Shareholders vs. Stakeholders: How Liberal and Libertarian Political Philosophy Frames the Basic Debate in Business Ethics

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Abstract

The “basic debate” in business ethics between shareholder and stakeholder theory has underlined the field since its inception, with wide ranging normative, descriptive, and instrumental arguments offered on both sides. We maintain that insofar as this is primarily a normative debate, clarity can be brought by elucidating how it is framed by the political philosophies of liberalism and libertarianism.

With liberalism represented by John Rawls’ theory of justice and libertarianism represented by the ideas of Milton Friedman and Robert Nozick, and (separately) Edward Freeman, the paper shows that both liberalism and libertarianism can be interpreted to justify shareholder and stakeholder theory respectively. The debate between shareholder theory and stakeholder theory is framed by liberal and libertarian justifications that hinge primarily on whether and to what extent one should have exogenous or endogenous safeguards on corporate behavior. Accordingly, political philosophy turns out to be highly relevant to both business ethics and corporate governance, not because the corporation resembles the state, but because of the potential safeguards placed on the corporation by the state.
The “basic debate” in business ethics is often characterized as one between whether managers should focus primarily on the interests of shareholders and whether they should consider or balance the interests of a wider group of stakeholders (Agle & Mitchell 2008; Boatright, 2002; Campbell, 2007; Freeman, 1994; Phillips, 1997). This has also become known as the Friedman-Freeman debate (Freeman, 2008). Business ethics as an academic field has reacted disapprovingly to the managerial focus on shareholder interests of the so-called Shareholder Theory of Milton Friedman, who asserted that the social responsibility of business is “to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game” (1962: 133). In contrast, Freeman’s (1984) seminal formulation of Stakeholder Theory, while not denying that profitability should be a goal of corporations, sees the primary purpose of the corporation as being a vehicle to manage stakeholder interests. This has become one of the most prominent theories both within business ethics (Phillips, 2003) and the wider field of management, as well as a dominant paradigm for Corporate Social Responsibility (McWilliams & Siegel, 2001).

The shareholders vs. stakeholders debate has underlined the field of business ethics since its inception with wide ranging normative, descriptive, and instrumental arguments offered on both sides. We shall argue that insofar as this is primarily a normative debate, clarity can be brought by elucidating how it is framed by the political philosophies of liberalism and libertarianism. By clarifying the political normative arguments that are at stake, we lay out the ground upon which this debate needs to be conducted. The aim is not to argue in favor of one position over the other, but rather to lay bare the underlying political justifications of each camp. The prescription that managers should focus primarily on shareholder interests has been closely tied to the Shareholder Primacy Norm (SPN). The SPN is the part of a manager’s legal fiduciary duty that requires managers to make decisions on behalf of the corporation that furthers the interests of shareholders. It has been treated as a
major obstacle to corporate social responsibility (CSR) because it is said to hinder managers from considering the interests of other corporate stakeholders besides shareholders (Boatright, 1994; Campbell, 2007; Dodd, 1932; Evan and Freeman, 2003; Hinkley, 2002; Phillips, Freeman & Wicks, 2003; Testy, 2002).

CSR has been defined in many ways. In general, however, “it means that the private corporation has responsibilities to society that go beyond the production of goods and services at a profit… a corporation has a broader constituency to serve than stockholders alone” (Buchholz & Rosenthal, 2002: 303). In other words, CSR contains a prescription for corporations to pursue ends that go beyond merely pursuing the interests of shareholders. Thus the definitions of the SPN and CSR suggest that they are in conflict as prescriptive concepts. As a consequence, the legitimacy of the SPN is at the core of the basic debate in business ethics (Agle & Mitchell 2008; Boatright, 2002; Campbell, 2007; Freeman, 1994; Phillips, 1997). By “legitimacy” in this context we mean that the norm based actions of corporations “are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman, 1995: 574).

The SPN is closely associated with the notion of Shareholder Value Maximization (SVM), because if one merges the SPN with an assumption that the interests of shareholders is to maximize their return on investment, then this results in a prescription to managers to maximize shareholder value. Thus the legitimacy of the SPN also has an important bearing on the goal of the corporation and whether it should be a vehicle for the pursuit of shareholder interests (Friedman, 1970; Jensen, 2002) or for managing stakeholder interests (Freeman, Harrison, & Wicks, 2007; Freeman et al., 2010). If the interests of shareholders are primary, then their interests will decide what goal the corporation should pursue, whether it is SVM or something else.
We start by maintaining that the SPN is perpetuated as a norm among managers due to the importance of shareholders’ sole voting rights for the board of directors. This places shareholders in a privileged position for managerial consideration among stakeholders. We then consider the prescriptive issue of whether or not such voting rights should be extended to a wider group of stakeholders along the lines of stakeholder theory. In order to represent stakeholder theory, we introduce the Stakeholder Equality Norm (SEN) as a norm of governance which is characterized by extending equal voting rights for the board to a broader group of stakeholders (thus removing the primacy of shareholders as found under the SPN). Acknowledging that all business is conducted within a political context for addressing social harms and goods we apply political philosophy to demonstrate that the choice between the SPN and the SEN is primarily based on the justifications of liberalism vs. libertarianism. Our aim is to show that each of these positions within political philosophy can serve as the justification for shareholder primacy and stakeholder theory respectively.

We apply Rawls’ theory of justice and demonstrate how his liberal theory would arbitrate between the SPN and the SEN based on empirical issues of economic efficiency. However, we maintain that neither norm would be unfettered in a putative Rawlsian society because justice considerations impose extensive exogenous safeguards on the corporation, primarily in the form of legislation. On the other hand, the libertarian foundations of stakeholder theory based on individual rights is contingent on whether the focus is on the equal rights of self-determination of stakeholders rather than the property rights of shareholders. We conclude that a focus on shareholder’s property rights along the lines of Friedman/Nozick (Friedman, 1970; Nozick 1974) leads to an endorsement of the SPN with weak exogenous safeguards, while a focus on the equal rights of self-determination of stakeholders along the lines of Freeman (Evan & Freeman, 2003; Freeman & Evan, 1990;
Freeman & Phillips, 2002) would lead to an endorsement of the SEN as an endogenous safeguard.

The basic debate about shareholder theory vs. stakeholder theory becomes largely a debate about how one interprets liberalism and libertarianism, where the liberalism tends towards strong exogenous safeguards and the libertarianism tends towards weak exogenous safeguards or endogenous safeguards. Accordingly, political philosophy turns out to be highly relevant to both business ethics and corporate governance, not because the corporation resembles the state, but because of the potential constraints placed on the corporation by the state. By regarding the debate as one founded on political philosophy this offers needed insight and a practical resolution to the conflict through an acceptance of the outcome of the democratic political process.

THE SHAREHOLDER PRIMACY NORM

Corporate law in the US and UK, comprising both common law and statutory law, is structured to ensure that corporations work in the interest of shareholders. However, this primacy of shareholders has not been formally identified in statutory law (Fisch, 2006). The SPN’s most famous articulation comes from the US case of Dodge v. Ford Motor Co. in 1919, wherein Chief Justice Ostrander said:

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among shareholders in order to devote them to other purposes.

The SPN is the part of managers’ legal fiduciary duty which obliges them to consider primarily the interests of shareholders in their decision-making. Technically, shareholders can launch derivative suits against directors on claims of breaching the SPN, but these rarely if ever succeed. Therefore, the view of CSR advocates (see e.g., Boatright, 1994; Campbell,
2007) that the SPN *legally* inhibits managers from considering the interests of multiple stakeholders lacks credence.

The reason for this is that the SPN has become muted within the law. The first step in this direction was the US mid-20th century development of the business judgment rule, which hinders the courts from making evaluations about the quality of business decisions. The courts may evaluate a director’s duty of loyalty or care towards shareholder interests, but this in practice becomes very difficult to prove as any decision can be justified as an unsuccessful business decision which the court must not evaluate (Smith, 1998). More recently, on both sides of the Atlantic, there have been statutory developments that explicitly allow directors to consider non-shareholder interests. In the US, most states have adopted “non-shareholder constituency statutes” that explicitly allow managers to consider the interests of non-shareholder constituencies when making decisions (McDonnell, 2004). In the UK, the 1985 and 2006 Companies Acts require directors to take into account the interests of employees and other stakeholders, although non-shareholder stakeholders have no judicial means to challenge directors’ decisions. Thus potential common law restrictions on managerial discretion for considering non-shareholder interests have largely disappeared.²

Although the SPN is muted as a legally enforceable norm it is still very much alive among directors and managers as a social norm³. A significant reason for this is that corporate law is structured towards shareholder primacy.⁴ Shares confer voting rights to shareholders, which gives them the power to elect and dismiss the board of directors, and therefore there is a real sense in which the directors of the corporation act as agents representing the interests of the shareholders (Kraakman et al., 2004). Quite simply, if directors do not please shareholders they may be dismissed. It should be acknowledged that although dismissal/non-reelection of a board member is a real threat, it rarely happens in practice in large public corporations (Benz & Frey, 2007). However, there are usually other incentive structures in place that aim to align
management interests with corporate financial performance; for example, the issuing of shares, stock options, and/or bonuses. Voting rights matter even in this context because it is common practice for shareholders to approve top management’s remuneration by voting. The legal power of shareholders to vote for the board of directors and their remuneration helps perpetuate the SPN as a social norm, not as a principle of law likely to be upheld in court.

We now turn to whether such voting rights should be extended to a wider group of stakeholders along the lines of stakeholder theory. We do not take sides, but lay bare the basis for liberal and libertarian lines of argumentation regarding the legitimacy of extending such rights.

LIBERALISM AND THE LEGITIMACY OF THE SPN

Any evaluation of legitimacy requires a “constructed system of norms” (Suchman, 1995: 574) within which that evaluation takes place. Liberal and libertarian positions within political philosophy represent two such constructed systems of norms.

Letting Rawls’ political theory (Rawls, 1996; 1999; 2001) represent the liberal system of norms seems obvious given that he is the most influential political philosopher of the 20th century. We also employ Rawls because his theory aims to develop the fundamental principles that are to govern the basic institutions of society and the corporate legal form may be regarded as such a basic institution. Furthermore, Rawls theory is a social contract theory (SCT) and such theorizing is becoming established as a core theory within business ethics (Wempe, 2005). In contrast to previous applications of Rawls’ theory within business ethics (Freeman & Evan, 1990; Hartman, 1994; Moriarty, 2005) that have been said to misapply his political theory directly to the governance of corporate organizations (Phillips & Margolis, 1999), we look at the governance implications of Rawls’ theory for the corporation as an institution that is part of the basic structure of society.
Justice as Fairness

Rawls’ (2001) “Justice as Fairness” theory is a form of political liberalism that assumes as fundamental the fact of reasonable pluralism, which is to say that citizens in any society will have profound and irreconcilable differences in their reasonable comprehensive religious and philosophical conceptions of the world. It is thus the task of political liberalism, and Justice as Fairness especially, to put forward a view of political justice that the spectrum of reasonable comprehensive conceptions can endorse. For this to be realized, Rawls suggests that we should reason as if we are putting together a social contract.

According to Rawls, the “basic structure” of society is the primary subject that should concern the contracting parties, which is to say how the main political and social institutions in society fit together into one system of social cooperation. Importantly, for our purposes, this includes not only the political constitution with an independent judiciary, but also the legally recognized forms of property and the structure of the economy. The most fundamental idea in Justice as Fairness is that society is regarded as a system of social cooperation and therefore it is the goal of the contracting parties to specify the principles of justice that are to govern the basic structure so that they fairly “assign basic rights and duties and regulate the division of advantages that arise from social cooperation over time” (Rawls, 2001: 10).^5

To explicate the reasoning for his principles, Rawls introduces a representation device called the original position. This is a hypothetical state of nature scenario (an approach also employed by philosophers such as Hobbes, Locke and Rousseau) where we are asked to envision a state of affairs before individuals started cooperating. Under Rawls, we imagine that the representatives of the relevant social positions in society come together to contractually agree on the principles of justice. In order to reach an agreement that would be acceptable to the spectrum of comprehensive views, the parties are placed behind a “veil of ignorance” in order to model impartiality. The veil of ignorance keeps the parties from
knowing things that would make them partial in a contracting situation such as their social status, gender, race, natural assets and their conception of the good. Instead of their own comprehensive conception of the good, the parties are assumed to want as much as possible of social primary goods, which are liberties, opportunities, wealth, income and a social basis for self-respect. These are all-purpose means that, Rawls asserts, anyone would want irrespective of their goals in life. Rawls (2001: 42) argues that the contracting parties would reach agreement on the following two principles of justice:

1. Each person has the same indefeasible claim to a fully adequate scheme of liberties, which is compatible with the same scheme of liberties for all (liberty principle); and
2. Social and economic inequities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity (equality of opportunity principle); and second, they are to be to the greatest benefit of the least-advantaged members of society (the difference principle).

The first principle is prior to the second, and in the second principle “equality of opportunity” is prior to the “difference principle”. These priorities signify that each principle is fully realized by the basic structure of society before the next is applied. In short, Justice as Fairness is an egalitarian conception of rights, liberties and distributive shares, where inequalities of income and wealth are only justifiable if they are to the benefit of the least advantaged members of society.

**How Justice as Fairness Relates to the SPN**

To evaluate the legitimacy of the SPN using Justice as Fairness, we must first demonstrate its appropriateness to the task. This includes establishing that a “Rawlsian society” would have private ownership as part of the means of production and the corporate legal form, as well as identifying the main criterion for choosing among alternative norms of corporate governance under Rawls’ theory.

Rawls insists on competitive markets in part because they “allow for more efficient allocation of factors of production” (S. Freeman, 2008: 222), but more importantly because “markets provide an essential means for ensuring equal liberty and fair equality of
opportunity” (Krouse & McPherson, 1988: 81). However, a market economy is compatible with both private and public ownership of the means of production. Rawls’ (2001: 177) theory is strictly speaking indeterminate as regards the public or private ownership of the means of production, but “in existing conditions it [private ownership of the means of production] is the most effective way to meet the principles of justice.” Hence, for the purposes of this paper, we assume a Rawlsian society in which the means of production may be privately owned.

Given that Justice as Fairness allows and “in existing conditions” even endorses private ownership in the means of production, some form of legal vehicle is needed through which citizens own (and organize) productive means as distinct from their private property. In our current societies there are several legal forms that enable the economic enterprise of citizens, such as sole proprietorship or partnerships, but by far the most dominant are corporations. “They [corporations] are the grand social institutions of our time” (Phillips & Margolis, 1999: 619). The success of the corporation as a vehicle for production and economic growth has been evident since the industrial revolution. In particular the legal attributes of limited liability and the transferability of shares have been instrumental to facilitate the pooling of capital necessary for large scale investments and enabling liquid stock markets (Easterbrook & Fischel, 1985). Rawls’ theory does not specify the exact attributes of the corporate legal form, but given the proven benefits of this form of productive association there seems little reason to think that a vehicle of this type should not be made available to citizens to engage in commercial enterprise. Therefore, we assume that a vehicle like the corporate legal form would exist in a Rawlsian society (i.e., with at least the central characteristics as we know it: corporate personality, delegated management, transferability of shares, limited liability, and investor ownership (Kraakman et al., 2004)).
Thus, while Rawls (2001: 12) observes that “the basic structure does not provide a sharp definition, or criterion, from which we can tell what social arrangements, or aspects thereof, belong to it,” it does include the legally recognized forms of property. Given that the corporate legal form is a legal vehicle through which citizens can own means of production this should make it a manifestation of the basic structure and, therefore, it needs to comply with the principles of justice. Hence Justice as Fairness is relevant to an evaluation of the legitimacy of the SPN because, as we have shown, this norm is contingent on the voting rights that are conferred upon shareholders as a part of the corporate legal form, which is part of the basic structure. With the appropriateness of using Rawls’ theory established, we now turn to identifying the main criterion for choosing among alternative norms of corporate governance.

**Justice and the Criterion of Efficiency**

A common approach when employing Rawls in business ethics is to take the representation device of the original position and apply it to corporate stakeholders. For example, one method is to place all stakeholders behind a veil of ignorance, depriving them of the knowledge of what stakes they have, to determine the rules of “fair contracting” among them (Freeman and Evan, 1990). However, this is more accurately seen as using the original position as a device for one’s own purposes rather than as an exercise in applying Rawls’ theory. Under Rawls, the relevant contracting parties are *citizens*, not corporate *stakeholders*. Rawls’ theory applies to the basic structure seen as a coherent system of social cooperation and therefore the relevant contracting parties are defined in terms of free and equal citizens distinguished by their “different expectations for the unequally distributed primary goods” (1999: 82).

While Rawls’ theory does not speak directly to stakeholders, it is relevant to the norm for corporate governance because the norm has consequences for citizens (and thus indirectly for stakeholders) as it affects the efficiency of the entire economic system in society. This is
accounted for in the difference principle. Rawls (2001: 63) says that “a scheme of cooperation is given in large part by how its public rules organize productive activity” and that, other things being equal, the difference principle directs society to aim for a system that is to the greatest benefit of the least advantaged members in society (defined in terms of the primary goods of income and wealth).

The lexical priority of the principles of justice guarantees that the liberty principle and the equality of opportunity principle are fully realized before the difference principle is applied. However, as Rawls (2001: 123) states, “a political conception of justice must take into account the requirements of social organizations and economic efficiency.” The difference principle is part of a broad conception asserting that a theory of justice must incorporate issues of efficiency. For Rawls (1999:69) “justice is defined so that it is consistent with efficiency, at least when the two principles of justice are fulfilled.” When the basic liberties and equal opportunities are satisfied, a more “efficient system” of cooperation that is to the benefit of the least advantaged is preferable to a less efficient one.

The difference principle is a type of efficiency principle. It is similar to the principle of Pareto-optimality in that it seeks distributive shares (of income and wealth) in society that are such that no representative man can improve his position without making some other representative man worse off. However, Pareto-optimality is indifferent to how unequally the shares are distributed and thus it “cannot serve alone as a conception of justice” (Rawls, 1999: 62). The difference principle adds to Pareto-optimality “by singling out a particular position [of distributive shares] from which the social and economic inequalities of the basic structure are to be judged… The difference principle is a strong egalitarian conception in the sense that unless there is a distribution that makes both persons better off (limiting ourselves to the two-person case for simplicity), an equal distribution is preferred” (Rawls, 1999: 65-66). Departures from an equal distribution, i.e. “differences”, are permissible if they are to the
benefit of the least advantaged members of society. Such differences between representative people are seen as capable of benefitting the least advantaged because the better prospects of the advantaged “act as incentives so that the economic process is more efficient” (Rawls, 1999:68). In Justice as Fairness, issues of justice are prior to efficiency, but other things remaining equal, a more efficient system is preferable to a less efficient one.

Rawls says that “the difference principle is, strictly speaking, a maximizing principle” (1999:68). A simple way to understand it is to think of it as a principle of constrained maximization; i.e. a principle that strives for the most efficient economic system constrained by the liberty principle and the equal opportunity principle, as well as the constraint that departures from equal distribution should be to the greatest benefit of the least advantaged. The first two constraints are set forth by basic institutions through rules and resources to guarantee liberties and opportunities while the last constraint can be implemented through redistribution of income and wealth. These constraints act on the level of society and as such are external to the corporation. These constraints do not directly decide which internal norm of governance should govern corporations. But with these constraints in place, the corporation should have the most economically efficient norm of governance in order that the greater wealth will benefit everyone, especially the least advantaged.

The efficiency of a macroeconomic system is in part given by the efficiency of the microeconomic systems of corporations within it. An economic system is more efficient if it can provide more goods and services without using proportionately more resources. Thus, central to our Rawlsian analysis of the legitimacy of the SPN is whether it is more efficient to give all corporate stakeholders a right to vote or to only give this right to shareholders.

**The Stakeholder Equality Norm**

We have argued that a Rawlsian society would likely have a legal vehicle for private ownership of the means of production with the central legal attributes of the corporate legal
form as we know it, such as limited liability and the transferability of shares. Yet when it comes to the goal for which the means of production are put to use, what type of norm should govern such a vehicle? Would the SPN or some alternative norm be endorsed by Justice as Fairness? With economic efficiency identified as the main criterion for choosing a norm of corporate governance, we now need at least one alternative to the SPN that can be used to evaluate if it is more efficient.

With the SPN allied to shareholder theory, we turn to stakeholder theory to identify a competing norm of governance. As earlier noted, these contrasting theories cut to the heart of the basic debate in business ethics regarding whether managers should focus on satisfying shareholder or stakeholder interests. Hence the most appropriate alternative against which we might evaluate the SPN would appear to be a norm of governance that reflects the content of stakeholder theory.

Shareholder theory holds that the purpose of the corporation is to be a vehicle for pursuing shareholder interests (Friedman, 1970). In contrast, stakeholder theory holds, as a normative theory and not merely an instrumental theory—and Donaldson and Preston (1995: 86) assert that it is “fundamentally normative”—that the purpose of the corporation is to be a vehicle for managing stakeholder interests (Evan and Freeman, 2003). Donaldson and Preston (1995) categorize stakeholder theory into normative, descriptive, and instrumental accounts. Freeman et al. (2010) do not deny that these categories can be useful, but suggest that they are by no means mutually exclusive. They regard the “separation thesis” to be a fallacy. The separation thesis is the view that one can separate positive and normative accounts in business. Instead they adhere to the “integration thesis” which says that positive and normative accounts need to be integrated. In this paper, we regard the purpose of stakeholder theory as fundamentally normative, not because we disregard its descriptive and instrumental aspects,
but because our interest is to explore its potential normative foundations from the perspective of political philosophy.

Under the stakeholder view, it is often said that the discretion of decision-making should lie with management together with stakeholder representatives (Melé, 2008). However, unless these representatives are given real power, such as an equal right to vote, ultimately we still have a situation of shareholder primacy (even if it is informed by the different interests of the firm’s constituencies). Accordingly, a viable formulation of a norm of governance for stakeholder theory would seem to lie in the idea of a Stakeholder Equality Norm (SEN). The SEN, as we propose it, would be a norm enforced by the fact that all stakeholders have representatives as members of the board with an equal right to vote (equal otherwise one stakeholder group will have primacy). Indeed, Freeman and Evan (1990: 353) argue in their application of the original position to the contracting of stakeholders that “it is rational for stakeholders to choose voting membership on the board” to avoid unilateral policies that are detrimental to stakeholders. Moreover, Donaldson and Preston (1995: 87) note that stakeholder theory “prohibits any undue attention to the interests of any single constituency.” Therefore the notion of equality seems appropriate for a norm representing stakeholder theory because if stakeholders are not equal in the eyes of management, one group must be primary.

The SEN would presumably include a right for stakeholders to vote for their representatives on the board (in order to achieve proper representation) which would lead to the removal of shareholder primacy (as it is the unique right to vote for the board that establishes shareholders’ current primacy). This would have the effect of extending the fiduciary duties of directors and managers to all stakeholders, thus charging them with the task of managing and balancing the pursuit of stakeholder interests.

Implementing stakeholder theory has received insufficient attention in the literature to date. Our formulation is not intended to be a “straw-person”—a misrepresentation of
stakeholder theory that is easily shot down and an approach often used by its critics (Phillips, et al., 2003). However, clearly there would be major practical difficulties in applying the SEN (e.g., how are the relevant stakeholders to be identified? is the size of the stakeholder organization important? how would they vote for their representatives on the board?). Nonetheless, provided the SEN is a faithful representation of stakeholder theory (once the importance of voting rights is appreciated), these practical difficulties are not crucial for our present purposes. Our aim is not to solve the problem of how to operationalize stakeholder theory but rather to offer a norm of governance that does not give primacy to any stakeholder group.\textsuperscript{9}

The SEN extends an equal right to vote to stakeholder representatives on the board which guarantees equal representation for each constituency. However, this does not necessarily mean that they are given equal consideration in every corporate decision that is made. The board (with its stakeholder representatives) chooses the CEO who is given the task of running the daily operations of the corporation and whose responsibility it is to balance the interests of stakeholders depending on the particular circumstances at hand, which does not necessarily demand equal consideration of all stakeholders in all circumstances. In this way, the SEN is consistent with the usual depiction of stakeholder theory (Boatright, 2002: 1839), in that: “1) all stakeholders have a right to participate in the corporate decisions that affect them, 2) managers have a fiduciary duty to serve the interests of all stakeholder groups, and 3) the objective of the firm ought to be the promotion of all interests and not those of shareholders alone.” Further, it “does not imply that all stakeholders should be equally involved in all processes and decisions” (Freeman & Phillips, 2002: 340). The SEN adds to this depiction the equal voting rights for stakeholder board representatives because, in our view, previous scholars have not sufficiently appreciated the importance of voting rights for maintaining the primacy of shareholders among stakeholders.\textsuperscript{10}
The intuitive appeal of the SEN as a principle of corporate governance is that it seems fair to let stakeholders have a right to voice their concern and be part of the decision process for issues that affect them. It seems justified on the grounds that Justice as Fairness is to be understood as a broad egalitarian conception only to be departed from when it is to the benefit of the least advantaged. However, it is essential to recognize that Rawls’ theory is narrow in scope and only applies to the basic structure. Justice as fairness does not concern itself with inequalities among stakeholders, but rather potential inequalities among relevant parties in the original position who view the most and least advantaged in terms of access to social primary goods, not what stakeholder group they belong to. From the perspective of the original position, the equal basic liberties of all stakeholders are guaranteed by the basic structure for all citizens.

Phillips et al. (2003: 493) note that “organizations are, to use Rawls’ (1993) terms, voluntary associations rather than a part of the basic structure of society.” This is correct. However there is a difference between the corporate legal form, which is part of the basic structure, and the “associations” (organizations) that citizens create when they engage in commercial enterprise through the corporate legal form. Rawls (2001: 11) writes: “One should not assume in advance that principles that are reasonable and just for the basic structure are also reasonable and just for institutions, associations, and social practices generally. While the principles of justice as fairness impose limits on these social arrangements within the basic structure, the basic structure and the associations and social forms within it are each governed by distinct principles in view of their different aims and purposes.”

The appeal of the SEN as an egalitarian and fair principle among stakeholders is misplaced in the context of Rawls’ theory. Inequalities of status among members of private associations are entirely permissible, and furthermore it is this which the difference principle
sanctions to create the necessary incentives in society for productivity. In a Rawlsian society what matters in arbitrating between the SEN and the SPN is which one is more efficient.

However, it is not our task here to evaluate which of the two norms of governance is most efficient. This is an empirical matter. Arguments have been put forward on both sides. For example, in favor of the superior efficiency of the SPN (generally construed as SVM) Jensen (2002) has argued that economic efficiency requires governance with a single objective function; Sundaram and Inkpen (2004a,b) have argued that control is best exercised by shareholders as residual claimants; and Williamson (1984) has argued that public representation on the board “would come at a high cost if the corporation were thereby politicized or deflected from its chief purpose of serving as an economizing instrument.”

On the other hand, Freeman has argued that corporate management according to stakeholder theory would be more efficient. Freeman (2008: 18) observes that, “If a business tries to maximize profits, in fact, profits don’t get maximized, at least in the real world.” Freeman et al. (2010: 11-12) say: “We believe that trying to maximize profits is counterproductive because it takes attention away from the fundamental drivers of value – stakeholder relationships. There has been considerable research that shows that profitable firms have a purpose and values beyond profit maximization.” The central idea here is that members of an organization will not be inspired or motivated by an explicit goal of profit maximization and that for the most profitable corporations profit maximization in this regard is incidental.11

In sum, our analysis suggests that from a position of liberal political philosophy (in this instance represented by Rawls’ Justice as Fairness) the main arbiter in the debate between shareholder theory and stakeholder theory is not an ethical or political criterion, but which norm of governance is more economically efficient.12
LIBERTARIANISM AND THE LEGITIMACY OF THE SPN

The starting point for libertarian political thinking differs starkly from the liberal one. Where liberalism regards society as fundamentally a cooperative exercise where the state has a central role in administrating that cooperation (both positive and negative rights), libertarianism starts from the negative rights of the atomistic individual outside a social context and then argues towards the limited role of the state in protecting those negative rights.

**Friedman / Nozick**

Friedman, who advocated shareholder theory (and thus the SPN), was a noted libertarian (Arnold, 2003). One of his primary arguments in favor of the SPN was that “[i]n a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business” (1970), and thus executives should act in the interest of their employers. According to Friedman, to act contrary to shareholder interests “would constitute a violation of the liberty rights of stockholders” who are entitled to dispose of their property as they see fit (Nunan, 1988: 891). The concept of ownership and the rights attached to private property thus carry much weight in his advocacy of shareholder primacy. He says that property rights are “the most basic of human rights and an essential foundation for other human rights” (Friedman & Friedman, 1998: 605). However, for our present purposes “the key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them.” (1970).

The starting point for Friedman’s thinking on the role of the state was that of the atomistic individual. Friedman’s (1962) argumentation rhetorically appeals to the lone and self-sufficient “Robinson Crusoe” on his island where social cooperation is primarily in the form of economic exchanges among a collection of Robinson Crusoes on other islands. This conjures up images of man unto himself with dominion of his surroundings. Friedman firmly
believed in the importance of strong private property rights but primarily argued for them on
the basis of their instrumental importance for other rights that would leave the individual “free
to choose”. He says that “economic freedom is an end in itself” and an “indispensable means
in the achievement of political freedom” (1962: 8). However his justification for economic
freedom being an end in itself (and thus presumably requiring strong private property rights to
dispose of property freely) is quite thin. It primarily rests on the assertion that “economic
freedom, in and of itself, is an extremely important part of total freedom” (1962: 9). In fact,
his main argument is instrumental on the grounds that economic freedom “promotes political
freedom because it separates economic power from political power and in this way enables
one to offset the other” (1962: 9). In other words, private property is the cornerstone of
economic freedom which in turn is also necessary for political freedom because only then can
empowered dissent against the government exist. This instrumental justification for economic
freedom is also consistent with his view on the nature of property rights. Friedman regards
property rights as a “complex social creation” that is defined by government. As such
property rights are created by us to serve instrumental purposes, although for Friedman those
purposes are very fundamental.

Nozick, on the other hand, decided that he would try and establish property rights as
fundamental in and of themselves. Nozick, who started off with strong socialist political
views, became inspired by Friedman and Hayek and later came to write Anarchy, State, and
Utopia, which is arguably the most influential libertarian text of the twentieth century.

Nozick opens Anarchy, State and Utopia by saying: “Individuals have rights, and
there are things no person or group may do to them (without violating their rights). So strong
and far-reaching are these rights that they raise the question of what, if anything, the state and
its officials may do… Two noteworthy implications are that the state may not use its coercive
apparatus for the purpose of getting some citizens to aid others, or in order to prohibit
activities to people for their own good or protection” (1974: ix, italics as per original).

For our present purposes the rights of relevance are property rights, in particular
shareholder rights. Would Nozick agree to extend voting rights to non-shareholder
stakeholders? He advocates property rights that are almost absolute and cannot be infringed
upon by the state in order to benefit others. Nozick goes as far as to say that “[t]axation of
earnings from labor is on par with forced labor” (1974: 169).

Nozick presents two arguments to justify property as an absolute right. The first is
known as the self-ownership argument. It tries to show how individuals can legitimately
acquire previously unowned things (in a hypothetical “state of nature” consisting of atomistic
individuals), which then become holdings that they are entitled to. For Nozick, the argument
is not that we mix our labor with unowned objects (as was argued by John Locke), but rather
that we own ourselves (in body and mind) and therefore we own everything that flows from
these natural endowments. When we labor we add value to external objects through our
natural endowments, and because we own our natural endowments we also come to have
property rights over external objects. However, it is not sufficient that we improve external
objects with our natural endowments in order to yield absolute property rights over those
objects if the appropriation of unowned objects might worsen the situation of those who do
not have the opportunity to appropriate. Nozick believes that this condition is usually met
because even though all natural resources may already have been appropriated, those being
born now need not be worse off because of the economic synergetic effects that come with
private property. Private property rights are said to allow the productive members of society
to gain, which in turn creates labor opportunities for all, which leaves “enough and as good
as” for others. Kymlicka (1990) explains that property rights enable markets, and markets are
efficient and give synergies, making people who cannot acquire property initially better off
than if there were no property rights. For Nozick, the concept of self-ownership together with the "enough and as good as" proviso are sufficient to yield absolute property rights that may not legitimately be violated by the state.

The second argument is known as the consent argument. It essentially says that the free and consensual market exchanges among individuals will lead some individuals to earn more than others, but because the exchanges are consensual there is no basis for the state to intervene to redistribute from some individuals to others. Nozick reasons that if part of your earnings are taken in the form of taxation, then part of the time you are working is for free, and this is "on par with forced labor". Nozick adheres to the Kantian dictum that people should always be treated as ends in themselves and never as means and suggests that high earners are used as mere means for those who earn less, as income is redistributed from the well off to the less well off. This adds to his argument for absolute property rights because if property rights are not absolute then people may be used as mere means without their consent.

Now what does this mean for extending voting rights to non-shareholder stakeholders? If we conceive of the corporation as the property of shareholders then absolute property rights imply absolute control rights over that property. In other words, those stakeholders that are not owners have no right to control the corporation unless explicitly requested to do so by the shareholders. Extending voting rights to non-shareholder stakeholders would infringe upon the control rights of shareholders. In fact, according to this view, current shareholder control rights are likely to be seen as too weak and should extend beyond merely voting for the board of directors.

Interestingly, both Nozick and Rawls adhere to the Kantian dictum of treating people as ends in themselves and not merely as means. People are not to be used for the benefit of others and this puts limits on what individuals may do to one another. “The debate between liberal egalitarians like Rawls and libertarians like Nozick and Milton Friedman is a
prominent feature of political argument in modern democratic societies. This debate reflects disagreement about what the correct principle of distributive justice is” (Sandel, 2008: 205). This is seen in their different interpretations of Kant’s categorical imperative. Kymlicka (1990) points out that Rawls and Nozick differ on the question of which rights are most important in treating people as ends in themselves. Rawls prioritizes rights to a certain share of society’s resources, while Nozick prioritizes the right over oneself which for Nozick implies absolute property rights. Seeing society as a fundamentally cooperative exercise, Rawls believes that we have both negative and positive rights, whereas Nozick, who regards individuals atomistically, only views us has having natural negative rights. ¹⁴

**Freeman**

Freeman too believes that it is a moral imperative that people never be treated merely as means and this forms the normative foundation for his stakeholder theory. Evan and Freeman write: “The right to property does not yield the right to treat others as means to an end. Property rights are not license to ignore Kant’s principle of respect for persons. Any theory of the modern corporation that is consistent with our considered moral judgments must recognize that property rights are not absolute” (2003: 100).

For Freeman, a libertarian defense of normative stakeholder theory cannot be grounded in the property rights of shareholders (Freeman & Phillips, 2002). Instead “[t]he hallmark of libertarian theory is one of consent and agreement.” (Freeman & Phillips, 2002: 341). In order for stakeholders not to be used merely as means they ought to have a right to participate in the decisions that affect them. If corporations use stakeholders as means then at a minimum stakeholders “must agree to and hence participate (or choose not to participate) in the decisions to be used as such.” (Evan & Freeman, 2003: 100). In other words there needs to be *consent* and *agreement* from all the parties affected by managerial decisions in order to meet Kant’s categorical imperative. ¹⁵
Compared to Friedman and Nozick, Freeman shifts focus from property rights to the right of self-determination, thus giving stakeholders a way to influence decisions that affect them. Self-determination is achieved by giving stakeholders participation rights in decisions rather than arguing that their property cannot be infringed upon. Would Freeman extend voting rights to non-shareholder stakeholders? As we noted earlier Freeman and Evan (1990) do endorse extending voting membership on the board for stakeholders, and this is one way of enabling stakeholders to participate and influence the decisions that affect them. Freeman et al. say that the “idea of stakeholder boards of overseers is actually quite interesting…. It may well turn out that such a board becomes a very effective “governance mechanism” to help managers create as much value as possible for stakeholders.” (2010:19).

EXOGENOUS vs. ENDOGENOUS SAFEGUARDS

All parties to the debate as we have framed it believe that safeguards are necessary in order to protect stakeholders and citizens more generally from the potential externalizing harms of business. However, disagreement abounds regarding whether such safeguards should be externally imposed (exogenous) or internally imposed (endogenous), as well as how extensive such safeguards should be.

Exogenous Safeguards

Irrespective of whether a Rawlsian society (on reflection of empirical considerations of economic efficiency) ends up endorsing the SPN or the SEN, it would endorse exogenous safeguards. According to Rawls (2001), the principles of justice are realized in a “property-owning democracy” (though they could also be realized in societies that do not have such private ownership). Such a society would ensure the widespread ownership of productive assets and human capital ex ante (rather than redistributed ex post) so that the distribution that results from the exchanges and agreements of citizens is just as a matter of pure procedural justice. Once the basic structure is set up, “individuals and associations are then left free to
advance their (permissible) ends within the framework of the basic structure, secure in the knowledge that elsewhere in the social system the regulations necessary to preserve background justice are in force” (Rawls, 2001: 54). For example, this means a set up with appropriate political institutions (Liberty Principle), a public education system (Equality of Opportunity Principle), and inheritance taxes (Difference Principle). By following the publicly recognized rules, the basic liberties and the fair distributive shares of citizens are realized.

In a Rawlsian society, neither the SPN nor the SEN would be unfettered because the corporation is embedded and regulated by the basic structure. Rawls (1999: 63) says that “Free market arrangements must be set within a framework of political and legal institutions which regulates the overall trends of economic events and preserves the social conditions necessary for fair equality of opportunity.” When this is achieved, markets and the actors within them can be left to take care of themselves. However, the pursuit of shareholder interests would be constrained by regulation, such as employment law (e.g., to ensure equal opportunity), market regulation (e.g. to regulate product safety), competition law (e.g., to avoid excessive market power), environmental law (e.g., to regulate externalities), and tax legislation (e.g., to provide redistributive effects). When this system of background justice is in effect, corporate activity will result in social cooperation (internally) and competition (between corporations) that is just for society as a matter of pure background procedural justice.

Boatright (2002: 1849) notes that “the stockholder and stakeholder theories disagree not about whether third parties ought to be protected from unjust harm, but how best to provide this protection.” Many concerns that stakeholder theorists wish to address are taken care of by the background institutions in Rawls’ theory and primarily through laws protecting the interests of the different stakeholder groups, as suggested above. Referred to as exogenous
safeguards by Freeman and Evan (1990: 346-347), they “effectively constrain the pursuit of stockholder interests at the expense of other claimants of the firm… they force management to balance the interests of stockholders and themselves on the one hand with the interests of customers, suppliers and other stakeholders on the other.”  

Exogenous constraints on corporate behavior that are part of the basic structure can also stretch beyond legislation. For example, the state can grant other legal forms, such as the non-profit corporation, that act as vehicles through which citizens can organize to pursue special interests. One such special interest can be the monitoring of corporate behavior, as is currently the case with many nongovernmental organizations (NGOs) (Campbell, 2007). Nevertheless, NGOs cannot be allowed free rein in their activities merely because they do not operate from a profit motive. They can suffer from the same legitimacy problems as corporations, not being democratically legitimate representatives of the citizens (Scherer & Palazzo, 2007).

To the limited extent that Friedman/Nozick would impose safeguards on corporate behavior, those safeguards would be exogenous rather than endogenous. Recall that Friedman asserted that the social responsibility of business is “to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game” (1962: 133, our emphasis). In other words, corporate managers ought to work so as to realize the interests of the owners subject to exogenous constraints. Their belief in absolute property rights inhibits endogenous constraints that allow non-shareholder stakeholders from infringing on the owners’ right to control their property. However, as libertarians they do also believe in strong negative rights of non-interference which importantly precludes harming others. The limited role of the state is to put in place the legal and enforcement institutions that are needed to guarantee contracts and protect negative rights. The envisioned limited role of government implies that such a system of government would espouse limited exogenous
constraints and regulation. For example, Friedman (1979) believes there is a role for government to play in rectifying market-failures such as addressing negative corporate externalities (“neighborhood effects”) such as environmental pollution. However, he cautions against too readily turning to the government as a solution. “The imperfect market, may after all, do as well or better than the imperfect government” (1979: 218). Friedman would regard extensive regulation to be a distortion to the efficiency of the market, while Rawls would regard it as essential to frame the market so that the interactions lead to a just result.

**Endogenous Safeguards**

Instead of such exogenous constraints, Freeman and Evan (1990) propose a theory with *endogenous* safeguards that do not externalize the costs of activities among contracting parties on others. (A simple way to understand the demarcation between endogenous vs. exogenous constraints is that the former involves corporate self-constraint while the latter involves externally imposed constraints.) However, for Rawls, it is essential that the safeguards are exogenous as his theory regards the basic structure as the primary subject of justice. The justificatory difference between Freeman and Rawls stems from their different libertarian and liberal starting points. Freeman and Evan (1990) object to exogenous constraints primarily on two fronts: 1) that endogenous constraints are more effective in protecting stakeholder interests, and 2) that exogenous constraints externalize contracting costs onto society.

First, Freeman and Evan (1990) wish to grant stakeholder voting membership on the board because it is seen as more *effective* in protecting stakeholders’ interests. In essence, they take the view that safeguards that are created endogenously to the corporation through bilateral contracting between the corporation and stakeholders, together with the more general safeguard of board stakeholder representation, will always be more effective than exogenous stakeholder safeguards imposed by government. This view is maintained because government
cannot legislate in a manner that is tailored to the particular circumstances of stakeholders of individual corporations. However, it is not clear that endogenous safeguards always are more effective (or more efficient) for protecting stakeholder interests. Although Freeman and Evan are correct in their view that government cannot tailor its safeguards to every corporation, there will be many circumstances when exogenous safeguards through government regulation are both more effective and more efficient. For example bilateral-agreements may not give effective protection to one party if the other party is in a significantly stronger bargaining position, and this is not circumvented by equal voting membership on the board because any stakeholder group in a system of voting is subject to the risk of minority oppression. Exogenous safeguards can on the other hand give protection to stakeholder groups irrespective of the internal contractual dynamics of the corporation. Boatright (2002: 1842) believes that stakeholder theorists regard the shareholder-management relationship as an ideal for treating all stakeholders, but that “stakeholders usually derive little benefit from the set of rights negotiated by shareholders and generally prefer other safeguards for their interests. Instead of seeking a seat on the board of directors or the benefit of fiduciary duties, consumers, for example, settle for manufacturers’ warranties, consumer and product safety laws, and a tort liability system.” Furthermore, it can also be argued that exogenous stakeholder protections that are applicable to all corporations can be much more efficient for protecting the interests of stakeholders as it saves the contracting of each of these safeguards for every corporation for every stakeholder group (Child & Marcoux 1999).

Moreover, although formal constraints (endogenous or exogenous) are important, one should not characterize stakeholders as helpless minions at the mercy of all-powerful managers. Stakeholders are capable of engaging in strategies to further their own ends (Frooman, 1999). Just as managers can engage in the management of stakeholders, stakeholders can engage in the management of managers. However, there will be differing
power relationships and therefore different strategies across stakeholders if they are to get what they want (Mitchell, et al. 1997).

Second, Freeman and Phillips (2002: 335) think that “Rawls’ first principle of justice is a paradigm case of a libertarian principle.” The first principle accords with them because it sets out the liberties of individuals and essentially puts forward negative rights of non-interference. However, the second principle would seem to be unacceptable because it affords citizens of the state positive rights which require the use of social resources that would involve a redistribution of wealth. For libertarians, positive rights only arise through individual consent and, moreover, state aid may violate some negative rights (such as the right not to have one’s property infringed upon) through the need for taxation. This helps explain Freeman and Evan’s second objection to exogenous safeguards that their costs “are spread over the entire society” (1990: 347). The cost of legislating and enforcing government regulation is spread across citizens, usually through taxation. This is objectionable to libertarians because it imposes costs on third parties to corporate contracting (without their consent). In other words those, and only those, who engage in contracting should bear the full costs that result from their agreements. However, for liberals and Rawls in particular, there is nothing objectionable per se for society to bear third party costs if this results in a fairer basic structure. Furthermore, it would be practicably unworkable and inefficient to internalize all the potential external costs of contracting as every potentially affected third party would need to engage in the contracting and be compensated bi-laterally (Child & Marcoux, 1999).

In a Rawlsian society, the corporate legal form, as part of the basic structure, would be regarded as an instrument to be used by citizens as allowed by the state. On the other hand Freeman, and libertarians more generally, regard the corporation as a nexus-of-contracts where the corporation is conceptualized as a set of voluntary agreements that should be self-enforcing in order to limit the role of the state (Freeman and Phillips, 2002). This helps
explain the different uses of exogenous and endogenous controls. With Rawls, the state provides a corporate legal form which is part of the basic structure where the exogenous controls provide a playing field that procedurally leads to a just outcome when individuals act within the rules, while for Freeman justice results from responsible individuals respecting the fundamental rights of others when contracting freely and through this process of contracting form corporations.

**SPN vs. SEN**

Both the SPN and the SEN operate on the inside of the corporation as norms of corporate governance. As such, these norms are about how corporations achieve their goals. From a liberal viewpoint that goal is efficient production within constraints, while from the libertarian viewpoint the goal is decided by the rights holders; in the case of Nozick by the shareholders, and in the case of Freeman by the stakeholders.

For liberals like Rawls, property rights are instrumental for enabling an efficient economy and likewise the choice between the SPN and the SEN also falls to efficiency. For libertarians the instrumental aspect of property is also important as is seen in the justification for Nozick’s “enough and as good” proviso, but primarily property is fundamental as a natural right irrespective of its beneficial consequences, which in turn leads to the advocacy of absolute property rights. “When Robert Nozick argues for the necessity, for reasons of justice, of guaranteeing individual liberties including the rights of property ownership… he is ready to leave matters in the hands of these institutions [needed to enable a legal and economic framework] rather than calling for any revision based on an assessment of outcomes” (Sen, 2009: 84). Similarly, with Freeman, although he believes that stakeholder theory on an instrumental interpretation will lead to the best outcome, normatively it is based on the rights of stakeholders to participate in the decisions that affect them irrespective of the consequences for the corporation.
Both shareholder theory and stakeholder theory are capable of sharing libertarian foundations through a nexus-of-contracts view of the corporation. On a libertarian interpretation, shareholder theory results from the nexus-of-contracts when a strong focus is placed on the property and control rights of shareholders, while stakeholder theory results when emphasis is placed on the stakeholders’ rights to participate in decision-making. Furthermore, shareholder theory and stakeholder theory are also capable of having foundations within political liberalism. Rawls’ theory might endorse the SPN or the SEN depending on which is found to be empirically most efficient. Rawls’ political liberalism advocates exogenous safeguards in order to protect citizens and as such protects them across the range of stakeholder hats they might wear. With the SPN, a Rawlsian society would constrain corporations with extensive regulation, while with the SEN, exogenous constraints might be more moderate due to its self-regulating nature.

Mintzberg (1985) provides a useful categorization of the different perspectives that have been put forward regarding who should control the corporation. This categorization is in the form of a “conceptual horseshoe” that places the different perspectives on a spectrum from purely social justifications where the corporation is nationalized, to purely economic justifications where the shareholders have complete corporate control. The preceding positions that we have discussed can be seen to fall into this spectrum of categories. Stakeholder theory in its Freemanite guise would fall under the category of “Democratize it”, implying that employees and other stakeholders have a right to be part of the corporate decision-making process. Rawls’ theory of justice, whether or not it endorses the SPN or the SEN, would fall under the category of “Regulate it”, showing the importance of exogenous constrains. And finally, shareholder theory in its Friedmanite/Nozickian guise would fall under the category of “Restore it”, implying that full corporate control rights need to be restored to the shareholders. Mintzberg suggests that in practice none of the positions can be
relied on exclusively. “I believe that we need to treat the conceptual horseshoe as a portfolio of positions from which we can draw, depending on circumstances. Exclusive reliance on any position will lead to a narrow and dogmatic society” (1985: 61).

The shareholder vs. stakeholder debate has played out over the years primarily as a normative debate between competing positions within moral philosophy, with utilitarian arguments often offered in favor of shareholder theory and deontological arguments often offered in favor of stakeholder theory. This is perhaps one of the reasons why the debate has not come much closer to a resolution. The two main normative branches of moral philosophy (utilitarian and deontological) are irreconcilable; either consequences are fundamental or principles are fundamental. Much the same can be said about different positions within in political philosophy. However, political philosophy, unlike moral philosophy, is not fundamentally about how we should treat each other, but rather about the terms upon which we should live and cooperate together and the principles that should govern the institutions that administer that cooperation. Philosophically, there is little consensus as to whether liberal or libertarian modes of government are preferable, but there is a consensus (or as close as we will ever get to a consensus) that the process for resolving such differences is called democracy. Democracy allows citizens to choose how they should be governed and this offers a practical solution to differing normative conceptions of political justice. Through a consensus to abide by the political principles of government that result from a democratic process, an actual choice is made in favor of one political philosophy over another. In this way, by regarding the shareholder vs. stakeholder debate primarily in terms of political philosophy, we can deem acceptable whichever of the two positions that results in any (well functioning) democracy.

How the differences between political conceptions affect the CSR initiatives of corporations in different nations is brought to the fore in the paper by Matten & Moon (2008)
on implicit and explicit CSR. “Explicit CSR” is defined as “corporate policies that assume and articulate responsibility for some societal interests” (2008: 409). To the extent that corporations engage in explicit CSR, it is more prevalent in the US where belief in individual responsibility and small government lead managers/owners to assume moral duties towards their stakeholders. On the other hand, “implicit CSR normally consists of values, norms, and rules that result in (mandatory and customary) requirements for corporations to address stakeholder issues that define proper obligations of corporate actors in collective rather than individual terms” (2008: 409). Implicit CSR is more prevalent in Europe were there is a greater acceptance of collective responsibility and large government with attendant regulation.

Neither European countries nor the US are entirely liberal or libertarian in the manner that we have presented the respective political philosophies in this paper, but there is a tendency towards large government and small government respectively, and this is related to liberal and libertarian justification which influence the nature and extent of exogenous and endogenous safeguards for stakeholders. In well functioning democracies, both shareholder theory and stakeholder theory, whether with endogenous or differing degrees of exogenous safeguards, must be regarded as acceptable.19

CONCLUSION

At the core of the basic debate in business ethics is the legitimacy of the shareholder primacy norm and thus whether managers should focus primarily on shareholder or stakeholder interests. This paper offers four key conclusions on the debate: 1) A recognition of the importance of voting rights for perpetuating the SPN leads to the Stakeholder Equality Norm as an appropriate operationalization of stakeholder theory with the SEN as a competing norm of governance to the SPN; 2) A Liberal society (Rawls) would arbitrate between the SPN and the SEN based on which is economically most efficient; 3) A Libertarian society (Fiedman/Nozick; Freeman) would arbitrate between the SPN and the SEN based on how one
interprets the right to self-determination; either it requires absolute property rights for shareholders or it requires an equal right for stakeholders to participate in decision-making; 4) The debate between shareholder theory and stakeholder theory is framed by liberal and libertarian justifications that primarily hinge on whether and to what extent one should have exogenous or endogenous safeguards.

Drawing on stakeholder theory as the competing theory to shareholder theory, we formulate the Stakeholder Equality Norm as the alternative norm of corporate governance to the SPN. The SEN extends an equal right to vote to stakeholder representatives on the board which gives equal representation for each constituency and leads to the removal of shareholder primacy (as it is the sole right to vote for the board that establishes the SPN).

Contrary to what one might first assume, but in keeping with Rawls’ egalitarianism, we then argue that the choice between shareholder primacy and broader stakeholder considerations does not hinge on deliberations of fairness in a Rawlsian society but on which governance principle is best from the perspective of economic efficiency. This is because the unit of analysis for Rawls is the citizens of society and not corporate stakeholders. Hence, when the basic structure fully realizes the two principles of justice, the primary arbiter among economic systems is efficiency to the benefit of the least advantaged. However, neither the SPN nor the SEN would be unfettered in a Rawlsian society. In Justice as Fairness the basic structure would impose exogenous constraints on management mainly through legislation that aims to regulate corporate behavior in line with Rawls’ two principles of justice.

On the other hand, libertarian political philosophy is also capable of endorsing both the SPN and the SEN depending on how one interprets the right to self-determination. Friedman/Nozick regard absolute property rights as fundamental to self-determination, otherwise property owners are used merely as means when others have control rights over the property that they have labored for. On this interpretation, the SPN is endorsed to guarantee
the corporate control rights of shareholders. Freeman, on the other hand, regards a right to participate in the decision-making process over issues that affect stakeholders as central to not treating stakeholders merely as means. On this interpretation, the SEN is endorsed to extend corporate control rights to a wider group of stakeholders than merely shareholders.

It is interesting that all parties to the debate (Rawls, Nozick, and Freeman) claim to have Kantian foundations that adhere to the categorical imperative. For Rawls it requires both negative and positive rights on a societal level that protect citizens from harms as well as extending a right to share in society’s resources so that liberties may be exercised; for Nozick it implies absolute rights to property to avoid “forced labor” of property owners; and for Freeman it implies decision-making rights to enable consensual stakeholder relations.

Finally, our analysis shows that the issue of how corporate behavior should be constrained cuts to the heart of the basic debate between shareholder theory and stakeholder theory. Shareholder theory promotes exogenous safeguards while stakeholder theory tends to promote endogenous safeguards, and the justifications for these differences essentially reduce to a debate between political liberalism versus libertarianism. Liberalism tends towards strong exogenous safeguards (Rawls, SPN or SEN), while libertarianism tends towards either weak exogenous safeguards (Friedman/Nozick, SPN) or endogenous safeguards (Freeman, SEN).

The basic debate between shareholder theory and stakeholder theory thus becomes a matter of liberal and libertarian interpretations applied to corporate constituencies. Therefore political philosophy is significant to both business ethics and corporate governance because of the potential constraints placed on the corporation by the state. By regarding the debate as one founded on political philosophy this provides a practical resolution to the conflict through an acceptance of the outcome of the democratic political process.
REFERENCES


**END NOTES**

1 It should be noted that Freeman himself rejects this characterization because he does not regard stakeholder theory as opposed to the satisfaction of shareholder interests. Rather he regards shareholder theory as encompassed by stakeholder theory (Freeman et. al., 2010).

2 With the introduction of the business judgment rule the SPN became **unenforceable**, but it was only with the introduction of non-shareholder constituency statutes that it ceased to be **prohibited** for managers to consider non-shareholder interests.

3 Anderson (2000: 170) defines a social norm as “a standard of behavior shared by a social group, commonly understood by its members as authoritative or obligatory for them.”
Justice as Fairness is not a moral theory that asks people (or managers) to be impartial in their treatment of others (or stakeholders); rather it is a political theory that asks the basic institutions of society to follow the two impartial principles of justice in their treatment of all citizens (irrespective of what stakeholder group they belong to). Citizens do not fall into discrete stakeholder groups; each individual citizen can belong to any...
number of stakeholder groups depending on their numerous relationships with corporations throughout society. As a political theory, Justice as Fairness covers the concerns of all stakeholders by virtue of their status as citizens. The basic structure seen as a coherent whole is egalitarian in its treatment of citizens (but that does not necessarily translate into egalitarian principles of how managers treat different stakeholders).

13 Technically the law separates the corporation and its assets from the shareholders. The corporation owns itself, while shareholders own shares as a separate form of property (Pickering, 1968). However, the fiduciary duties imposed on managers in common law are due to early judicial depictions of their relationship with shareholders as one of trust (e.g. Berle, 1931; 1932). Managers were considered *trustees* for the shareholders who were the owners of the corporation. Despite the mid-19th century separation of the corporation from its shareholders in terms of ownership, important features of the structure of corporate law that came with the earlier depiction remained, both in terms of fiduciary duties and more importantly in terms of voting rights of shareholders (Tricker, 2009). Although shareholders do not technically own the assets of the corporation, the spirit of the law still treats them as owners and gives them the power to direct the corporation through their voting rights.

14 Rawls and other liberals hold that positive rights, which may interfere with some negative rights, are necessary to make the negative rights meaningful. For example, the liberty to pursue one’s own destiny is vacuous unless one has some means (income and wealth) with which to pursue it (Nagel, 1975).

15 Although Freeman explicitly argues for a libertarian defense (Freeman & Philips, 2002) as well as a Kantian defense (Evan & Freeman, 2003) of normative stakeholder theory, the connection between the two has not been explicitly made before. This connection does seem palpable given Freemans rejection of absolute property rights, his concern with consent and agreement making, as well as his adherence to not treating people merely as means. This connection is made stronger by noting how other libertarians like Nozick also ground their theories in an adherence to Kant’s categorical imperative.

16 Friedman and Nozick do not disregard the importance of self-determination, but they see absolute property rights as necessary for the self-determination of property owners whereas Freeman sees absolute property rights as inhibiting the self-determination of those who are not the property owners.

17 Note that voting rights for the board of directors in a Rawlsian society qualify as an exogenous safeguard because they are part of the corporate legal form that is part of the basic structure. However, voting rights have the property of operating internally by making directors and managers responsive to the interests of the voting right holders. As such, one would imagine that the SEN would entail a diminished need for other exogenous safeguards for stakeholders as it is designed to respond to stakeholder concerns internally.

18 Certainly attempts have been made to reconcile the two, such as rule utilitarianism, but the fundamental conflict regarding the mode of argumentation in terms of either consequences or principles still remains.

19 Varying degrees of exogenous and endogenous safeguards on corporate behaviour are today influenced at the political level by liberal and libertarian sentiments regarding the role of government. However, if the democratic political process is to truly provide a resolution to the shareholder vs. stakeholder debate, then the debate itself (rather than just the extent of safeguards) needs to be politically and directly debated.
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