Notes on “The Purpose of the Corporation”

Milton Friedman: “The Social Responsibility of Business is to Increase Its Profits”

His main argument:

1. Corporate executives are employees of the owners of the business, i.e., the stockholders. (In their jobs, they hold a fiduciary duty as agents to principals.)
2. Their job is to maximize profits (while staying within the rules of the game).
3. Executives are only authorized to do their jobs (i.e., to maximize profits).
4. Profits belong to the stockholders [B and B: as owners, and through contracts with other stakeholders].
5. “Social responsibility” usually means something other than responsibility to increase profits.
6. If executives spend company funds to discharge “social responsibilities,” they are spending someone else’s money (owners’, employees’, or customers’) without their authorization/consent.
7. Spending money in this way is wrong. [It is a form of taxation and wrong for two reasons: (1) on principle (if they are civil servants, they should be elected; they are seeking to attain by undemocratic procedures what they cannot attain by democratic ones); (2) on consequences (how will they know if they are really serving the public good?)]
8. Therefore, those who claim that businesses have “social responsibilities” (besides maximizing shareholder profit within the rules of the game) are wrong.
R. Edward Freeman: “A Stakeholder Theory of the Modern Corporation”

His main argument:

1. Changes in the law of corporations (e.g., products liability law, National Labor Relations Act, Clean Air Act) have placed constraints on management’s pursuit of stockholder interests to the exclusion of other stakeholders. (“legal argument”)
2. When management is allowed to seek stakeholder interests at the exclusion of other stakeholder interests, the “invisible hand” has not always produced the greatest good for the greatest number (e.g., “tragedy of the commons”, moral hazards, monopolies). (“economic argument”)
3. The assumption of primacy of stockholders is false. (by 1 and 2)
4. Six stakeholder groups have a right not to be treated as a mere means (stockholders, managers, employees, suppliers, customers, and the local community).
5. To be part of the end, stakeholders must participate in determining the future direction of the firm in which they have a stake.
6. Stakes require action of a certain sort, and conflicting stakes require methods of resolution.
7. One way (the best way) to resolve conflicts among stakeholders is by appeal to the Doctrine of Fair Contracts. [The purpose of the firm is not best described as the maximization of profit for stockholders; the purpose of the firm is best described by a “normative core,” e.g., the liberal idea of fairness that ensures a basic equality among stakeholders (a la Rawls). A Rawlsian contract would generate something like the Doctrine of Fair Contracts (with its six groundrules and three principles.)]
8. A firm should be managed for the balanced benefits of the stakeholders.
9. Therefore, management’s responsibility is to balance the claims of stakeholders (according to the Doctrine of Fair Contracts).
Important points from other articles:

**John Hasnas: “Two Normative Theories of Business Ethics: A Critique”**

- Deontological argument against “social responsibility” of managers is strong: spending on “social responsibilities” violates agreements and spends other people’s money without their consent. (Can’t overcome deontological argument by reference to an act utilitarian one (i.e., “as long as it’s being done to promote the public interest”).)
- Logical gap when one says that respect for another’s autonomy requires that the other have a say in any decision that affects his or her interest (e.g., students and their grades; the Republican candidate for president).
- Deriving ethical conclusion about the status of stockholder rights from the state of law is dangerously close to fallacy of assuming that what is legally required must be ethically correct.

**John R. Boatright: “What’s So Special About Shareholders?”**

- Logical gap between property rights of shareholders and the fiduciary duties of management (to shareholders alone).
- Stockholder’s argument: Stock ownership is a unique property right. The whole of their investment is placed at hazard; also, no particular assets, which makes protective contracts difficult. This is said to give shareholders special rights, including fiduciary rights over management. (equity argument)
- But in the law of corporate governance, shareholder rights are in place (e.g., elect board of directors, receive dividends) as are legal duties for corporate officers and directors. Since these address special position of shareholders, not clear why fiduciary duties of management are required as well.
- Also, shareholders can dispose of their stocks at any time, while other stakeholders cannot sever their relationship so easily.
- Though implied contracts are recognized by law, the case for implied contracts between stockholders and management of a fiduciary relationship is weak.
  - Shareholders are expected to be treated as (passive) investors, much like bondholders.
  - Virtually no opportunity for the two parties to negotiate the terms of their relation. Shareholders are offered shares on a “take it or leave it” basis as determined by the laws of corporate governance.
- Historically, shareholders were given a privileged position from considerations of public policy; it was thought the most socially beneficial system of economic organization. As public policy changes regarding what is best for society, so goes the privileged position.