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Abstract:

This article argues that shareholder primacy cannot be defended on the grounds that there is something special about the position of shareholders that grounds a *right* to preferential treatment on part of management. The notions of property and contract, traditionally thought to ground such a right, are now widely recognized as incapable of playing that role. This leaves shareholder theorists with two options. They can either abandon the project of arguing for their view on broadly deontological grounds and try to advance consequentialist arguments instead. Or they can search for other morally relevant properties that could ground shareholder rights. The most sustained argument in that vein is Marcoux's (2003) attempt to show that the *vulnerability* of shareholders mandates that managers are their fiduciaries. I show that this argument leads to the unacceptable conclusion that it would be unethical for corporations to make incomplete contracts with non-shareholding stakeholders.

Keywords: Shareholder Primacy; Stakeholder Theory; Marcoux; Vulnerability of Shareholders; Business Ethics.

Shareholder Primacy and Deontology

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1. Introduction

The shareholder primacy view, i.e. the idea that the management of business corporations ought to strive to maximize shareholder value, is not particularly popular with many business ethicists. Indeed, it seems fair to say that the shareholder view is the principal foe of mainstream business ethics (cf. e.g. Green, 1993, p. 1410; also Mitchell, 1993; Attas, 2004; Ferrero et. al. 2014). This status is underlined by the fact that the most influential paradigm in business ethics in the last three decades, the stakeholder paradigm, was developed (and named) explicitly as a response to the shareholder view (cf. Freeman, 1984). Milton Friedman's (in)famous New York Times Magazine article from 1970 is included in most business ethics textbooks and often read towards the beginning of business ethics courses. But more often than not Friedman's contention that, as the provocative title of the piece put it, “the social responsibility of business is to increase its profits” is not really given a hearing in that context (Friedman, 1970). As far as students of business ethics are taught in many introductory courses, Friedman might as well have said that “the social responsibility of business does not exist.” That is to say the shareholder view is often treated not as a genuine theory of business ethics, but rather as an expression of the (mistaken) view that there is no need for business ethics.² This is a misrepresentation. The shareholder view places genuine constraints on the behaviour of corporate managers by making them *fiduciaries* of shareholders. And this means that managers are not allowed to pursue their own self-interest. After all, maximizing profits is not the same as maximizing management's compensation packages (Chan 2008).³ And, considering the exponential rise of C-level executive compensation over the last few decades, it is not unreasonable to think that the moral demands made by the shareholder view could underwrite many of the complaints of the *Occupy* movement (Matsumura/Shin 2005). That being said, however, the ethical constraints endorsed by the shareholder view are rather minimal. While managers are not allowed to enrich themselves, if they could increase profits instead, there are no further ethical

1 For helpful comments on earlier versions of this paper, I would like to thank Joseph Heath, Chris MacDonald, Sareh Pouryousefi, Andreas Tupac Schmidt, as well as two anonymous referees.

2 This is not to say that serious scholars of business ethics make that mistake, nor that all textbooks do.

3 This remains the case even when executive compensation is tied to stock prices or other performance measures.

restrictions – as long as a strategy is profit maximizing it is moral.⁴ Thus, the shareholder view concurs with the sentiment that shenanigans like the ones at *Enron* were immoral – Ken Lay, Andy Fastow and others made out like bandits while leaving shareholders with worthless stock of a bankrupt company. But many people feel that the ruthless pursuit of profit, emblematically typified by WalMart in the US, is also morally problematic; and the shareholder view does not have anything to say about that. Thus, whether the shareholder view is treated as the denial of a need for business ethics, or as a (minimal) theory of business ethics, the important point is that very few business ethicists think that the view is acceptable.

Yet, the labours of business ethicists notwithstanding, the shareholder view is the dominant view in American corporate law. In those circles the view is so widely accepted that Henry Hansmann and Reinier Kraakman can confidently assert the “End of History for Corporate Law” (Hansmann/Kraakman, 2000). In the abstract of the paper of that title they describe what they see as “the widespread normative consensus that corporate managers should act exclusively in the economic interests of shareholders including noncontrolling shareholders” (Hansmann/Kraakman, 2000), in other words: the shareholder primacy view. This is a striking disconnect. How can a view that is all but universally rejected in the business ethics community nevertheless be the *normative consensus* in corporate law? It would seem like lawyers and ethicists need to pay more attention to each other's arguments, for clearly at least one side is missing something. In this article, I will clear some ground to facilitate such a dialogue.

There are, very broadly speaking, four different arguments in favour of the shareholder primacy view (for a similar classification cf. Heath, 2011). The first makes appeal to property rights and says that since shareholders are the owners of corporations, they have a right to reap all the benefits that come of it. The second argument, which we may call the *contractual argument*, claims that managers are obliged to maximize shareholder value, because that is what they were hired to do. Traditionally, these arguments were quite important and they continue to fuel a lot of popular rhetoric about corporate governance. However, as the scholarly debate has advanced, it has become widely recognized that these arguments cannot stand on their own (cf. Greenfield, 1997, p. 47; Heath, 2011, p. 8). At best they can serve to enhance the case for shareholder primacy once it has gotten off the ground on the strength of some other arguments. I show why these arguments, when unsupported by other considerations, are

4 This is still a bit unfair if one thinks of Friedman (who remarks that profit maximization has to be constrained by respect for both ethical customs and the law); but there are more extreme versions of the view out there – cf. Easterbrook and Fischel, 1982.

question begging, in section 2.

A third line of argument claims that shareholders as a group exhibit some morally relevant property that sets them apart from all other constituency (or stakeholder) groups. It is in virtue of that morally relevant property that shareholders are entitled to the undivided loyalty of management. These kind of arguments are what Joseph Heath has called *moralizing arguments* (Heath, 2011, p. 8), and they have received their clearest articulation in Alexei Marcoux's "A Fiduciary Argument Against Stakeholder Theory" (Marcoux, 2003), where he argues that shareholder primacy is a moral imperative grounded in the special vulnerabilities that shareholder exhibit vis-a-vis management. This argument is my main target in this article. In section 3, I will argue that Marcoux's argument, if sound, would show many business practices to be immoral that are in fact entirely unproblematic from a moral point of view. I further explain why it is unlikely that any other moralizing argument could succeed where Marcoux fails (section 4).

This leaves, fourth, what following John Boatright can be termed the *public policy argument* (cf. Boatright, 1994, p. 401). This is the idea that shareholder primacy is in the best interest of not only the shareholders but all constituency (or stakeholder) groups. This argument is the shareholder view's best (and last) hope, and it is worth noting that it differs from the other three arguments in a significant way. While the first three arguments reflect the traditional concern of shareholder theorists with the *rights of shareholders*, the public policy argument rests on a claim about the *social good* that shareholder primacy is supposed to achieve. Thus, insofar as the public policy argument has gained popularity over the last twenty years, we might speak of a consequentialist turn in the defence of shareholder primacy. While adequately addressing the debate over the public policy argument would go well beyond the scope of the current article, I will briefly discuss the prospects of this line of argument in section 5.

2. The Property Argument and the Contractual Argument

In one of the memorable lines of his defence of the shareholder view, Friedman says that corporate executives who forgo an opportunity to make a profit in order to exercise a perceived social responsibility are “spending someone else's money for a general social interest” (Friedman, 1970). Spending other people's money without their consent is, of course, usually not acceptable. The fact that it is *their* money ordinarily yields a strong presumption that it is *they* who get to decide what to do with it. Friedman's thought is that, since a corporation is owned by its shareholders, they have a right to all (financial) benefits that can be derived from it.

In response to this line of thinking stakeholder theorists have advanced arguments designed to show the falsity of the premise. Corporations are not owned by their shareholders, so the slogan goes, corporations have no owners (cf. e.g. Clarkson, 1998, p. 1; Bowie, 1999, p. 144). I do not think that this rhetoric is particularly helpful. There might or might not be a sense in which shareholders are owners (cf. Boatright 1994, pp. 394-396). The important point is that this sense does not justify the identification of the maximal amount of attainable profits as money belonging to shareholders. To own property is to hold a bundle of rights and there are different kinds of property ownership corresponding to different bundles of rights one might hold. It is quite obvious, for example, that shareholders, as owners of a corporation, do not have the same bundle of rights regarding 'their' corporation as car owners have regarding their cars (cf. Greenfield, 2006, p. 45). Shareholders (even majority shareholders) cannot simply commandeer corporate assets for personal use, or liquidate the corporation by withdrawing their funds. Whether, despite that, shareholders still ought to be called owners is not the important question. The important question is which of the rights typically associated with ownership shareholders should have. And once we put things this way, it is easy to see how defending the shareholder view via an appeal to property rights is question begging. The shareholder primacy view asserts that shareholders should have the right to the exclusive loyalty of management. This is a claim about what rights the bundle associated with 'owning' a corporation should contain. And, plainly, such a claim cannot be argued for by pointing out that shareholders *are* owners of the corporation. For that amounts to nothing more than the claim that they should have *some* bundle of rights.

The appeal to property rights in defence of the shareholder view is hardly more than a rhetorical slight of hand. It depends on a naive understanding of property and as such cannot be part of a serious argument about legitimate corporate objectives. This is reflected in the fact that such appeals, while often made by popular

commentators, are almost entirely absent from scholarly defenders of shareholder primacy (cf. Greenfield, 2006, p. 47).⁵

A much more common argument is the idea that senior executives have a contractual obligation to put the interests of shareholders first. This is the main line of argument in Friedman's piece and it fuels the rhetoric (if not always the argument) of Frank Easterbrook and Daniel Fischel who are among the most prominent recent champions of the shareholder view. They argue that whether profit maximization is the goal of a corporation or not is nobody's business but that of the contracting parties. And since it is shareholders who have contracted for management's loyalty, it is them who get to call the shots (cf. Easterbrook/Fischel, 1989, p. 1421). But while it is often asserted that shareholders contract for the loyalty of management and protection through fiduciary duties, this is actually anything but obvious.

The first thing to note is the all but universal absence of explicit contracts binding executives to the maximization of shareholder value. Neither their employment contracts nor corporate charters typically mention profit maximization as a goal (cf. Stout, 2008, p. 169). The argument, then, has to be that managers have agreed *implicitly* to maximize profit or, more generally, put shareholders' interests first. But it is not easy to see why we should believe this to be the case. One way of arguing for the existence of such implicit contracts would be to point out that the courts will read a commitment to profit maximization into corporate charters or employment contracts. But this is not a viable route, for as a matter of fact courts almost never do this. The high profile of *Dodge v. Ford* notwithstanding, courts have been very hesitant to enforce, or even express a general commitment to, anything close to the shareholder view. The *business judgement rule* pretty much reigns supreme (cf. Marens/Wick, 1999, pp. 275-280; Lee, 2005, pp. 72-73; Stout, 2008, pp. 170-172). One may be tempted to think that the business judgement rule expresses a commitment to shareholder primacy combined with an unwillingness to enforce this particular part of corporate law except in the most egregious cases. But the business judgement rule leaves the question of the corporate objective open. While it asserts that management has a duty of care towards shareholders,

5 It is worth pointing out here that Friedman (and with him many popular commentators) seem to assert that what flows from the owner-status of shareholders is a *moral* (rather than a mere legal) obligation to maximize profits. If the appeal to ownership was meant to show that shareholders have a legal right to have their profits maximized, it would have to be shown that this is in fact what the law prescribes. As we will see presently in the context of the contractual argument, corporate law does not seem to take a stance on this issue, and thus this would not be a promising route to take. In any case, I take it that appeals to ownership are usually meant to make a point not about what the law *does* say, but rather about what it *should* say (on moral grounds).

it explicitly orders them to act in the best interest of the corporation – whether or not the latter should be thought of as identical with the interests of shareholders is precisely the question at issue here and the courts have, wisely, used language that does not commit them to a stance on it.

A second way of attempting to make the existence of implicit contracts plausible can be found in Easterbrook and Fischel's work. They assert that when shareholders invest their money in a standard business corporation they do so with the expectation that their return on investment is the paramount objective of the management team. If management does not run the corporation in the interests of shareholders, they fail to make good on the promises that helped to lure investors to become involved in the first place (cf. Easterbrook/Fischel, 1898, 1446). But this just adds an epicycle to the arguments we have already seen. Profit maximization is rarely promised explicitly (certainly not routinely enough to justify the shareholder view in general, rather than just in particular instances). Thus, the promise has to be implicit. And given the reluctance of the courts to enforce shareholder claims, it is hard to see how shareholders could reasonably form the expectation that their interests would trump the concerns of all other corporate constituency groups. There does not seem to be any good reason, then, to think that the implicit contracts on which the contractual arguments relies do exist.⁶ One might, of course, regret that fact. In particular, one might think that the courts *ought to* read the shareholder view into corporate charters and executives' employment contracts. But this argument would have to be made on independent grounds. As it stands, the contractual argument too begs the question.⁷

6 For a much more detailed examination (and rejection) of the claim that (explicit or implicit) contracts ground shareholder primacy cf. Stout, 2012.

7 That being said, however, it is worth noting that if an independent argument could be given for shareholder primacy – along the lines of the public policy argument discussed below, for example – the contractual argument could serve as a powerful amplifier for the force of such arguments. I think that the most charitable reading of Easterbrook and Fischel would ascribe a position along these lines to them.

3. Marcoux's Fiduciary Argument

We have seen that both the property argument and the contractual argument must assume what they purport to prove, namely that there is a good reason why corporations should be run exclusively in the interests of shareholders. This is where Marcoux's argument becomes pertinent. Marcoux claims that the relationship between shareholders and managers is such that putting shareholder interests first is *morally required* of managers. He thinks that, in their relationship with managers, shareholders display a peculiar kind of vulnerability and that this vulnerability gives them a right to the special treatment recommended by the shareholder primacy view, apart from whether this is required by the contracts they signed or desirable from a public policy point of view: "... shareholders seem to be morally necessary beneficiaries of fiduciary duties – and not merely as a matter of public policy" (Marcoux, 2003, p. 16). In this section, I will examine this argument in some detail. And I will show that, if sound, Marcoux's argument would render all relationships between managers and stakeholders involving incomplete contracts immoral. I take this to be an untenable conclusion amounting to a reductio of Marcoux's argument. Moreover, as we will see, the failure of the argument is instructive, in that it provides good reason to think that no argument resting on some morally relevant characteristic that shareholders are supposed to possess could succeed in grounding shareholder primacy.

Marcoux's argument rests on two premises. (1) It is impossible to be a loyal fiduciary to more than one party. (2) The relationship between shareholders and managers morally mandates that the latter be fiduciaries to the former. If true, these premises would entail a very strong presumption in favour of the shareholder view. In particular, the two premises suffice to close the door for the stakeholder view in both of the two variations it typically comes in (cf. Marcoux, 2003, pp. 2-3). *Multi-fiduciary* stakeholder views adopt the shareholder view's notion of the manager as a fiduciary, expand it, and claim that managers have fiduciary duties to all stakeholder groups (cf. Goodpaster, 1991, pp. 61-63). If Marcoux's (1) is correct, it would seem that such views are conceptually confused (cf. Marcoux, 2003, p. 4). *Non-fiduciary* stakeholder views, on the other hand, do away with the notion that managers are fiduciaries at all. According to such views managers, while not any one group's fiduciaries, have duties of a non-fiduciary form towards all stakeholder groups. If Marcoux's (2) is correct, such views fail to account for the special nature of the manager-shareholder relationship and are thus "morally lacking" (Marcoux, 2003, p. 1).

Marcoux defends (2) by drawing on Robert Goodin's account of special duties that are grounded in 'peculiar vulnerabilities' (cf. Marcoux, 2003, p. 7; Goodin, 1985). The idea is that within contractual relationships fiduciary duties arise whenever one party to the contract is vulnerable to the other in ways (and/or to a degree) that the other party is not vulnerable to them. Following Goodin, Marcoux shows how this model can explain the presence of fiduciary duties within the relationships between doctor and patient, lawyer and client, and guardian and ward (cf. Marcoux, 2003, pp. 7-8). These are relationships in which the vulnerability of one party usually stems from the fact that they are less capable or knowledgeable with regards to how to best advance their own interests. But, according to Marcoux, this is not what does the normative work. It does not matter, he argues, whether my lawyer or doctor knows more about legal or medical procedure than I do. Imagine that I myself am the best lawyer in the world. If I hire another lawyer to represent me, she still has fiduciary duties to me. And this is as it should – indeed must – be, says Marcoux, because even in this scenario I am vulnerable to her. The kind of vulnerabilities, then, that give rise to fiduciary duties are not grounded in intrinsic differences in knowledge and ability between the contracting parties. Rather, they arise out of the contractual arrangement itself. There are two kinds of vulnerability, in particular, that Marcoux points to: *control vulnerability* and *information vulnerability* (cf. Marcoux, 2003, pp. 8-10). Control vulnerability is the result of the fact that one party authorizes the other party act to on its behalf. This means that my “fiduciaries can do many potentially damaging things that I may undo only with considerable difficulty” (Marcoux, 2003, p. 9). Once I have relinquished control, it is also likely that my fiduciary will gain an information advantage over me. In tending to my affairs, she will become more knowledgeable about them than me. This is particularly so in situations in which she also controls the flow of information that I receive (as is usually the case in the relationships between me and my doctor, lawyer, or guardian). That is what Marcoux means by 'information vulnerability'. Having argued that it is the presence of control and information vulnerabilities that morally mandates fiduciary duties, Marcoux goes on to argue that shareholders are both control and information vulnerable to managers (cf. Marcoux, 2003, pp. 12-14). From this, he concludes that the relationship between managers and shareholder is such that, as a matter of morality, the former have to have fiduciary duties to the latter (cf. Marcoux, 2003, p. 16).

Marcoux is certainly right that shareholders display these kinds of vulnerabilities vis-a-vis corporate managers. Once they have invested their money, which they cannot withdraw at will, they effectively turn over

control to management. Managers continue to be involved in the day to day operations of the business with undoubtedly superior access to information about both the state of the business and the quality of their own performance. But while it is relatively uncontroversial that shareholders are thus control and information vulnerable, it is less clear that this is *uniquely* true of shareholders. Before I address that question, let me briefly consider what is at stake by looking at the consequences for Marcoux's argument, if it were true that some non-shareholding stakeholders was also control and information vulnerable to managers. It is easy to see that Marcoux's premises (1) and (2) form an inconsistent triad with: (3) one or more other stakeholder group has a relationship with managers of the kind that morally mandates fiduciary duties. So, Marcoux's original argument goes through only if (3) is false. Marcoux acknowledges this and provides some cursory arguments to the effect that (3) is indeed false (cf. Marcoux, 2003, pp. 16-19). Presently I will argue that these arguments do not hold much water, but for the moment let us simply assume that (3) was true. Given the inconsistency of (3) with (1) and (2), Marcoux would then be forced to give up or weaken one of his original premises. Would there be a way to rescue at least the spirit of his argument?

One could give up or weaken (1), i.e. the claim that it is impossible to be a loyal fiduciary to more than one party. Marcoux's defence of (1) rests on an understanding of fiduciary duties as being duties of (a strong kind of) partiality. He understands partiality to involve putting the interest of the person that you are partial to before everyone else's. Given that understanding, the truth of (1) is evident. It is conceptually impossible to put the interests of more than one group ahead of the interests of all others. And, as Marcoux points out, in the context of managerial decision making this impossibility is particularly pronounced, for there will inevitably be conflicts between different constituency (or stakeholder) groups (cf. Marcoux, 2003, p. 4). However, fiduciary duties are usually described as "the duty of loyalty and the duty of care" (Easterbrook/Fischel, 1991, p. 91). It is not readily apparent why it should be necessary to spell this out in terms of strong partiality. One could weaken the notion of a fiduciary duty, for example, to a duty to give special consideration to the interests of the other party, i.e. to give it more weight in one's deliberations than would be appropriate absent the fiduciary obligation. Plausibly, this could be combined with a duty to disregard one's own self-interest in dealing with that party. Once the notion of a fiduciary duty is weakened in this way, there is no reason anymore to accept (1). And there is some plausibility to such weakening of the notion. For example, the weaker notion I sketched can accommodate the compelling idea

that parents have fiduciary duties towards all of their children, whereas this seems incompatible with the notion involving strong partiality. However, giving up (1) is not an option that Marcoux should find appealing, for it would spell a comeback of the stakeholder theory in its multi-fiduciary form.

Alternatively, one could qualify (2). This is the claim that fiduciary duties arise from the vulnerabilities engendered by shareholder-manager relation considered, as it were, in isolation. Instead, one might say that fiduciary duties arise from the fact that shareholders are the group that is *most vulnerable* to management in these ways, and it is this comparative fact that grounds their entitlement to protection through fiduciary duties. A version of (2) thusly qualified would no longer be in conflict with (an accordingly weakened version of) (3). Thus, Marcoux could argue that while some stakeholders might have the kind of relationship with managers (i.e. be control and information vulnerable to them) that in the abstract might engender fiduciary duties, they are not the group that has that kind of relationship to the highest degree. And since fiduciary duties are owed only to the group that displays control and information vulnerability to the highest degree, the stakeholders cannot lay claim to protection through fiduciary duties. I think that Marcoux's arguments against (3) can *at best* support this weaker thesis (cf. Marcoux, 2003, pp. 16-19). Nevertheless, weakening (2) is not an appealing way of resolving the inconsistent triad. If information and control vulnerabilities engender an entitlement to protection through fiduciary duties, it seems implausible that this should be contingent on being more vulnerable than anyone else. Just imagine your doctor telling you that, as it turns out, your insurance company is more control and information vulnerable than you are; and, thus, from now on he will act as their fiduciary when treating you.⁸ I take it that to anyone who

8 It might be charged that the example is unfair because an insurance company could never be more vulnerable to a doctor than a patient. But I think that this charge rests on an equivocation on the notion of vulnerability. When we say that A is more vulnerable than B we may mean two different things. First, we may mean that A stands to lose more in absolute terms than B; second, we may mean that A could end up in a worse overall position than B. If we apply the former notion, it seems that an insurance company may well be more vulnerable than a patient (consider that not every patient is in with an issue that significantly impacts the quality of their life).

If we apply the latter notion, it does seem unlikely that an insurance company working with many doctors (who are usually independent contractors) will be vulnerable to a doctor to the degree that a patient is (who can be put in very dire straights by their doctor). However, it is also true that according to this second notion there can be no general presumption that shareholders are more vulnerable than, say, employees. Shareholders are usually diversified and thus cannot be brought to ruin by the management of a single firm (just as insurance companies cannot be bankrupted by a few doctors). Whereas an employee who loses their job can be in very dire straights indeed.

The example looks unfair to Marcoux only if we apply the first notion to the case of shareholders vs. other stakeholders and the second notion to the case of insurance company vs. patient. The example is fine, I believe, as long as we apply either notion consistently.

believed in the first place that vulnerabilities engender fiduciary duties, this would seem unacceptable. I conclude that giving up or weakening either (1) or (2) are not viable options for Marcoux. The only way to reach his desired conclusion is to show that (3) is false.

Let us pause for a moment to reflect on the inconsistency of (1), (2), and (3). The inconsistency is, as it were, *merely practical*. It is not conceptually impossible for all of (1), (2), and (3) to be true. It is just that in such a situation it would be impossible for managers to fulfil all of their duties. Managers would find themselves in a situation akin to someone who promised to watch the game with their friends on the same night they also promised to have dinner with the in-laws. Or, closer to home, a lawyer who took on both parties to a legal dispute as clients. These situations are clearly not impossible. What we would usually say about such cases is that the person who put themselves in a situation in which it is impossible to fulfil their duties has acted immorally in doing so. This is particularly true, if the duties are of a fiduciary kind, as the example of the lawyer illustrates. Translated to the current context, this means that Marcoux's argument implies that, given that managers are in a relationship with shareholders that leaves the latter vulnerable to them, it would be immoral for them to enter relationships with non-shareholding stakeholders that involve these groups being control and information vulnerable also.

Let us consider, then, whether there are non-shareholding stakeholders that are control and information vulnerable to management. Marcoux denies this mainly because “[w]hatever their informational disadvantages with respect to managers, non-shareholding stakeholders may relatively easily identify discrepancies that, in turn, give rise to legally cognizable claims against the firm” (Marcoux, 2003, p. 18). Examples of what Marcoux has in mind are employees who do not receive their biweekly paychecks or are turned away by their doctor despite being promised medical coverage. Marcoux discusses similar points with regards to suppliers, customers, and communities. Because it is these kind of examples that Marcoux concerns himself with, he can confidently assert that “unlike shareholders, non-shareholding stakeholders have complete or near-complete contracts with the firm and it is the completeness of their contracts that obviates the need for fiduciary obligations.” (Marcoux, 2003, p. 18). In fact, for Marcoux the incompleteness of contracts is the fundamental source of vulnerabilities that engender fiduciary duties (cf. the discussion of shareholder vulnerabilities at Marcoux, 2003, p. 13). I will not quibble with that idea here. But it is worth making explicit that in the context of Marcoux's argument this entails a rather striking result; namely that *it is immoral for managers to make incomplete contracts with non-shareholding stakeholders!*

Managers already have incomplete contracts with shareholders who are thus vulnerable to them which means that they are being owed fiduciary duties. If management proceeds to make incomplete contracts with other groups also, it replicates this situation leading to conflicting fiduciary obligations. This would be analogous to the example of the lawyer who promises to represent both sides of a legal dispute.⁹

It is important to emphasize just how implausible this claim – that managers are morally prohibited from making incomplete contracts with non-shareholding stakeholder groups – is. While there are many transactions between a firm and its stakeholders that are governed by (near-) complete contracts, there are also common transactions in which this is not feasible or preferable. There will be situations in which a stakeholder prefers to trust the firm (to some degree) instead of drawing up a complete contract. According to Marcoux it would be immoral for the firm to respect that wish. Sometimes it will simply be impossible to draw up complete contracts. This is particularly likely when the relevant stakeholder group cannot be easily identified or organized (cf. Brown, 2013, p. 489), or when the transaction involves a firm specific investment on part of the stakeholder which will pay off, for both parties, only in the long run (cf. Freeman/Evan, 1990, pp. 342-344). Since the future is uncertain, complete contracts covering the long run are not feasible (for an extended discussion of incomplete contracts between non-shareholding stakeholders and the firm cf. Brown, 2013, pp. 494-497). One way of inducing the stakeholder to make the specific investment in the absence of contractual guarantees would be for the firm to make a credible promise to consider the stakeholder's interest in future decisions. This would seem to be a good way to overcome a potential market failure (in this case an underinvestment in firm-specific assets). This is, of course, not just an academic point. Corporations do use promises that are not contractually guaranteed to induce their stakeholders to make firm-specific investments. Promotion schemes like job ladders, for example, are used to induce employees to acquire firm-specific human capital (cf. Prendergast, 1993). But, if Marcoux's argument was sound, such schemes would constitute immoral behaviour on part of the firm's management.¹⁰ I take this to be an untenable result.

The case of labour is particularly instructive and bound to provide the clearest examples of incomplete

9 Note that the reason why this is so problematic for Marcoux is his his premise (1) according to which it is *impossible* to fulfill fiduciary duties to more than one party.

10 It is one thing to worry whether such arrangements are realistic (maybe managers could not make credible promises of this nature); it is quite another to say that management would be acting immorally, if they did make a promise like that (although I am very skeptical about the first claim also).

contracts between the corporation and a non-shareholding stakeholder group. The reason for that can be easily deduced from the transaction cost theory of the firm (cf. Coase 1937). If it was possible or desirable to have complete contracts with the people who are supplying the labour, it would be somewhat mysterious why a corporation should have employees at all. The natural solution in such a situation would be to use the market mechanism to obtain labour, i.e. to have labour supplied by independent contractors.

The main reason why this is not done more frequently is precisely the (near) impossibility of writing complete contracts (cf. Blair, 1999, pp. 72-74; Williamson, 1981, pp. 558-567). In other words, the very fact that a corporation has employees at all, creates a strong presumption that these employees have incomplete contracts. And, as Marcoux rightly points out, incomplete contracts create control and information vulnerability. Taken together with the earlier result that Marcoux's view seems to prohibit incomplete contracts with non-shareholding stakeholder groups, Marcoux's argument comes very close to the manifestly absurd conclusion that it would be immoral for a corporation to have employees.

Where does Marcoux's argument go wrong? I think the crux of the matter is that fiduciary duties do not follow quite as smoothly from control and information vulnerabilities as Marcoux suggests. The analogies with doctors, lawyers and guardians are misleading. It is true that patients, clients and wards are vulnerable in much the same way as shareholders are. However, the former three are also in a situation in which they *must* make use of the services offered by doctor, lawyer and guardian. Shareholders on the other hand do not have to invest their money in ways that will leave them control and information vulnerable. As Easterbrook and Fischel point out, investors do not just find themselves owning shares, gasping "Woe is me, I'm powerless" (Easterbrook/Fischel, 1989, p. 1419). That investors' vulnerabilities are not a necessary fact of economic life is easy to see, once we remember a premise that is common ground between Marcoux and me: the main source of control and information vulnerabilities in the economic realm are incomplete contracts. All that investors have to do to get rid of incomplete contracts is to become lenders or buy corporate bonds instead of shares. All that a patient can do, by contrast, is to see a different doctor (with whom she will have an incomplete contract) or have his interests not looked after at all (the same is true for someone in need of legal council).

I would suggest that this is the missing ingredient in the shareholder-manager relationship absent which fiduciary duties within it are, pace Marcoux, morally optional. Fiduciary duties are morally mandated by

vulnerabilities, only if the vulnerabilities cannot be avoided.¹¹ Interestingly, Marcoux comes close to admitting that vulnerabilities all by themselves do not justify fiduciary duties. In a footnote towards the end of his paper, he considers Margaret Blair's arguments to the effect that employees or suppliers might also be control and information vulnerable (cf. Blair, 1995). Granting this for the sake of argument Marcoux asks: "why does this legitimate vulnerability give rise to claims that firms be managed in employees' or suppliers' behalf? ... How does [it] justify a blank check on (or equal participation in) managerial care and concern?" (Marcoux, 2003, p. 24). Why indeed? Marcoux does not offer an answer to this question. But as far as morality is concerned we may ask the very same questions about shareholders.

4. Rights-Based Arguments in General

What Marcoux's argument has in common with contractual and property arguments is that it tries to make a case for shareholder primacy but focusing on what is owed to shareholders. If the arguments presented so far are correct, the prospects for such a defence are very dim indeed. Property rights and contractual obligations seem to be the obvious starting points for grounding a rights-based defence of shareholder primacy. Given that they fail, Marcoux's idea of grounding such rights in the peculiar vulnerabilities of shareholders would seem to be the next best thing. If we are looking for a property that can ground a right for special treatment and loyalty, it is hard to think of a better candidate than vulnerability. This is not to say that there are no other possible candidates. One might think, for example, that shareholders' interests deserve special consideration because in a corporate environment shareholders are the principal bearers of risk (cf. the discussion at Stout, 2001/2, pp. 1192-1195).

There are, however, a number of reasons to think that such an argument would not succeed. To start with, it is not clear that being the bearer of economic risk is enough to ground any particular rights – risk bearing just does not seem to have the same intuitive moral clout as being vulnerable. Moreover, the amount of risk that shareholders bear is in most jurisdictions capped through limited liability statutes which, in turn, allows shareholders to further minimize their risk-exposure through the diversification of their assets. Moreover, as in the

11 One might object by pointing to the case of a proficient lawyer who hires another to represent her in court. Does not the hired lawyer still owe fiduciary duties to his client? He does. What is a lot less clear is whether in such a case the fiduciary duties are morally mandated or merely a matter of contractual agreement. Only the former would help Marcoux. Given the counterintuitive consequences of his argument, I do not think that intuitions supporting this interpretation could carry the day in reflective equilibrium.

case of Marcoux's vulnerabilities, shareholders willingly assume whatever risk there remains. Finally, while it may be true that shareholders are the principal risk bearers in the economic endeavour that is the corporation, they certainly are not the only ones. As we have seen before, non-shareholding stakeholder groups will make investments that are firm-specific and thus unrecoverable outside the context of a specific corporation. Thus, while it is true that shareholders may lose their entire investment in the case of bankruptcy, other stakeholders will lose significant parts of their investments too.

This last point is worth emphasizing. For it is this point that justifies a general pessimism about rights-based arguments for shareholder primacy. Any property of shareholders that is supposed to provide a moral ground for the shareholder primacy view is going to face particular challenges and I cannot simply presume here that no property can be found that can meet them all. But there is also a general problem that any such argument would have to overcome. The problem is that the shareholder primacy view makes a sharp distinction between the way management should treat shareholders and the way it should treat non-shareholding stakeholders. But it is hard to imagine that there is a property that (a) can morally ground such special treatment and (b) is exclusively a property of shareholders or, at least, is consistently instantiated by shareholders to a much higher degree than by all other stakeholders. But such a clear difference in a morally relevant dimension would be needed in order to justify a correspondingly sharp distinction in terms of rights.¹² Simply put, rights-based arguments for the shareholder view do not work, because shareholders are not different enough from other stakeholder groups.

5. The Consequentialist Turn

In discussing Marcoux's argument, I said that investors can avoid being vulnerable to management by becoming lenders instead of shareholders. But, it may be replied, what if every investor did that? Is an economy with equity investors not far more efficient and thus more desirable than one without them? These are sensible questions. However, the fact (if it is a fact) that we are better off with equity investors than without, does nothing to negate the fact that these investors assume their role voluntarily. Thus, this observation cannot ground an objection to my arguments against Marcoux. What it does suggest, instead, is a different argument for the shareholder primacy

¹² This is not to deny that there might be pragmatic reasons to introduce a sharp distinction in the way that different constituent groups should be treated by management. The point is just that such a sharp difference cannot be justified by through moral reasons alone.

view. This is what, following Boatright, I call the *public policy argument*. According to the public policy argument shareholder primacy is simply the best (i.e. most efficient) way to organize corporate governance; and it is that fact that justifies it. That is to say there is nothing special about shareholders that entitles them to loyalty, fiduciary duties or what have you; it is just that having managers be accountable to shareholders happens to be the best arrangement for everyone involved.¹³ What this means is that, compared to the arguments considered so far, the public policy argument represents a bit of a paradigm shift. Put bluntly, the arguments considered so far operated within a deontological framework, whereas the public policy argument is consequentialist.

In the introduction to this article, I have called this the *consequentialist turn* in the defence of shareholder theory. This was to some degree misleading, for alluding to the beneficial consequences of shareholder primacy (or to the negative consequences of other arrangements) has been a staple in defending it for a long time. Even in Friedman, who clearly thinks that shareholders are simply owed the loyalty of managers whom he thinks of as their agents, there are some traces of such consequentialist thinking. This is apparent when he cites Adam Smith to the effect that the social good will in general be better served by self-interested individuals than by those who are directly motivated by it. Accordingly, one of the reasons why he thinks corporate executives should not pursue social objectives is that he suspects they would not be very good at it (cf. Friedman 1970). Similarly, Easterbrook and Fischel, despite their libertarian rhetoric, appeal occasionally to consequentialist considerations (for example, cf. Easterbrook/Fischel, 1991, pp. 38-39). Nevertheless, it is only more recently that shareholder theorists like Boatright or Hansmann have openly embraced an unabashedly consequentialist paradigm; witness the following passage from Kraakman/Hansmann et al.'s *The Anatomy of Corporate Law*: "...the appropriate goal of corporate law is to advance the aggregate welfare of a firm's shareholders, employees, suppliers, and customers without undue sacrifice – and, if possible, with benefit – to third parties ... This is what economists would characterize as the pursuit of overall social efficiency" (Kraakman et al. 2004, p. 18; also cf. Boatright, 1994, 2002, 2006; and Jensen, 2002).

¹³ Who counts as 'involved' here is an interesting question. There are two ways of spelling this out – roughly corresponding to Freeman's distinction between the broad and the narrow definition of 'stakeholder' (Freeman/Reed, 1983, p. 91). Only if a broad notion is implied – roughly: all of society counts as involved – can the argument really be considered a *public policy argument*. At least at some places, however, Boatright seems to have a narrower notion in mind, simply stating that shareholder primacy is best for all the groups that have direct contractual relationships with a corporation (cf. Boatright, 2006).

The fate of such public policy arguments is not my concern in this article. Rather, I wanted to show that if shareholder primacy can be defended at all, it has to be done in terms of social welfare. Whether such a defence can be successful is a question that merits careful discussion and cannot be answered in the confines of this article. That being said the debate about the public policy argument is well under way. Let me give some brief pointers as to where it stands.

One possible strategy of arguing for shareholder primacy on public policy grounds would be to deduce its overall advantageousness from economic first principles. In a recent article Thomas Jones and Will Felps sketch an argument of that kind as follows.

In the context of competitive markets, shareholder wealth maximization leads to economic efficiency. Efficient markets, because they make the most productive use of society's resources, lead to greater levels of aggregate economic wealth. Greater economic wealth leads to greater social welfare. (Jones/Felps, 2013, p. 216)

As they go on to show, there are serious empirical and conceptual questions about each step in this argument. That being the case, it seems highly implausible that the public policy argument could be made from the armchair (as it perhaps could be, if real world markets were actually ideally competitive).¹⁴

But not every version of the public policy argument relies on obviously unrealistic assumptions about real world markets. The probably most sophisticated and empirically-minded version of the public policy argument can be found in Hansmann's *The Ownership of Enterprise*. Hansmann argues, very roughly, that the mere fact that shareholder controlled corporations dominate the economy despite competing with other kinds of firms (such as co-ops and not for profits) on a level playing field, is a strong indication that such corporations are by and large more efficient than other organizational forms. If a worker co-op, for example, could run a given business more efficiently, this efficiency surplus should create a budget that workers could use to buy out shareholders. The fact that most of the time they do not do this suggests, Hansmann argues, that they would rather be employees in a shareholder owned firm than worker-owners in a co-op.

I cannot discuss this argument at length here (for a critical discussion cf. Heath, 2011). But there are at

¹⁴ Jones and Felps do not cite Easterbrook and Fischel. Nevertheless, in so far as we can understand the latter's views to be a form of a public policy argument they would be a good target for Jones and Felps' critique, as Easterbrook and Fischel seem to rely on unrealistic idealizing assumptions about stock markets in particular.

least two points where opponents of the shareholder view might find fault with it. First, the argument depends critically on the contention that, say, customer co-ops compete with standard business corporations on a level playing field, and this assumption may well be disputed. This might not be an easy task, for there is some reason to think that the decks are actually stacked *against* shareholder controlled corporations. In contrast to corporations, for example, co-ops can disburse residual earnings without first having to pay tax on them (cf. Heath, 2009, pp. 189-190). Opponents of the shareholder view might push back, for example, by pointing to the fact that stakeholder groups other than investors have less access to credit markets and might thus be incapable of obtaining control, even in cases where they could run a given company more efficiently (cf. Bowles, 2012, pp. 50-59). Second, the argument, as far as sketched, can at best provide a defence of the status quo of corporate governance. The status quo, however, is one in which *Dodge v. Ford* is a legal outlier. In other words, from the fact that workers prefer employment in shareholder controlled firms under the current legal regime, no conclusions can be drawn about the efficiency properties of a legal regime that implemented the shareholder primacy view more explicitly.

6. Conclusion

I have argued that shareholder primacy cannot be defended on deontological grounds. This is the lesson from the failure of the first three arguments considered in this article. The property argument and the contractual argument beg the question, and moralizing arguments like Marcoux's cannot justify the sharply preferential treatment of shareholders that the shareholder primacy view recommends. Defenders of the shareholder primacy view increasingly recognize this and have begun to develop consequentialist arguments instead. There are two ways of defeating these new arguments. On the one hand one could simply reject the consequentialist framework. This maybe somewhat tempting, but I do not think it is a very promising route to take. While the arguments for establishing a deontological basis *for* shareholder primacy fail, this failure does not entail a deontological basis *against* shareholder primacy. In other words, just because there is no moral duty for managers to put shareholder interests first, there is not yet a reason to think that they are not allowed to do so. Of course, other groups have certain rights that need to be respected by any legitimate economic arrangement. But, as Marcoux rightly points out in the passage cited above, this does not entail any conclusions about corporate governance. After all, even the most hard-nosed shareholder theorists allow that the maximization of profit is subject to certain legal and/or moral side

constraints. Alternatively, one could meet the new shareholder theorists on their turf, by showing that, pace Jensen, Hansmann, Boatright and others, shareholder primacy does not promote the social good. Now, consequentialism is often viewed with suspicion by some of the same people who have reservations about the shareholder view (Gustafson 2013). But one does not have to be an all out consequentialist to think that some questions should be decided by appeal to the social good. And reservations about consequentialism should not obscure one's view from the fact that forcing shareholder theorists to get off their deontological high horse represents significant argumentative gain for their opponents. Shareholder theorists now have to defend the prima facie implausible claim that focusing exclusively on the interests of one group produces, in a business setting, the greatest benefits for all other groups as well.

In this paper, I have not concerned myself with the question whether this can be done, i.e. the question whether shareholder primacy promotes the social good. Instead, I have argued that providing a satisfactory answer to that question is the key to defending or defeating the shareholder view, for it cannot be defended on deontological grounds. Once this is recognized we can see that rhetorical appeals to property, contracts, or vulnerability are simply distractions.

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