciary duties toward shareholders, and that the primary goal of corporations is to make a profit.

Yet it is able to avoid the charge of moral laxity often leveled against the shareholder model of business ethics, because it imposes strict moral constraints on the range of permissible profit-maximization strategies.

There is a close analogy, from this perspective, between “corporate social responsibility” and the concept of “good sportsmanship” in competitive team sports. In the case of sports, the goal is clearly to win—but not by any means available. Every sport has an official set of rules, which constrain the set of admissible strategies. Yet it will generally be impossible to exclude strategies that respect the letter of the law, while nevertheless violating its spirit (e.g., taking performance-enhancing drugs that have other legitimate uses, and therefore have not been banned). “Good sportsmanship” consists in a willingness to refrain from exploiting these loopholes, while nevertheless retaining an adversarial orientation. In other words, the obligation is to be a team player and to compete fairly, but not necessarily to let the other side win. The fundamental problem with stakeholder theory is that it tries to eliminate the adversarialism of the managerial role, rather than merely imposing constraints upon it.

Conclusion

One of the charges that hostile critics frequently make against business ethicists is that they are implicitly, if not explicitly, anti-capitalist. Insofar as one equates business ethics with the stakeholder paradigm, there is more than a grain of truth in this accusation. Goodpaster was certainly not wrong to observe that the multi-fiduciary stakeholder theory “blurs traditional goals in terms of entrepreneurial risk-taking, pushes decision-making towards paralysis because of the dilemmas posed by divided loyalties and, in the final analysis, represents nothing less than the conversion of the modern private corporation into a public institution and probably calls for a corresponding restructuring of corporate governance (e.g., representatives of each stakeholder group on the board of directors).”⁶³ There is, of course, nothing wrong in principle with arguing for institutional reforms of this sort. But a theory that has this as its consequence is unlikely to provide much guidance when it comes to dealing with the ethical challenges that arise in the day-to-day operations of firms in an unreformed capitalist economy.

One of the central advantages of the market failures approach to business ethics is that, far from being antithetical to the spirit of capitalism, it can plausibly claim to be providing a more rigorous articulation of the central principles that structure the capitalist economy. If firms were to behave more ethically, according to this conception, the result would be an enhancement of the benefits that the market provides to society, and the elimination of many of its persistent weaknesses. It would help to perfect the private enterprise system, rather than destroy it.

Of course, none of this is intended to show that one *cannot* continue to talk about corporate social responsibility in terms of stakeholder interests. The question is simply whether this vocabulary encourages a more or less perspicuous articula-

tion of the important moral issues. In this respect, it is important to remember that the term stakeholder was coined precisely in order to suggest an *analogy* between the relationship that managers have with shareholders and the relationship that they have with other interested parties. But as we have seen, the *moral* obligations that managers have toward these disparate groups are not analogous; in fact they are quite dissimilar. So while the term “stakeholder” may remain a useful piece of shop-talk in strategic management circles, as a piece of ethical vocabulary, for use in a theory that tries to articulate the central moral obligations of managers, it is inherently misleading. It creates considerable mischief in business ethics, while offering no real conceptual gain.

Notes

The author would like to thank Wayne Norman and Alexei Marcoux for their input and advice with the writing of this paper.

1. For a discussion of the scope and impact of stakeholder theory, see Thomas Donaldson and Lee E. Preston, “The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications,” *Academy of Management Review* 20 (1995): 65–91. For an overview, see Jeffrey S. Harrison and R. Edward Freeman, “Stakeholders, Social Responsibility and Performance: Empirical Evidence and Theoretical Perspectives,” *Academy of Management Journal* 42 (1999): 479–85.

2. Ronald K. Mitchell, Bradley R. Agle, and Donna J. Wood, “Toward a Theory of Stakeholder Identification and Salience,” *Academy of Management Review* 22 (1997): 853–86, at 855.

3. See, for example, Joseph R. DesJardins and John J. McCall, *Contemporary Issues in Business Ethics*, 5th ed. (Belmont, Calif.: Wadsworth, 2005). In Robert C. Solomon and Clancy Martin, *Above the Bottom Line*, 3rd ed. (Belmont, Calif.: Wadsworth, 2004), the authors go so far as to introduce the environment as “the silent stakeholder,” p. 310.

4. For a recent, high-profile example, see “Survey: Corporate Social Responsibility,” *The Economist* (Jan. 20, 2005).

5. The first two correspond well to the typology introduced by John Hasnas, “The Normative Theories of Business Ethics: A Guide to the Perplexed,” *Business Ethics Quarterly* 8:1 (1998): 19–42. On the third, my “market failures” model differs from the “social contract model,” in that it provides more explicit recognition of the adversarial structure of market transactions.

6. Thus, for example, Milton Friedman, the most influential proponent of the shareholder-focused view, criticizes the loose talk about “business” having social responsibility, and argues that these responsibilities, should there be any, must fall upon the shoulders of managers. “The Social Responsibility of Business Is to Increase its Profits,” *New York Times Magazine* (Sept. 13, 1970). Similarly, R. Edward Freeman, in his classic work on stakeholder theory, *Strategic Management: A Stakeholder Approach* (Boston: Pitman, 1984), identifies it quite explicitly as a set of obligations that fall upon managers, as part of their professional role.

7. John C. Maxwell, *There’s No Such Thing as “Business” Ethics: There’s Only One Rule for Making Decision* (New York: First Warner, 2003). One can find a considerably more sophisticated, but essentially similar, version of this idea in Norman Bowie, *Business Ethics: A Kantian Perspective* (Oxford: Blackwell, 1995).

8. This is the framework that is implicitly assumed by Andrew Stark, in his widely discussed paper, "What's the Matter with Business Ethics?" *Harvard Business Review* (May/June 1993).
9. The *locus classicus* is Emile Durkheim, *Professional Ethics and Civic Morals*, trans. Cornelia Brookfield (Glencoe: Free Press, 1958).
10. For an overview of moral hazard in this context, see Paul Milgrom and John Roberts, *Economics, Organization and Management* (Upper Saddle River, N.J.: Prentice Hall, 1992), 167–97.
11. Oliver Williamson, "Markets and Hierarchies: Some Elementary Considerations," *American Economic Review* 63 (1973): 316–25, at 318.
12. This is why, as R. M. MacIver emphasizes, "Each profession tends to leave its distinctive stamp upon a man, so that it is easier in general to distinguish, say the doctor and the priest, the teacher and the judge, the writer and the man of science than it is to discern, outside their work, the electrician from the railwayman or the plumber from the machinist." "The Social Significance of Professional Ethics," *Annals of the American Academy of Political and Social Science* 101 (1922): 5–11, at 11.
13. See, for example, Rakesh Khurana, Nitin Nohria, and Daniel Penrice, "Management as a Profession" in *Restoring Trust in American Business*, ed. Jay W. Lorsch, Leslie Berlowitz, and Andy Zelleke (Cambridge, Mass.: MIT Press, 2005).
14. Robert C. Clark, "Agency Costs vs. Fiduciary Duties," in John W. Pratt and Richard J. Zeckhauser, *Principals and Agents: The Structure of Business* (Cambridge, Mass.: Harvard Business School Press, 1985).
15. It is worth noting that there have been some moves afoot among business schools to start offering students some of the trappings of a professional association. One school in Canada, for instance, has begun offering a ring ceremony modeled on that of engineers, where students "make a public oath to behave honorably and, in return, receive an inscribed silver ring to wear as a reminder." Jane Gadd, "Is Ethics the New Bottom Line?" *The Globe and Mail* (March 8, 2005), E6. It seems to me that the question of whether we want to describe management as a profession should not depend upon the success or failure of such efforts.
16. There are parallels between this aspect of my argument and that of Wayne Norman and Chris MacDonald, who argue that so-called 3BL accounting is also "inherently misleading." See "Getting to the Bottom of the 'Triple Bottom Line,'" *Business Ethics Quarterly* 14 (2004): 243–62, at 254.
17. This should be interpreted as a positive (i.e., factual) claim about the structure of corporate law. See Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Cambridge, Mass.: Harvard University Press, 1991), 90–91. Whether managers *should* be fiduciaries of shareholders, or just shareholders, is of course the subject of considerable controversy among business ethicists. For a defense of the claim that they should be, see Alexei M. Marcoux, "A Fiduciary Argument Against Stakeholder Theory," *Business Ethics Quarterly* 13:1 (2003): 1–25.
18. Marjorie Kelly, "Why all the Fuss about Stockholders?" reprinted in her *The Divine Right of Capital* (San Francisco: Berrett-Koehler, 2001).
19. The paper that really set economists off in the wrong direction was Armen A. Alchian and Harold Demsetz's "Production, Information Costs, and Economic Organization," *American Economic Review* 63 (1972): 777–95, with their suggestion that the firm is really just a "privately owned market," p. 795. It should be noted, however, that subsequent work by incentive theorists has been considerably less sanguine about the efficiency properties of such "markets."
20. For a critique of these and other "framing assumptions" in agency theory, see J. Gregory Dees, "Principals, Agents and Ethics," in *Ethics and Agency Theory*, ed. Norman E. Bowie and

R. Edward Freeman (New York: Oxford University Press, 1992), 35; also John Boatright, *Ethics in Finance* (Oxford: Blackwell, 1999), 49.

21. For example, the chapter in Milgrom and Roberts, *Economics, Organization and Management*, on moral hazard has a section entitled “Controlling Moral Hazard” (pp. 185–192), which discusses, among other things, employee monitoring, supervision, incentive contracts, performance pay, bonding, and ownership changes as managerial strategies for preventing shirking. At no point is it mentioned that employees may respond to changes in “internal” motives (such as whether they love or hate the company they work for). It also exhibits a lack of concern for the fact that external performance incentives, such as pecuniary compensation, have the potential to “crowd out” moral incentives, and thus in some cases *generate* collective action problems rather than resolve them. See Bruno S. Frey, Felix Oberholzer-Gee, and Reiner Eichenberger, “The Old Lady Visits Your Backyard: A Tale of Morals and Markets,” *Journal of Political Economy* 104 (1996): 1297–1313.

22. *Pepper v. Litton* 308 U.S. 295 (1939) at 311. Cited in Robert C. Clark, “Agency Costs versus Fiduciary Duties,” p. 76. As Clark observes, the use of moral rhetoric in cases involving breach of managerial duty is highly significant, because as a general rule “our society is reluctant to allow or encourage organs of the state to try to instill moral feelings about commercial relationships in its citizens,” p. 75.

23. Although admittedly an unscientific survey, I have in my office fifteen different introductory business ethics textbooks, many of which discuss insider trading, but only one of which (John E. Richardson, *Business Ethics*, 16th ed. [Dubuque: McGraw-Hill, 2004]) makes any mention of the issue of employee expense account abuse or employee theft. Even then, the discussion focuses upon falsification of expenses, and does not mention the issue of mere profligacy.

24. See Alex C. Michalos’s critique of “the loyal agent’s argument,” in *A Pragmatic Approach to Business Ethics* (Thousand Oaks, Calif.: Sage, 1995), 50–52. Also Richard T. DeGeorge, “Agency Theory and the Ethics of Agency,” in *Ethics and Agency Theory*, 65–66.

25. Arthur Isak Applbaum, *Ethics for Adversaries* (Princeton, N.J.: Princeton University Press, 2000).

26. For example, see Tom L. Beauchamp and Norman E. Bowie, *Ethical Theory and Business*, 6th ed (Upper Saddle River, N.J.: Prentice Hall, 2001); Deborah C. Poff, *Business Ethics in Canada*, 4th ed (Scarborough: Prentice Hall, 2005); and Thomas White, *Business Ethics: A Philosophical Reader* (New York: Macmillan Publishing, 1993).

27. Khurana, Nohria, and Penrice, for example, in “Management as a Profession,” argue that a *bona fide* profession requires of its members “a renunciation of the profit motive.” They then blame “the doctrine of shareholder primacy” for recent corporate ethics scandals, on the grounds that it “has legitimized the idea that the benefits of managerial expertise may be offered for purely private gain.” This “led directly to many of the worst profit-maximizing abuses unmasked in the recent wave of corporate scandals.” Such an analysis is almost exactly backwards. The problems at Enron (for example) were not due to managers maximizing profits; they were due to managers *failing* to maximize profits, then creating special-purpose entities to keep more than \$26 billion worth of debt off the balance sheet, precisely to generate the *illusion* of profitability. The fact that they were able to line their own pockets in the process demonstrates the extent to which the goal of maximizing one’s own personal earnings and maximizing the profits of a firm can diverge. Professional conduct requires setting aside the goal of maximizing one’s *own* earnings, but that does not preclude one from earning money *for others*. Divorce lawyers seek to secure the largest settlement *for their clients*, without that compromising their status as professionals.

28. David Gauthier, *Morals by Agreement* (Oxford: Clarendon Press, 1986).

29. For an especially clear example of confusion on this score, see Ronald F. Duska, “Why Be a Loyal Agent? A Systemic Ethical Analysis,” in *Ethics and Agency Theory*, 157–59. He talks

about the “self-interested pursuit of profit,” and argues that in order to diminish the level of self-interested behavior on the part of individuals within a firm it will be necessary to challenge the orientation toward profit-making on the part of the business as a whole.

30. John Kay, *The Truth About Markets* (London: Penguin, 2003), writes “it is not true that profit is the purpose of the market economy, and the production of goods and services the means to it: the purpose is the production of goods and services, profit the means,” p. 351.

31. See Nicholas Barr, *The Economics of the Welfare State*, 3rd ed. (Stanford, Calif.: Stanford University Press, 1998), 70–85.

32. Kenneth Goodpaster, “Business Ethics and Stakeholder Analysis,” *Business Ethics Quarterly* 1:1 (1991): 53–73, at 60.

33. R. Edward Freeman, “A Stakeholder Theory of the Modern Corporation,” in *The Corporation and its Stakeholders*, ed. Max B. E. Clarkson (Toronto: University of Toronto Press, 1998), 126.

34. Freeman, “A Stakeholder Theory of the Modern Corporation,” 129.

35. *Ibid.*, 132. For an example of this view, further developed, see the list of “Principles of an Ethical Firm,” in Norman Bowie *Business Ethics: A Kantian Perspective*, 90.

36. Goodpaster, “Business Ethics and Stakeholder Analysis,” 61–62.

37. Some U.S. states have been moving in this direction, see n. 54 below.

38. Joseph Heath and Wayne Norman, “Stakeholder Theory, Corporate Governance and Public Management,” *Journal of Business Ethics* 53 (2004): 247–65.

39. For a survey of attempts to define the term, see Mitchell, Agle, and Wood, “Toward a Theory of Stakeholder Identification and Salience,” 856–58.

40. The narrow definition is from Freeman, “A Stakeholder Theory of the Modern Corporation,” 129; the wide is from Freeman, *Strategic Management*, 46.

41. Mitchell, Agle, and Wood, “Toward a Theory of Stakeholder Identification and Salience,” propose a very nuanced analysis of stakeholder groups, classifying them in a way that reflects their relative “salience” to managers. They go on to observe that, “if the stakeholder is particularly clever, for example, at coalition-building, political action, or social construction of reality, that stakeholder can move into the ‘definitive stakeholder’ category (characterized by high salience to managers),” p. 879. This sort of observation shows how stakeholder analysis may be useful for strategic management, but when employed without further ado as the normative foundation of business ethics tends to favor the squeaky wheel.

42. See Bruce Langtry, “Stakeholders and the Moral Responsibility of Business,” *Business Ethics Quarterly* 4 (1994): 431–43, at 432.

43. Mitchell, Agle, and Wood, “Toward a Theory of Stakeholder Identification and Salience,” 859.

44. Heath and Norman, “Stakeholder Theory, Corporate Governance and Public Management,” 255–56.

45. Milton Friedman, “The Social Responsibility of Business Is to Increase its Profits,” 34.

46. Applbaum, *Ethics for Adversaries*.

47. For an example of the former, see Freeman, “A Stakeholder Theory of the Modern Corporation,” 132; for an example of the latter, see Mitchell, Agle, and Wood, “Toward a Theory of Stakeholder Identification and Salience.”

48. See Rogene A. Buchholz and Sandra B. Rosenthal, “Toward a Contemporary Conceptual Framework for Stakeholder Theory,” *Journal of Business Ethics* 58 (2005): 137–48.

49. Kelly, "Why all the Fuss about Stockholders?" Also Max Clarkson's introduction to *The Corporation and its Stakeholders* (Toronto: University of Toronto Press, 1998). Bowie offers an approving survey of such strategies in *Business Ethics: A Kantian Perspective*, 144–45.
50. Clarkson, *The Corporation and its Stakeholders*, 1. For a clear antidote to these sorts of views, see Henry Hansmann, *The Ownership of Enterprise* (Cambridge, Mass.: Harvard University Press, 1992).
51. See Easterbrook and Fischel, *The Economic Structure of Corporate Law*, 90–91.
52. See, for example, E. W. Orts, "Beyond Shareholders: Interpreting Corporate Constituency Statutes," *George Washington Law Review* 61 (1992): 14–135; also Donaldson and Preston, "The Stakeholder Theory of the Corporation," 75–76.
53. Freeman, "A Stakeholder Theory of the Modern Corporation," 128.
54. John Boatright, "Fiduciary Duties and the Shareholder-Management Relation: Or, What's so Special about Shareholders?" *Business Ethics Quarterly* 4 (1994): 393–407, at 402. See also James J. Hanks, Jr., "Playing with Fire: Nonshareholder Constituency Statutes in the 1990s," *Stetson Law Review* 21 (1991): 97–120.
55. Donaldson and Preston, "The Stakeholder Theory of the Corporation," 76.
56. Ronald Coase, "The Nature of the Firm," *Economica* 4 (1937): 386–405, at 389. See also Williamson, "Markets and Hierarchies," 316.
57. Eric Noreen, "The Economics of Ethics: A New Perspective on Agency Theory," *Accounting Organizations and Society* 13 (1988): 359–69.
58. Allen Buchanan, "Toward a Theory of the Ethics of Bureaucratic Organizations," *Business Ethics Quarterly* 6 (1996): 419–40.
59. Kenneth Arrow, in "Social Responsibility and Economic Efficiency," *Public Policy* 21 (1973): 303–17, puts particular emphasis on the consequences of firms maximizing profits in cases where there are pollution externalities and information asymmetries that favor the firm. "The classical efficiency arguments for profit maximization do not apply here," he writes, "and it is wrong to obfuscate the issue by invoking them," p. 308.
60. For more extensive discussion, see Joseph Heath, *The Efficient Society* (Toronto: Penguin, 2001).
61. Langtry, "Stakeholders and the Moral Responsibility of Business," 434–35.
62. Goodpaster, for example, moots such a proposal in "Business Ethics and Stakeholder Analysis," 67–68. The term "side constraint" is from Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974), 28–32, whose discussion of the issue is also quite helpful.
63. Goodpaster, "Business Ethics and Stakeholder Analysis," 66.