

Respectable Trade

**The Dangerous Delusions of Corporate Social
Responsibility and Business Ethics**

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Bibliographical Information

Published in the UK in 2000 by ASI (Research) Ltd

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ISBN: 1-902737-10-5

Set in Palatino 12pt
Printed in England by *Imediaprint*, London NW1

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1. Why is there an issue of social responsibility?

Socialism may have few admirers today but that does not mean that capitalism is enjoying unqualified success in the intellectual world, whatever its achievements economically. The market may have triumphed, but the kind of business practised on Wall Street and in the City of London is having to endure as much criticism as it did in the heyday of Marxism. The difference is that the erstwhile believers in central planning have forged new tools with which to criticise the typical capitalist institutions of Western society.

Capitalism and morality

These new critical weapons have a distinct advantage over the traditional condemnations of the market. Those who wield them can claim that they are not against capitalism but only that they want to make the actions of its practitioners and the institutions they have created more consistent with the tenets of traditional Western morality. Capitalism is not self-justifying as an economic system merely because it emerges spontaneously from the free exchanges that individuals may legitimately make under the rule of law (encompassing crime, contract, tort and property) but has to be licensed by moralists using extra-market criteria. Capitalism is only legitimate if it passes certain tests, normally set by religious leaders, professors of moral philosophy and others sceptical of individualism and private property. Free trade, exchange and the search for profit are not intrinsically moral even when they are conducted within the confines of conventional ethics: they are only so if they are consistent with the demands of 'community' or the high ideals of Christianity or any other religion that would put a restraint on individual gratification.

It is not enough for business to satisfy the wants of members of the community for better and cheaper products, more jobs and higher standards of living; it must also meet standards, which are not related to profit and economic progress. These standards, if too rigorously pursued, will ultimately undermine capitalism's capacity for satisfying what many of its critics call the 'baser' human instincts.

The rise of business ethics

Hence there is an academic subject called business ethics. It is no coincidence that it has prospered in two of the most successful capitalist post-war economies, the United States and Germany — and there is indeed a connection between Germany's current economic travails and its adoption of certain ethical values for business which have significantly attenuated the cutting edge of its once much-venerated industrial efficiency. It is no surprise that the practitioners of business ethics have concentrated on the corporation as their major target — it is held to be beyond the corrective processes of the market and the regulatory power of the state; especially when capital can be relocated in more hospitable regulatory environments.

The collapse of communism and the fading appeal of socialism have revealed that capitalism is not an homogeneous economic system which has the same features wherever it is found, but it exists in a variety of often competing forms. The Anglo-American model is only one, and it is not by chance that critics of capitalism have appealed to alternative types of market arrangements in their struggle to salvage something serviceable from the wreckage of socialism.

The cost of distrust

It is true that all forms of market capitalism must fulfil certain basic requirements if they are to be successful. These might constitute what may be called a generic moral code that encompasses respect for property, the sanctity of contract and the promotion of trust and reliability in business dealings. There is, of course, an economic rationale for the satisfaction of these foundational moral demands; after all, the more honest and reliable transactors are the less they will have to rely on law if they are to succeed. Indeed, one of the plausible criticisms of Anglo-American capitalism is that its remorseless individualism, restless search for profit and apparent absence of trust raises transactions cost; a form of economic inefficiency.

Systems with a greater sense of community and a well-developed concern for the potential 'victims' of necessary economic change allegedly generate a form of social solidarity that enables persons to co-operate without the legal paraphernalia of Western capitalism. A prominent non-socialist French politician was to say recently that France had no intention of descending to the 'jungle' of Anglo-American capitalism.

It cannot be denied that Anglo-American capitalism satisfies the demands of generic morality as well as any other market system. Of course, there have been well-documented business scandals throughout its history and they have been mercilessly exposed in the past twenty years. Indeed, that they have been so well publicised is a tribute to the transparency of the Anglo-American system; business's transgressions of basic morality are quickly exposed even without the intrusion of the law. Information about the practices of a publicly-quoted company in the US and the UK is normally easily available to any shareholder prepared to do the required research.

Secrecy and the shareholder

Here the contrast with the relatively enclosed worlds of the German and Japanese systems, which are much favoured by the critics of the Anglo-American model for their alleged anti-individualistic foundations, is striking. German companies seeking a listing on the New York Stock Exchange were quite surprised that they had to meet with much stricter disclosure requirements than they were used to. Japanese companies, although superficially resembling the Anglo-American model, are notoriously secretive and they make sure that shareholders are excluded from all important aspects of the business; criminal elements are often recruited to make sure that dissident shareholders are silenced at annual general meetings. The traditional secrecy of these companies means that information about potentially very damaging scandals rarely surfaces. But it is not the capacity or incapacity of Anglo-American capitalism to conform to basic moral rules that concerns the critics of that economic system: it is its apparent indifference to its supposed communal obligations in its pursuit of profit and its toleration, indeed welcome, of particular business techniques which are individualistic in inspiration.

Takeovers and perceived immorality

Thus the enthusiasm with which the takeover method of industrial reorganisation is embraced is especially condemnable, and even in those economies where there might not be regulations which make it difficult there are usually social restraints that are powerful enough to deter all but the most determined of corporate raiders. Here the banks play a crucially important role, not only in terms of ownership (in the US they are forbidden by law from holding equities and in the UK they do not do so as a matter of practice), but equally importantly through their co-operation with significant social groups, especially trade unions. It is true that on the continent of Europe, including Germany, takeovers are less rare than they once were but there is still opprobrium attached to the predator. In Japan they are extremely rare. Such reluctance is usually given some communitarian justification by philosophically-inclined anti-capitalists.

The social responsibility of business

The Anglo-American corporation is not only urged to refrain from takeovers, but there are a whole host of other social duties that are imposed on it; if not directly by law, then certainly by intellectual opinion. The superficially alluring phrase of the moment used to describe the company's proper role is 'the social responsibility of business'. This has become the mantra of the critics and its prescriptions extend to the demands that business should show a concern for the environment that reaches beyond legal requirement and a respect for property rights; that it should adopt employment practices, such as guaranteeing a form of equality in the workplace even at the cost of labour productivity (and hence profitability); that it ought not to

let wages be determined by marginal productivity but they should be fixed to inchoate notions of 'social justice'; and overall that it should foster the interests of all affected by the company, including suppliers and residents of the community in which it is located. All these often uncommercial activities sum up to the ideal of the 'stakeholder society', to be considered in detail below.

Differences in the various types of capitalism reflect not merely the different nuances that are almost certain to be the result of the various social values and circumstances in which the enterprise system is nested, but a fundamentally different approach to wealth creation. It is to be noted that the critics of Anglo-American capitalism are not exclusively concerned with its supposed immorality, but also with the economic argument that the relentless pursuit of shareholder value is economically unsound because it leads to 'short-termism'. Its reliance on the stock market as the sole measure of value apparently means that long term investment projects are neglected since they will not be valued immediately by the capital market. Directors and managers, furthermore, cannot be expected to plan rationally for the future if they have continually to look over their shoulders at the stock price. The fear is that any fall in value will simply tempt a predator who thinks he can make a quick profit by breaking up what the market registers as an under-performing company. The critics of Anglo-American capitalism say the market could be wrong.

It is the contention of this paper that the traditional legal and economic environment of the US and the UK (and the English-speaking world and common law system in general) is to be radically altered by the importation of corporate arrangements which emanate from a quite different social system. This would have deleterious consequences for economic well being. To understand why this should be so it is necessary to delineate the major features of Anglo-American corporate capitalism.

2. The corporation: its genesis and rationale

The corporate form is only one manifestation of Anglo-American capitalism; there are single proprietorships, partnerships, co-operatives, non-profit enterprises and other types of commercial endeavour. But it is the corporation that has attracted most criticism, often of a moral kind, especially in its form as a publicly-quoted firm whose shares are traded on the market. The type which has provoked predictable wrath from the moralists is the 'multinational corporation', precisely because it appears beyond the control of a single national government. The corporation was originally known as the joint stock company and it incurred the criticism of Adam Smith, not for any ethical shortcomings arising out of its alleged 'power', but because he thought that only owner-managed enterprises could ever provide the incentives necessary for people to realise fully the value of assets. Owners had a direct interest in work.

Indeed, the original difficulty of providing managements with the right incentives to work for the owners (the 'agency problem') is familiar to business economics today. It might be thought insoluble in the modern world because the owners (the shareholders) are dispersed and would appear to be at the mercy of opportunistic managers. But a number of methods have been developed which have united the interests of the agents (the salaried managers) with the principals, the owners of the assets. The most notable of these is the takeover threat, itself a perennial problem of business ethics and corporate responsibility. Of course, the board of directors is supposed to be separate from the management and directly responsible to the shareholders.

The reason why there is a demand for corporate responsibility derives from the *public* nature of a corporation's activities and the legal context within which they take place. A corporation does not merely buy and sell, exchange and deal voluntarily with its competitors and co-operators, it also affects the lives and well-being of its employees, those of its suppliers and the inhabitants of the area in which it is located. Corporate affairs cannot be governed, it is said, by the ethical rules that govern face-to-face transactions because the firm's behaviour, for better or for worse, affects everybody; their employment prospects, their remuneration, their environment and so on.

Legal privileges of the corporation

What is crucial is that corporations are said to have certain legal advantages that are not featured in person to person trading. These could not have emerged spontaneously from the common law of contract and depend on the state and its statutory framework for their existence.

These legal 'privileges' include the collective form (the corporation can sue and be sued), perpetual life and, most importantly, limited liability for debts. This last feature means that investors have only their actual investments, that is, their shareholdings, at risk and cannot be sued for their personal wealth (unlike members of partnerships) in the event of corporate insolvency or other financial claims against the company. The corporation, then, is an 'artificial person' created by statutory law. It must therefore pay the members of 'society' something back for their benevolence. The claim that it owes some kind of social debt is not an arcane argument confined to obscure texts on business ethics but has a resonance in public debate. Robert Reich, Secretary of State for Labor in President Clinton's first administration said that: 'The corporation is...a creation of law. It does not exist in nature.'¹ He went on to say that in return for their privileges it is 'only reasonable to ask corporations to be more accountable for the social costs and benefits of economic change'. At the time he was writing and speaking he was clearly thinking of the 'downsizing' that was widely taking place in the US. He proposed that corporations that fulfilled government-promoted social goals should be rewarded with favourable tax and regulatory treatment.

Following the same logic, other writers have suggested that they should be deprived of their advantages if they do not behave responsibly. It might seem odd to complain about the corporation's failure to fulfil a major social goal, the provision of high employment, at a time when the American labour market has rarely been more propitious for potential workers, but the attitude expressed nevertheless epitomises a common view of the corporation. It can only maintain its economic supremacy because of a favourable legal system that the state has granted.

The historical perspective

However, the view is mistaken historically and analytically. It possesses a superficial plausibility in that corporations in England initially were awarded specific grants of privilege from the Crown and, though some had commercial functions, certain public interest duties were imposed on them. The same was true of the American states in the early years of the republic: they granted monopolistic powers to favoured companies to provide public goods, such as canals. Their activities were subject to political control and they had specific reciprocal duties. However, purely commercial companies developed spontaneously out of the common law of contract. They were recognised as 'corporations' in important Supreme Court decisions. Incorporation was achieved under common law, and the limited liability company simply had to be registered: there was no suggestion of 'duties' owed to society and the resulting institutions were recognised as profit-seeking business enterprises.

Things were a little different in the UK, although incorporation had similarly developed under common law. The 'South Sea Bubble' scandal denigrated the name of joint stock companies, and they were actually forbidden by law (although exemption from that prohibition could be secured by statute). Eventually, in the 1860s, statutory law allowed the creation of corporations with the familiar legal features. But it does not at all follow from this that a corporation could not exist *without* the state any more than it follows that because the state imposes a common currency on everybody, one would not have developed through a market process.

Theoretically, the status of the corporation is not one of legal privilege which has been derived from statute law. Individuals have an interest in pooling their resources and combining to pursue their joint interests to seek profit in a collective form. These rights come from contract rather than actual property ownership; after all, the fact that somebody owns shares in a company does not give that person the right to enter its property without authorisation merely because he is the 'owner'.

The limited liability corporation

But anybody can make a contract with another that embodies limited liability, and the fact the corporation does so collectively saves the costs of doing it individually with each separate 'owner'. The corporate form arises out of contract. There is nothing in it that gives the collective body rights and privileges that are not conceptually derived from the rights of individuals. And the corporation certainly did not make a contract with 'society' to pursue worthy goals as the necessary price for its doing business. Let us not forget, nobody is compelled to trade with someone, or a commercial body, that demands limited liability. But it is undoubtedly the case that capitalism has gained immeasurably from the limited liability corporation.

It is the first duty of the directors of such a company to act in the best interests of its ultimate owners, the shareholders. In common law courts in the UK and the US this has been upheld repeatedly. In these countries, there is the strict *fiduciary* duty of employees to act in the interests of owners. Despite the depredations that the capitalist system has suffered from statute in many areas of the corporation's activities, the basic duties have prevailed at common law. This fundamental argument is repeated in the influential *Hampel Report*:

The single overriding objective shared by all listed companies, whatever their size or type of business, is the preservation and the greatest practicable enhancement over time of their shareholders' investment. All boards have this responsibility and their policies should reflect this.²

There is a minor difference in the legal systems of the two major Anglo-American countries in that in the US the shareholders are guaranteed the protection of the law, whilst in Britain, it is the company itself. But it is a distinction without a difference,

for a company *is* its shareholders. Nevertheless, many believers in social responsibility think that if the company is the object of the law, then its autonomy is somehow attenuated. After all, as has been pointed out, the corporation cannot pollute the environment or allow its headquarters to be used for immoral purposes, and it is subject to a whole range of restrictions on its freedom. The implication here is that other, perhaps more positive, duties should be laid on the corporation.

Courts, fiduciary duties and the corporation

But this does not follow at all from the definitions proposed, and the apparent exclusion of specific ownership rights from the account of the company. For we soon know who owns a company when it is 'in play' in a takeover battle. The shareholders have every right to sell out to the highest bidder and permit the transfer of ownership rights to him or her. If the courts were to modify at all the fiduciary duties of directors and managements to act in the best interests of owners and they were to sanction interests, such as those of socially significant groups not related to the company in a property rights sense, or the community at large, such action would constitute a revolution in the company and would probably herald the end of capitalism under the rule of law. The purpose of the corporation is to advance the interests of the owners; and this normally means the pursuit of shareholder value.

3. Objections to the shareholder model

Almost all critics of the Anglo-American theory and practice of the corporation reject the idea of the exclusive fiduciary duty of managements to shareholders. Naturally, that indefinable and nebulous entity 'the community' is recommended as the major focus (indeed, beneficiary) of the corporation's activities. Naturally, the corporation should aim at 'inclusiveness'; every person or group that has a connection with the company should be involved in its decision-making and, presumably, share in its profits. In an influential report, the Royal Society for the Encouragement of Arts, Manufacturers and Commerce claimed that the 'purely economic model of the company will be found to be wanting'³ and like many writers in this area, its authors claim that the exclusive concentration on shareholder value will not, in fact, enhance shareholder value. Still, no serious scientific evidence is ever produced to show that this proposition has any truth. They seem to be saying that on the one hand shareholder value should not be the sole concern of the corporation's management, and on the other, that that purpose will be better achieved anyway by adopting communitarian-type policies of business organisation. Every group has an equal influence on the company irrespective of the property it may have invested in it. The report also suggests that the corporation is 'licensed' to operate by society.

Value beyond the shareholder

What should a company do if it is not to maximise *exclusively* shareholder value? It would appear to be the case that its obligations cover not merely an excessive concern for what has been called 'generic morality', an observation of the 'do nots' of economic and moral life, but they should also extend to what the philosophers call 'supererogatory' moral duties. That is, those such as acting charitably, which are desirable but not compelling. However, these latter duties are subtly converted into compulsory actions by the moralists and companies are expected to go beyond the kind of moral actions expected of ordinary people: hence the 'licensing' of companies would partly be a function of how virtuous they are in the extended sense.

But there is an initial theoretical problem that relates to the feasibility of such projects: the distribution of company largesse is very largely a function of its profitability. If it has some niche in the market which gives it a certain economic privilege, then it would be possible for it to contribute to worthy causes without suffering the consequence of a dramatic fall in dividends or a loss in pay to its workers. Most often such a favourable position is the result of some market

imperfection, the exploitation of a quasi-monopolistic position or some other anti-competitive feature which is quite often the result of a government intervention: protection from foreign competition is the most obvious example.

The irony of corporate largesse

But the more competitive a market is the more profits will be whittled down to the level at which they are just sufficient to keep the enterprise in business: there is little surplus left for virtue. In fact, as the market approaches 'perfect competition', the smallest relaxation of technical efficiency is likely to result in instant oblivion. We can take it that the corporation's promotion of sporting events or artistic activities is part of its general economic and marketing strategy and not an act of charity. Even superficially clear cut cases of corporate virtue, like donations to worthy causes, could be interpreted commercially: companies like good 'reputations'; they may wish to deter government regulation; or they might be concerned to protect some extra-market privilege.

Competition is supposed to be a feature of the moral justification of capitalism. It produces cheaper goods for the consumer, more jobs for workers and all-round economic improvement: monopoly is normally thought of as economically and morally undesirable. But the person most able to act charitably is clearly the monopolist. It is a strange irony indeed that corporate virtue should only be possible in a situation which would fail by all the conventional criteria of market ethics. Who is to be preferred, the virtuous monopolist who gives much of his excess profits to worthy causes or the hard-pressed capitalist working under fierce competition? The latter provides wanted goods or services and much-needed employment but has very little left over for charitable giving.

The price of ethics

Anyway, the kind of supererogatory ethics propagated by the believers in corporate responsibility must surely involve some loss. If we are talking about the ethics of goodwill then we would expect them to involve some personal cost, and we would give a high moral grade to those people who were prepared to incur it. The same reasoning applies to enterprises that forgo profit in order to meet some socially desirable goal. The economically damaging employment of disadvantaged minorities, for example, or the paying of people more than their marginal productivity, would result in an inefficiency that harms everyone in the aggregate and often the groups whom it is intended to favour.

But even where there is some 'excess' to distribute there is still a problem as to who are to be the beneficiaries. For if the company does not distribute profits to shareholders (as legal claimants of the residual) there is no rational method for their allocation. It is most likely that the company will choose those groups that will

attract favourable publicity. This defeats the moral object of the activity. There is a classic example of the issue recorded by Henry Manne.⁴ He noted the case of Coca-Cola in Florida in the early 1970s. It employed some immigrants in rather unpleasant working conditions at its plants. Eager to do the right thing, the company instituted what was in effect a private enterprise welfare system, although the conditions that already existed were still far better than those in the Third World countries from which the immigrants had come. However, the scheme was rather costly and resulted in significant job losses. What is analytically and practically important was the fact that the virtuous action of Coca-Cola was *seen*: however, the resulting unemployment was not. And that is often the case with corporate responsibility. Virtuous action is highly visible (which is often the reason why companies practise it) but the probably undesirable consequences are not, spread as they are among dispersed groups who are less effective at organising publicity campaigns. Similar stories could be told of corporate social responsibility throughout Anglo-American capitalism.

What about the shareholders?

But there is an even more fundamental problem: the effect that corporate 'morality' has on fiduciary duty. It is perfectly acceptable for privately owned companies to engage in virtuous activity. It is the owner's money which is at stake and he or she is entitled to do whatever they like with it. But in a public company, shareholders' money is not available as a 'costless' resource for the moralist. The management is under a legal obligation to return profit to shareholders and the directors, who must be separate from management, are charged with the duty of ensuring that this happens. And pressure of competition in the capital market will in the long run eliminate costly ethics. It is all very well if the shareholders agree to donate to charitable causes, or to the performance of other worthy activities, but they are rarely consulted.

The case of Body Shop. The recent experience of Body Shop plc is instructive. Under the elevated moral leadership, if not business acumen, of company founder Anita Roddick, Body Shop has always had a high moral profile. It has refused to use animal-tested products in its cosmetics, it campaigns strenuously against the low wages and poor working conditions in the Third World, and is eloquent over human rights issues. The last thing on its list of priorities was shareholder value. However, in the mid-1990s⁵ the company experienced a serious drop in the price of its stock, partly through intense competition from rivals who developed similar production techniques. It should also be noted that the company came under increasing scrutiny over its own business methods, and moral sincerity, from American business ethics writers.

The response of the company was perfectly correct. Mrs Roddick calculated that the share price might be low enough for her to buy up the stock and take the company private. However, it was soon discovered that the burden of bank debt would be as onerous as that of shareholder pressure, and the scheme was abandoned. It was

even claimed that shareholder value would be resuscitated as a company target in the future. In fact the share price has not recovered and the intense pressure of competition in the cosmetics industry is not likely to leave much slack for ethics in the future.

Morality versus self-sacrifice

The experience of Body Shop gives the lie to the oft-repeated claim that ethics is *always* good for business. The advocates of ethics fail to distinguish between the two sorts of ethics that have been described here: the generic morality, or basic rules of the game, that are followed daily by business agents without publicity; and the supererogatory ethics of self-sacrifice which are only very imperfectly followed, and then only genuinely by private owners. Indeed, a public company that continually breached its moral obligations and cheated on its suppliers and competitors would quickly go out of business, if only because of the adverse publicity such behaviour would attract. The very openness of the Anglo-American company ensures that corporate misdeeds will be quickly exposed. This is not the case in the relatively enclosed business worlds of Germany and, especially, Japan. However, the opportunities for moral conduct of the second type, the non-compulsory displays of social virtue, are strictly limited under all types of capitalism. A fully competitive business world simply leaves little opportunity for this to be practised consistently and sincerely.

But there is an immorality which is rarely considered by business moralists. When the employees of public companies engage in the non-compelling moral strategies just discussed, they invariably are in breach of their legal and moral duties to manage the corporation in the best interests of its owners (the shareholders). It is important to stress that the relevant personnel here are the managers, not normally the directors, who tend to be in the vanguard for the demands of business ethics and corporate responsibility. It is not their money that is at risk, and ethical activism is more satisfying, in terms of moral self-esteem at least, than working for the shareholder.

We should remember that every human agent is a potential 'rent seeker'. All productive activity creates economic rent, that is, income over and above that which is required to draw the factors of production into their most productive uses. In large-scale organisations it is not always possible to guarantee that economic rent will be paid, in the form of bonuses and other salary arrangements, to its creators: or that it will be returned to shareholders who are the residual claimants. In other words, there will be wealth within the firm that will be available for appropriation by the unscrupulous in the absence of shareholder vigilance. Managements may behave opportunistically and grab this rent. They sometimes use 'business ethics' to do this.

4. The current attack on the corporation

The two sorts of ethics distinguished above have been run together by anti-business activists in recent years. Thus they have concentrated on what might be thought of as the breach of compulsory ethics. For example, some actual damage or threat to the environment, or a plausible case of a human rights violation, when what is really being challenged is the moral viability of capitalism itself, the remuneration of company executives or the dividends of stockholders: microethics very quickly become macroethics. It is the alleged breach of the compulsory, or generic, moral code that provides the campaigners with a morally appealing case that attracts publicity. They then use the alleged violations of ordinary ethics as reasons for attacking capitalism itself.

This was never better illustrated than in the campaign against McDonald's,⁶ the hamburger chains, which eventually reached the libel courts. McDonald's, who eventually brought the libel action, were largely vindicated but what was really significant was the fact that McDonald's is an immensely successful company that has brought cheap food to millions, and jobs to many. But it was accused of all sorts of misdeeds, from damaging the environment to serving dangerous food to its customers and exploiting workers: all of which were shown to be false after an extraordinarily lengthy trial. The subtext of all this was that a profitable and popular company was remiss in its social obligations and paid high dividends to its shareholders rather than spend that money on the community. There is no chance that McDonald's will ever recover the damages that it was awarded.

Shareholder activism

Ironically, anti-capitalist activists are now using something that had long been advocated by shareholders, and other supporters of the corporation — shareholder power. It had been felt that corporate governance was inadequate and that shareholders were at the mercy of irresponsible managements. They were anonymous, dispersed, difficult to organise and short of the information that would be required to secure the proper accountability of management. Their only remedy was to sell their shares (which, of course, should not be underestimated): 'exit' became the rational strategy given the relative ineffectiveness of 'voice'. But those most likely to use voice turned out to be the very people anxious to campaign against the corporation, and to use this method to harass management on behalf of

ethical principles or the 'public interest'. What happens is that an activist buys a few shares in a hated company and then takes part in a campaign of vilification against it. The activists are the people whose opportunity costs, the value foregone from doing other things, are likely to be low. They attend annual general meetings assiduously and involve themselves in company affairs, not to increase shareholder value but to harass the enterprise.

The case of Shell. Royal Dutch Shell⁷ has been the most well known victim of this activism. They had incurred the wrath of environmentalists because of their oil exploration off the coast of Nigeria and their (in fact, innocent) relationship with the military dictatorship in that country. The company got into trouble with human rights campaigners, culminating with the opprobrium they attracted after the execution of political opponents of the regime. BP has been in similar difficulties over the deaths of some political activists near its oil-exploration plant in Columbia; it had no connection with the deaths and was the victim of a politically inspired conspiracy. In no way could Shell be blamed for any of the charges that were levelled against it but this did not stop the campaign. In fact, Shell had already been in trouble with the moralists when they tried to dispose of a disused oilrig in the North Sea. They were quite within their rights and their actions posed no threat to the environment but they provoked the rage of Greenpeace, a well-funded pressure group, which committed all sorts of illegal acts in its (successful) attempt to prevent this.

A dangerous precedent? The anti-Shell shareholder group managed to get a resolution put forward at the annual general meeting in 1997 which demanded that the company appoint a member of the top management to be responsible for the environment and human rights. The resolution also demanded that external auditors should report on the company's compliance with a rigorous set of essentially non-economic demands. The quest for a social audit alongside the conventional financial audit has long been a demand of corporate moral activists. As it turned out the resolution was defeated but it could well be a grim precedent for future developments in corporate governance. Given the dispersed nature of share ownership in the Anglo-American corporation it is certainly possible for well-organised pressure groups to influence corporate policy in non-economic directions.

Indeed, the activists secured something of a victory, for Shell now annually reports publicly on its environmental and human rights record. In its latest report it was highly critical of the human rights record of some of its sub-contractors, blamed European law for the company's own inability to take action against them, and made all the right moral noises. But in the latest report, *People, Planet and Profits*, it almost comically revealed the dilemma of modern business in these ethically charged times. It included shareholder critiques of its social development policy and one read: 'All very well, but how did you manage to lose 25% of the stock value in two months?'. The chairman of Shell could only tamely comment: 'Our commitment to sustainable development is inextricably linked to our long-term business⁸ which is exactly what American business ethicists say when they point to the alleged compatibility of extra-moral behaviour with profitability.

Pinning the blame

It is a feature of anti-capitalist activists that, in their attempt to blame the corporation for every ill that might befall the consumer, they badly attenuate the notion of personal responsibility on which a prosperous and free economy depends. This has reached absurd proportions in the US where tort law (which can be used to ruin companies) has gradually replaced contract (which is the foundation of freedom and responsibility) in the business world. Companies cannot contract their way out of liability for wrongs by voluntary agreements with consumers; they face tort actions, however careful they are to warn them of potentially risky products.

Liability and free choice. A good example is tobacco, which until very recently had resisted the intrusions of an excessively punitive legal system. Now, as the result of a long social and legal campaign, it is under severe threat. But, most importantly, it is likely that it will have to bear the costs (mainly to do with health care) of people's free choices for tobacco. It had been known for at least thirty years that there were potential dangers to health from smoking but most of the current claims have come from people who began smoking a long time after the threats to health were discovered. They would have been perfectly aware of the risks. This was not the case in the 1950s when tobacco companies were morally remiss in advertising the advantages to health from smoking.⁹ Corporations do occasionally exploit the asymmetrical knowledge that exists between them and the consumer and it might have been the case that tobacco companies were aware of the medical knowledge before it became generally known. However, present-day smokers are perfectly rational and are in no way victims of pressure by companies and advertisers, who, in many jurisdictions, are not allowed to promote the product.

A recent example of a corporation having to pay the costs of aggrieved persons, or alleged victims, of corporate activity occurred over breast implants in the US. The difference is that in this case there is serious doubt as to whether the corporation did any wrong at all. Dow Corning, the manufacturer of the implants, suffered a succession of ruinous law suits, which forced it into bankruptcy, from women who claimed to have suffered serious health problems after receiving treatment for breast enhancement. Subsequent research has revealed that the company was not responsible for the ailments from which the women suffered; the overwhelming evidence is that they would have experienced them anyway and that there was no causal connection between the implants and the medical problems.¹⁰ Anyway, one would have thought that the individuals involved should have been expected to be aware of the possible risks of such cosmetic surgery and that the decision to have it was theirs alone.

Vulnerability of real shareholders

It is the shareholder who suffers in all these examples of the costs involved by the retreat from personal responsibility. Corporations are highly vulnerable to these legal actions because they are thought to have 'deep pockets'. These are, in reality, the far from voluminous wallets and handbags of ordinary shareholders. It is not often realised that the shareholder is peculiarly vulnerable in modern economic society. Workers and minority groups have all sorts of statutory protection against the vicissitudes of the market. There are exemptions from the rule of law that protect trade unions, redundancy agreements for the victims of necessary change and equal opportunity provisions for minority groups; and these often run counter to the logic of the market.

The shareholders have only their investment, and as a group they have little or no social and political strength. They cannot expect protection from the fortunes of the market. After all, they only invest in equities to earn a better return than bank and building society deposits, and it would be most unwise to recommend something that has already happened in the US; the suing of companies whose share price does not reach some arbitrarily determined point. But they have every legitimate expectation that the company in which they invest should not be unduly restricted. This becomes all the more important as the spread of private share ownership widens, largely as a result of privatisation. We would not like a situation to develop in this country similar to that which occurred in Japan when the meltdown in the Tokyo stock market began in the early 1990s. There, share ownership is reasonably widely spread and the real victims of the fall in values were ordinary people. Japanese corporations pay derisory dividends anyway and most investors are dependent on capital gains, which very quickly vanished after 1990.

It might be difficult to maintain that all the depredations to corporate viability that have occurred in the UK represent a *de jure* departure from the shareholder model of the company. The effect, however, is just the same as if the company had been made legally responsible for actions other than the formal owners. In modern times, the wealth of the company is sometimes treated as a kind of common asset that can be raided by almost anyone with a connection, however remote, with its activities. This point leads directly to what has become the most serious attack of all on the corporation — the idea of a stakeholder society.

5. The stakeholder fallacy

The notion of the 'stakeholder', which is a kind of inept play on the word 'shareholder' (it tries to capture all the grandeur of ownership while systematically undermining every salient feature of it), has become very fashionable in economic debate about the corporation. It is clearly linked to the 'third way' between capitalism and socialism, in that it attempts to retain the obvious productivity and success of market capitalism, while rejecting what are thought to be its objectionable features. These include its allegedly anti-social individualism, the reliance on 'greed' as a motivating force and its apparent ruthlessness in the way it treats individuals and groups in such things as industrial reorganisation and plant relocation. It is claimed that the reliance on the unaided market as an economic mechanism disrupts communities and leaves groups and persons who have served a company and community well as disposable units in the relentless and remorseless search for profit. It is said that people who work loyally for companies have just as much right to 'fair' treatment as shareholders. But an unalloyed market society, which defines value only in terms of money, neglects other sources of social and economic well-being which are just as essential for progress.

There is a curious, and unstable, combination of the above-mentioned moral considerations and straightforward efficiency arguments in the stakeholder model. The greed-driven corporation apparently is too short-termist, and its reliance on the capital market for investment means that it misses out on long term opportunities. Its cavalier treatment of labour produces uncertainty and a reluctance of people to invest in the acquisition of skills which might suddenly become redundant (the problem of 'firm-specific' human capital) or highly vulnerable in the event of a takeover.

Shortcomings of the ideas

There are, of course, many answers to these objections, most of which rely on the basic teachings of elementary economics. One obvious point is that the Anglo-American corporate model is extremely flexible and much better equipped to cope with the uncertainties of market society than known alternatives — its unemployment figures are probably the best of all economic systems. People often complain about the short-termism of the stock market but any alternative investment procedure is certain to be highly politicised and insensitive to real economic movements. Such problems as that of firm specific human capital can be

coped with by individually negotiated contracts, which mitigate the inevitable uncertainty of market society.

Part of the reason the stakeholder model is attractive is the fact that many successful economies *seem* to embody features that look different from the Anglo-American model. Germany and Japan are clearly not shareholder driven; in fact much of their investment is financed by bank debt, and shareholder value is a long way down the list of company priorities. Groups other than stockholders are protected by law in Germany. For example, trade unions have had since the early 1950s (as part of the 'social market economy') representation on the supervisory boards of German public companies guaranteed by law (the two-tier board is a distinctive feature of German company law). And while the Japanese system is superficially more like the Anglo-American model, in practice it departs significantly; the Japanese company is more concerned about market share than profit, and its 'communitarian spirit' ensures that various groups within the organisation have greater power than stockholders.

Undermining accountability and structure

The stakeholder model of the economy undermines the conventional Anglo-American system in at least two important areas: the ownership structure of the firm and the accountability of the key decision-makers in it. In a sentence, it could be said that by relaxing the demands entailed in the maximising of shareholder value, it reduces the incentive structure required for the efficient management of resources, and by blurring responsibility it attenuates good management. If a myriad of socially-significant, but non-owning, groups have an influence over the company, and its aims are more to do with satisfying their demands than securing satisfactory returns to shareholders, the motivation to invest will be reduced. And this is precisely what stakeholding promises to do. Every person or group that has some connection with the organisation, and the list includes suppliers, workers, residents of the community in which it is situated, banks and shareholders (who have no priority in the management process) and others too numerous to mention, have some claim on the company in the stakeholder model. There is even an extended version of the equality principle, for voting is not to be determined according to the amount of property held (share ownership) but by reference to the position occupied. A fully consistent model would have voting at annual general meetings by one person one vote rather than one share one vote.

Now it might not be strictly true to describe the Anglo-American company in purely ownership terms. A more accurate account would have it as a nexus of contracts. The things that people do, the positions they occupy and the terms of their employment depend on the contracts they have made. Somebody, or a group, could be crucially important irrespective of their ownership rights. But this modification makes little or no difference when it comes to the critique of the stakeholder model, for the highly politicised model of the company it proposes is as destructive of legally negotiated contracts as it is of strict ownership. The efficiency of the corporation is

highly vulnerable to stakeholders, since while contracts are made for *economic* reasons, agreements made between stakeholders are made for quasi-political reasons. It is no coincidence that stakeholder theorists are as critical of the heartless contract social order as they are of the soulless property-based society: after all, the philosophy that lies behind their model is specifically anti-individualist. The contracts in Anglo-American corporations lead to value creation and the directors of the corporation are under a fiduciary duty to advance it.

All this is not to say that the stakeholder idea is completely useless, either as a concept or as an integral part of business strategy. As a matter of prudence, a business would be advised not to treat a valued employer as disposable labour, to be dispensed with as soon as the labour market changed, or to reject a reliable supplier if an alternative one offering a slightly better price came long. Actions such as these would do very little for a firm's *reputation*, a vital ingredient in success. But this has nothing to do with corporate social responsibility or business ethics. Theorists of the stakeholder society want to revolutionise business, but most importantly they want to upset the relationship between owners and managers.

Upsetting the balance

In the conventional corporation the directors are responsible to the shareholders for the efficient handling of the assets and the managers conduct the day-to-day business affairs. The relationships here are hierarchical, in the best sense of that word. There are clear lines of responsibility based on a necessary inequality which derives from specific roles that emerge from contract and property and which are governed ultimately by the market. Stakeholding, in the sense used by its ideologues, would disturb these delicate arrangements. What would happen would be the transformation of an economic institution into a political one, with the predictable loss of rationality. Indeed, it is no coincidence that its advocates regularly use the word 'constituencies' to describe the groups that are held to be integral to the organisation.

The point here is that the elimination of hierarchy and determinate decision-making power would create a vacuum in the corporation which would be filled by subordinate but nominally equal groups, most likely trade unions; they would have sectional interests at heart. It is a well-known theorem in social theory that if there is a choice to be made between three decisions and three individuals have different preference orderings over the available decisions, deadlock (or 'cycling') must result, for as the issues are voted on one by one a stable majority cannot emerge. If all the decisions that have to be made regularly by a company were put to the vote there are enough competing groups to make it certain that the resulting indecision could only be resolved by a 'dictator'. Imagine a company faced with the problem of plant relocation. The number of sites could be relatively high and the number of stakeholder groups affected significantly large so that if the issue were put to successive votes no consistent democratic decision would result. Exactly the same problem would occur over questions of remuneration or redundancy. By contrast, in a world of property and contract, 'correct' decisions are reached by those

authorised to make them.

Given the presence of rent-seeking in all aspects of life, especially business and politics, it is inevitable that under stakeholding the wealth of a corporation would not go to its rightful creators but would be distributed between the most powerful groups, whose influence would not necessarily be a function of their economic value to the corporation. Two prominent philosophical stakeholder theorists¹¹ recognise the problem of endless disputes between groups with rival agendas that would occur, but the solution they propose is almost comic. They suggest that the corporation should appoint a 'metaphysical director' who would adjudicate impartially between the competing groups; which is surely an example of rent seeking by philosophers. Such a director would quickly repress as much market influence on decisions as possible, for the application of that mechanism to company problems would quickly make his or her position entirely redundant. A clever director could exploit the corporation up to the point at which its viability could be threatened.

It is obvious that if the shareholder were to be treated merely as one stakeholder among many, and if the company were not focused exclusively on maximising shareholder value, there would be very few people prepared to invest in it. A viable corporation depends on a perfectly legitimate inequality. It is not a kind of 'government' charged with the responsibility of pursuing the public good but an organisation with a specific purpose: maximising long term owner value and the purposes of the different personnel that take part in it under contract. In a stakeholder corporation there would be no proper accountability precisely because the various stakeholder groups cannot constitute a feasible hierarchy with a determinate goal; if everybody is in charge nobody is in charge.

One might ask, how is it that economies that have done rather well seem to have management structures that to some extent resemble the stakeholder model, as in Germany and Japan? It might be the case that these countries do have more inclusive social structures than the US and the UK, or that there is a greater degree of trust between workers and employers. There seems not to be that confrontational stance that used to characterise industrial relations in the UK in the 1970s. It is worth pointing out that the distrust between stockholders and managements in the US is legendary. The shareholders think the managements are all rent seekers who want to pay as low dividends as possible, and the managers think the stockholders have no interest in the long-term future of the company and will sell their stock at the slightest hint of a downturn.

The invisible hand

None of these apparent disadvantages seems to have any relevance at all in today's world, and the US is the world's most successful economy. The market itself performs the therapeutic role of providing incentives for each player in the game of commerce to work, almost accidentally, for the common good of the enterprise. It would be a rash person indeed who recommended the Japanese model for Western capitalist economies. Already in Germany, disgruntled shareholders are openly campaigning for an American-style concentration on stock market values.

It is clear that the stakeholder model has nothing in common with Anglo-American capitalism. It is true that its advocates often claim that it is the best way to maximise shareholder value. The Royal Society for the Encouragement of Arts, Manufactures and Commerce claimed in its report, *Tomorrow's Company*, that firms which did not practise its special brand of inclusiveness would be 'punished sooner or later by an efficient capital market'¹² but this is no more than optimistic assertion. It was perhaps unfortunate that this work was published in 1995, a little before the significant rise in stock market values but it is hard to claim that this has anything to do with inclusiveness. It is also the case that in the US a rise in the stock price often follows an announcement of downsizing. Although this is a favourite target of stakeholders, there is no evidence at all that the moral outrage it is supposed to produce has had any influence at all with the ordinary shareholder. It is true that some evidence is often produced of increased share prices being associated with stakeholderism, and other well-publicised ethical practices. Here, however, the commentators pick on a few well-known examples, such as Ben & Jerry, the high moral profile ice cream producers, and Body Shop in its early days. But there are as many companies that have either been penalised by the market or have merely kept pace with normal economic developments.

In fact, the current boom in the American stock market has seen a noticeable decline in the popularity of stakeholderism. Most Americans invest to maximise returns. This prudence is especially noticeable as the 'baby boom' generation approaches retirement and worries about its future income. America has a large proportion of shares held by private individuals who cannot afford the luxury of investing in companies that pursue moral goals at the expense of profit. It is of course true that most people would want to invest in companies that observe basic moral rules (the generic code) but to satisfy their demands does not require the meeting of the high standards of stakeholder theory. A glance at ethical investment trusts is all that is required for the ethically punctilious, or those who want their companies to do more than follow conventional morality.

6. Genuine problems and the shareholding solution

The rejection of the stakeholder model does not mean that all is well with the publicly quoted company. But the main questions arise out of the agency problem. They are not moral problems. How can one ensure that the directors fulfil their fiduciary duty of caring for the shareholder, and that the managements work for the company and not for themselves, or, one might add, for their favourite moral causes? Anger has been aroused over mistakes made by companies, the irresponsibility of directors and, most important of all, remuneration. A number of private inquiries¹³ have been commissioned to deal with these issues.

Dispersed shareholders

Such genuine problems arise out of the fact that ordinary shareholders are normally widely dispersed and are passive. They have little incentive to get involved in the firms they nominally own and the annual general meeting is quite ineffective at controlling possibly wayward management. Just as in democratic political systems, apathy is the rational attitude. Also, passive shareholders 'free ride' on the activism of some; behaviour that eventually leads to a diminution in the numbers of activists.

But, unlike in a political system, shareholders have one weapon: they can sell their stock. Institutional investors are crucially important on this issue, for they have the time and expertise to monitor effectively the companies in which they entrust their members' funds. Furthermore, they have fiduciary duties to manage the funds as effectively as possible for their members.

The problems that afflict the corporation are not serious enough to warrant any kind of government regulation. There are eventually incentives for the personnel involved in the corporation to take corrective action. The main aim must be to align the interests of the directors of a company with its owners, the shareholders. One clear way would be to design a system of remuneration that encouraged this. Superficially, it is understandable that people should get agitated at some of the massive salaries earned by some directors. If these are linked to the share price then one wonders why they should be rewarded so well from a rise in the share values that they may have had little to do with. It might have been just the result of a

general rise in the stock market. In fact, this might be a good reason for not rewarding directors with stock options in addition to salary.

However, ordinary stock ownership remains the most effective way of inducing directors and managements to act in the interests of the shareholders. It is noticeable that America's remarkable economic renaissance, which began in the mid-1980s, was presaged by the rise of the owner-manager. Managements became owners when they engineered leveraged buyouts and made big profits after they had reorganised the company and then brought it back to market. An extraordinarily successful buyout firm, Kohlberg, Kravis and Roberts, emerged and cut through old, inefficient management structures and changed the face of corporate America.

Fat cats and market value. It is surely obvious that complaints about the high earnings of company executives should not be motivated by the somewhat jejune concept of 'social justice', an emotive principle as much governed by envy as by rationality. Complaints about pay must be impelled by the needs of the company itself. The market is the best judge of someone's worth and the main problem might lie in determining what the market is saying; this is especially the case if remuneration committees are staffed by personnel with an interest in something other than the firm's well-being. Perhaps it is a bad idea that executives sit on the committees of other companies so that a kind of mutual rewarding process takes place. It is here that there is a role for truly independent, non-executive directors who do not have a direct interest in the reward system.

Once again, it is for the private sector itself to find solutions to the more or less permanent, and perhaps intractable, problem of the 'right' pay. It is much better if a solution is found from within the corporate structure itself, with shareholders being fully informed.

The value of active shareholders

A body of active (but not towards political ends) shareholders is obviously the best means of holding corporate managements to account and overcoming the free rider problem. The only people who have any real incentives to prevent managerial capture of the corporation are institutional investors. They are often criticised for their lack of interest in direct management: their only concern is the price of the share. This is part of the much exaggerated, if not conceptually incoherent, problem of short-termism. However, things are beginning to change. In the US, institutional investors are more active in the companies they 'own'. The best example is the biggest public sector pension fund, the Californian Public Employees Retirement (CalPERS).¹⁴ This regularly targets companies it invests in and constantly supervises their management. This has led to remarkable improvements and it is a style of non-passive ownership that is spreading quite rapidly. Unfortunately this type of activism has been slow to develop in this country but it is quite likely to be a feature of the future development of corporate governance.

7. Corporations and the takeover mechanism

Perhaps the single most decisive feature of Anglo-American capitalism, certainly compared to Germany and Japan, is its preference for the takeover method of industrial reorganisation. Takeover rules vary from country to country, and it may be institutionally and legally easy for managements to resist the corporate raider in some economies while the system may be relatively open in others (New Zealand is perhaps the Anglo-American economy with the fewest restraints on takeovers). But the method may be as much deterred by social attitudes as formal rules. In Germany the predator is looked upon with some disdain, sufficient enough to put off bidders, especially foreign. Even domestic bidders find the going difficult. In 1997 Krupp¹⁵ made a bid for Thyssen, a bigger company, in what was a rational reorganisation and amalgamation of the German steel industry. However, a coalition of stakeholders, including trade unions and banks, turned it into a tame merger with none of the unpleasant consequences (for example, job losses) that emanate from a hostile bid. In Japan takeovers are almost unheard of. The legendary American raider, T. Boone Pickens, once built up a stake in a Japanese company as a prelude to a bid, only to be met with hostility and obstructionism as soon as he tried to proceed further.

But things are changing in Europe. In Italy Olivetti has just completed a spectacular £40 billion bid for Telecom Italia; even stakeholderism and the legendary impenetrability of Italian companies could not resist the lure of shareholder value: the fact that Telecom Italian was a recently privatised company might have helped matters. Even in Japan, as this is being written, the first hostile bid is being made. Cable & Wireless plc is trying to take over Digital Communications and the bid is being fought by Nippon Telegraph & Telephone Corp.

It might be the case that non-individualistic economies have adequate methods for ensuring effective management performance. Perhaps they are characterised by a great sense of social solidarity so that managements do not behave opportunistically and seek advantages for themselves at the expense of others. Perhaps maximising owner value is less of a concern anyway and increasing market share, or even the achievement of some form of commercial power, are the major goals. But in Anglo-American economies the wealth of owners is the over-riding purpose of the corporation. The only serious way of ensuring that managements aim at this is to threaten them with a takeover, which is almost certain to lead to job losses and other painful consequences of reorganisation. It is the responsibility ultimately of the

board to act for shareholders' interests and this may well imply that on occasions they should recommend a sell-out to a raider: but they are obviously reluctant to do this. They have in the last twenty years invented all sorts of exotic devices to prevent takeovers.

However, not all takeovers are in the interest of shareholders and they can be promoted by managements for their own advantage. In the 1960s and 1970s, especially in the US, they tended to be examples of empire building: corporations, instead of returning money to the share holders, acquired more companies which often had no real connection with the original operation.¹⁶ Hence the rise of unwieldy conglomerates. The takeover boom of the 1980s, which continues to this day, was designed to break them up and this process was actually a case of the raiders restoring power to the shareholders. A number of Hollywood movies, despite being in the main anti-capitalist, normally portrayed this quite well. The predator is pictured at the annual general, or emergency, meeting eloquently promising massive premiums to the shareholders and attacking slothful management (the 'fat cats').

So far from being immoral, the raider is fulfilling a function which the incumbent management has failed to do. He promises, and normally delivers, shareholder value. Indeed, all the empirical evidence shows that the gainers from the takeover process are the shareholders of the acquired company. And, so far from leading to the concentration of industry, they lead to the reverse, the break-up of companies. Perhaps the motivation behind the German hostility to takeovers stems from the fear of monopoly ownership and the irresponsible cartelisation of industry, which had been a big problem in the early part of the century. In today's world, and especially with the expansion of free international trade, these fears are groundless.

Stakeholding and takeover enmity

There is clearly a connection between faith in the stakeholder society and hostility to takeovers. For the Anglo-American corporation is specifically concerned with the rights of ownership and obviously the exercise of these rights might indirectly harm some people. Since the ideal of stakeholderism is to put various groups in the corporation in a protected position, irrespective of ownership, it is bound to run up against the interests of owners.

Of course, the fear of unemployment is the main motivating force behind the anti-takeover, stakeholding movement. The stakeholder's corporation does not regard price as the true measure of value, so that any form of industrial change that is powered ultimately by the stock market is certain to arouse the ire of stakeholder theorists. However, all the evidence indicates that the major 'victims' of takeovers are not the workers but redundant layers of management. Indeed, it is extremely odd to attribute the causes of unemployment to the takeover mechanism since joblessness has fallen significantly in Anglo-American economies. Germany, perhaps the most obvious example of a stakeholder economy, has unemployment at much

higher levels than the UK and the US respectively. Still, all the anti-takeover statutes that were passed in the US in the late 1980s as a result of the hostility to the takeover boom, were formulated in such a way as to protect incumbent employees, significant local groups and other potential losers from the activities of corporate raiders.

Takeovers and market efficiency

Throughout the world politicians are now beginning to learn the lessons of the 'efficient markets hypothesis': that is, the claim that at any one point in time the capital market values companies and their future prospects accurately. Its evaluation is based on information that is constantly circulating and is not available to political leaders. The stock market thus automatically directs capital towards its most productive uses. Of course, entrepreneurs have to make guesses about the future, and they sometimes turn out to be wrong and are therefore punished by the market. But the hypothesis does not claim to predict the future. Despite the erstwhile claim that stock market manipulators are parasites who live off the genuine productive efforts of others, most governments, including nominally Labour ones, now realise the value of the capital market and its personnel. Certainly the experience of Britain in the 1970s taught politicians a valuable lesson: that governments cannot beat the market in its assessment of future economic prospects. There were too many failed projects that led to unemployment to make that at all plausible. Even if governments could have the knowledge of economic circumstances to make accurate predictions they would be diverted from them by the constant pressure of interest groups to direct resources their way.

The current economic success of the US is partly a consequence of the takeover boom of the 1980s. The market was revaluing assets and this gave opportunities for astute entrepreneurs to reallocate resources. Large corporations were broken up and new and up and coming companies with innovative technologies replaced them. New financial instruments, developed by financial geniuses like Michael Milken, provided monetary backing for the ventures; and the takeover mechanism was the threat to complacent companies that thought they had assured markets. All this is a tribute to Anglo-American flexibility, for although economic change must come eventually, as Europe and Japan are beginning to find out, it comes much more slowly and with greater long term pain, if it emanates from government.

A common charge levelled against corporate raiders was that they loaded companies with debt. It is true that most of them were accomplished by heavy borrowing but in most cases that was repaid as the entrepreneurs spun off the unwanted parts of a target company, so as to construct a viable, slimmed down and lean, enterprise. In fact, these companies consisted of incompatible elements, and they were not put together to exploit genuine synergies.

In any case, there is no theoretical argument that demonstrates what the precise relationship should be between debt and equity in the financing of a company. It is ironic that critics of Anglo-American capitalism should be so concerned about debt

since the companies in the economies they admire are loaded down with debt from the beginning. European corporations raise much less of their capital from the market and much more from, mainly bank, borrowing.

Real problems of takeovers

There are some problems with the takeover device which have vexed critical observers of Anglo-American capitalism. But usually the critics get the wrong target. It was the corporate raider who was, and is, accused of all sorts of immoral and anti-social tactics, causing unemployment and breaking up communities in the pursuit of greed. But the real villains were the incumbent managements of the target companies who were responsible for the wrongdoing, and they were entirely motivated by an anti-social self-interest; for example, to keep their own jobs or to maintain corporate power. In general, they were in breach of their duty to advance the interests of the shareholders. Takeover rules vary from jurisdiction to jurisdiction but managers are usually able to manipulate them for their own advantage: in the US especially, corporate lawyers have devoted considerable time and effort at inventing arcane devices to make the takeover difficult for the predator.¹⁷

Poison pills. The most notorious is the 'poison pill'. Here the Articles of Association of a quoted company are altered so that a group of shareholders have special rights which can be exercised in the event of a takeover: these rights usually include enhanced voting privileges and the right to sell stock at favourable prices. They make takeovers prohibitively expensive: some companies in the US became effectively bid proof. Although there is some doubt about the legality of poison pills in the US, ever since one was upheld in 1985 in the Delaware courts, they have inhibited the takeover process. They are often used by incumbent managements to favour bids from potential acquirers who are more amenable to them. There are some circumstances in which poison pills may be useful. Shareholders may wish to put off a raider because they think that there is a better prospect of long-term value under the present management. And it is the case that poison pills that meet with shareholder approval are economic; but not all of them are put to the shareholders. The insistence that they be approved by the shareholders would be a good case of shareholder power and corporate accountability. Poison pills are forbidden by the UK Takeover Code.

Two-tier takeovers. The Code also forbids 'two tier' takeovers, in which a different (higher) price is offered to those whose stock is required to achieve control, from the price offered to others. In the UK, the bidder, once he passes 30%, has to offer the same price to everybody. It is not absolutely clear that the equal price rule is necessary to secure justice in the bidding process. In the US the same price rule applies only to tender offers; although equality tends to prevail there naturally as bids are often hotly contested. It might be the case that the lucky stockholders have earned their good fortune by playing an active part in the management of the

company and thereby increased its value. The relaxation of the equal price rule might well be an encouragement to shareholder activism in the UK.

Greenmail. Greenmail, from which the late Sir James Goldsmith made a lot of money, is thought to be particularly reprehensible; it has ugly connotations of blackmail, and is not a pleasant aspect of takeovers. But here, again, the critics have the wrong target. In greenmail, a predator who acquires a stake in a target is bought off with the offer of a high price for his shares that is not available to other shareholders. Managements borrow money to pay him, so loading the firm with unnecessary debt. Unprepossessing though he often is, the greenmailer is not to blame. He is merely signalling that the company is a viable target, and if he has no real intention going ahead with the bid then managements should spot this and refuse to pay.

Golden parachutes. In comparison to poison pills and greenmail, the award of 'golden parachutes', highly favourable deals to existing managements so as to make the deal easier to complete, look fairly mild. They may, in fact, be good business policy, though the moralist might wince at some of the reported agreements; see, for example, the payoff to Ross Johnson in the takeover of R.J.R.Nabisco. The real danger, however, is if managements subtly invite takeovers just to secure golden parachutes. But, once again, it is up to the shareholders to monitor managements so that this does not happen. As in other examples of corporate inertia, what is required is shareholder activism. This may be difficult, given the strong likelihood of free riding amongst shareholders, but it is hard to imagine how government could improve things.

UK Takeover code. In fact, the UK Takeover Code is quite an effective regulatory device. While it does not have the force of positive law its prescriptions are rigorously adhered to. The system in the UK, as compared to the US, is not plagued by excessive legalism. It has one inestimable advantage: it does not require takeovers to be *in* the public interest, only that they are not *against* the public interest. That is, if they should lead to monopoly power or give the acquirer too big a market share.

European strictness. The current proposals for the adoption of a European Union code are extremely dangerous. It would appear to be the case that the European Commission will recommend a much stricter system than the UK's. It will make takeovers more difficult and subject them to significant legal tests. Any statutory code (or European Directive) is certain to lead to the kind of costly and prohibitive litigation that the UK has avoided so far. European countries are not as familiar with takeovers as British business and they do not like the individualism that underlies them. The only people who benefit from a convoluted regulatory scheme are managements.

Insider dealing. The problem of insider dealing¹⁸ tends to crop up in takeovers; some of the biggest scandals in the 1980s involved intermediaries, normally investment bankers, divulging information about takeovers for money. This causes

the price of the target company to rise, thus making the takeover much more costly than it otherwise would be. There is not really a moral problem here. The insiders are clearly in breach of their fiduciary duties not to reveal price sensitive information. But the immorality of insider dealing itself is not so easily demonstrable.

The opponents of the practice maintain that it produces an injustice for outside shareholders; they 'own' the company and are surely entitled to advance use of valuable information? This is not obviously true. Value is being created in the firm all the time and often it is the result of entrepreneurial activity by employees; they might make new discoveries or seize opportunities that no one had noticed before. Why should they not be entitled to some of the returns? Do not the criminal and civil laws against insider dealing arbitrarily reassign property rights? Ordinary shareholders are not too bothered about it; the campaign against insider dealing was engineered by moralists and politicians.

From a straightforward utilitarian perspective, insider dealing can be quite valuable. The faster the information flows the more accurately the market will value companies, to the ultimate benefit of everybody. Certainly the latest law against insider dealing, provoked by a European Directive, seems designed to inhibit the flow of information. Analysts are frightened of being seen with company chairmen, at least without a witness, for fear of accidentally becoming insiders. It is very difficult to do essential research under such circumstances. Since the meaning of the key terms used in the law depends on judicial interpretation there is a great deal of uncertainty in the law.

In an ideal world, it would be up to shareholders to determine what information may be revealed by employees, and any legal action would be under private law. The earlier quoted examples of breaches of fiduciary duty in takeovers would produce typical legal actions. But legislators are obsessed with the idea of 'level playing fields' in securities markets and are trying to reproduce these by the artifice of law. But there will always be asymmetric information here and the attempt to criminalise insider dealing will only make the activity even more rewarding for the really unscrupulous. Efficiency, basic justice and the demands of the rule of law together are producing a case for lighter regulation, that is, non-criminal, here.

What is intriguing is that the inclusiveness favoured by critics of Anglo-Americanism makes insider dealing almost inevitable; most of the groups relevant to the corporation will have access to price-sensitive information. Germany did not have a law against insider dealing before the country was compelled to adopt the European Directive in 1995. A minor scandal did occur prior to that when a trade union member of a supervisory board was accused of insider dealing. This only illustrates the ethical problems that arise when two different business cultures are intermingled.

8. The corporation and the future of capitalism

Though it has never been a popular institution of capitalism, the corporation has earned some recognition and respect for its contribution to economic growth and social progress. Some of its harshest critics, for example, John Kenneth Galbraith¹⁹ have softened their original condemnation and have come to accept it. This is no doubt because the original accusations of 'corporate power', 'imperialism' and of being beyond the control of the market or the state, look tame and jejune in today's highly competitive world. The idea that a company can be immune to shareholder pressure looks laughable in the age of takeovers. Likewise, the claim that it cannot be regulated by competition looks similarly out of touch with reality as new products come into the market and enterprising innovators upset established corporate power structures. Technology is crucially important here and some of the richest corporations in the US are high tech companies that are less than twenty years old. No company is safe from competition and no significant monopoly has ever been generated by a free market.

It should also be remembered that the corporation is only one, although the most important, institution that capitalism has developed. Single owner proprietorships, partnerships and various mutual and co-operative organisations have always existed. Obviously, much that has been said about corporate responsibility will not apply to them.

Although many of the mutuals, such as building societies, are rapidly converting to public limited companies, there are subtle developments in capitalism that might imply that the opposite will occur—the gradual diminution of the significance of the corporation. As was pointed out long ago,²⁰ the firm (it is not always the same as the corporation but for present purposes they may be treated as equivalents) has a particular rationale. It developed because of the immense transactions costs of doing business entirely by the market. Pure market arrangements would have each economic agent; for example, painters, mechanics, secretaries, bricklayers and clerks, making contracts with each other to produce an output. Clearly there would be no problems of corporate power in such a world. But it was an unlikely world and it turned out to be much more economical to do business via a firm or corporation which produced bilateral contracts between owners and employees. They bound the employee to the firm and to an extent reduced his or her freedom. It created those problems of corporate power which so exercise writers on business ethics.

Perhaps these problems will be less pressing as capitalism develops. The rise of part-time employment, working from home and taking advantage of the new information technology may mean that in the future fewer people will be tied to a single employer; the contract society will find a new lease of life. In this world, corporate responsibility will not be an important question — it won't be asked because there will be no institution to which it can be addressed. All that critics will be left with is moral vanity. But even in a world well short of this nirvana the problems of corporate power will be less significant. Increased competition and the globalisation of the economy actually reduce corporate power. It is true that the increased mobility of capital enables companies to flee to regimes with less restrictive regulations, which German companies are doing right now, but this does not raise the spectre of irresponsible corporations for they will be exposed to the best regulator of all — competition. As long as Anglo-American capitalism preserves its tradition of openness, transparency and its rigorous commitment to the generic moral code it will pass any test set by the moralist. For there is no need for an *additional* set of moral principles with which to appraise it. If it goes beyond conventional morality, it arrogates for itself a political role, which is bad for business and bad for politics.

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