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Corporate Governance, Corporate Social Responsibility and the Corporation's Purpose[1]

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ABSTRACT

Purpose:
To rethink the idea that corporate governance is about the alignment of interests of all stakeholders. To indicate this idea's main problems, in making the manager's job significantly more difficult, and in creating numerous avenues for managers seeking merely to advance their own interests. To look into corporate social responsibility in the light of value rationality, and to understand that taking into account stakeholders' interests may be extraneous to purpose rationality and to the corporation's purpose. To indicate this main difference between a corporation as a juristic person of limited purpose on the one hand, and a state government on the other. To relate these ideas to Freeman's "new story of business" and to the declaration that profits are an outcome of successful business rather than its purpose.

Design/methodology/approach:
The approach is conceptual/ philosophical.

Findings:
The stakeholder theory of corporate governance is misguided, insofar as it is taken to assume that the purpose of the corporation is to serve the various interests of all stakeholders. Considerations of corporate social responsibility may (and should) be understood as value rational, having little bearing on the corporation's purpose, i.e. shareholders' profit, but placing essential constraints on the means of its achievement. This however should not be seen as being at odds with Freeman's "new story of business".

Research limitations/implications:
The "stakeholder theory of corporate governance" may be construed (in light of the above) as placing the interests of stakeholders other than the shareholders, outside the corporation's purpose. History may result in corporations taking over parts of government, thus integrating common good in the corporations' purpose from a normative point of view.

Originality/value:
The application of the distinction between value rationality and purpose rationality, to what CSR means for the purpose of the corporation and for stakeholder theory, is totally original, and so is the main conclusion of the argument.

Summary:
The original core problem of corporate governance is the agency problem and the alignment of interests between managers and shareholders, under the principle that the purpose of the corporation that managers ought to serve is shareholders' profit. The idea of corporate social responsibility has brought about stakeholder theory, that is the idea that corporate governance is about serving all stakeholders' interests. This multiplies the conflicts of interests to be aligned and creates in effect many more avenues for managers seeking to advance their own interests. We present an example of a board of directors seeking to allocate a substantial part of the corporation's wealth to the alleviation of social poverty, and we revisit the question of the purpose of the corporation as a legal boundary to the possibilities of the juristic person that is the corporation. We advance the idea that corporate social responsibility and taking stakeholders other than shareholders into account is about value rationality, not purpose rationality, and should not be understood as necessarily

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depending on long term profit or any win/win situations. It mostly places constraints on the purpose rational means to achieve the corporation's purpose, which remains shareholders' profit. It must not be understood to alter this purpose, nor to make the corporation assume a social role paralleling state government. Freeman's advocacy of the "new story of business", and his concomitant ideas that business is about the business idea rather than profit, that people are not primarily driven by greed, that stakeholder relationships are crucial for business, and that creative imagination in balancing all values and interests is at the root of greater value creation, are in fact perfectly reconcilable with the above.

Keywords:
Corporate Governance, CSR, Stakeholder Theory, Value Rationality, Purpose Rationality

1. Introduction

Whenever I say that I teach business ethics, or corporate social responsibility, I invariably get this response: "Is there such a thing?".

And I often respond by invoking the distinction between the descriptive and the normative disciplines. Business ethics is a normative discipline; it is not about what is, but about what ought to be. Responsibility, and accordingly corporate social responsibility, is a normative concept.

Corporate governance is also normative. It is, incidentally, interesting in this respect, for it starts by being descriptive (practices and procedures of running a corporation) and ends in being normative (practices and procedures of running a corporation efficiently, to achieve its objectives). Although we can of course still speak of "corporate governance" descriptively, distinguishing it from "good corporate governance", the academic discussion on "corporate governance" is not in fact concerned with describing how actual corporations happen to be governed, but with seeking to determine how an ideal corporation is to be governed, thus prescribing rules of governance that actual corporations are to follow.[1]

So corporate governance, and corporate social responsibility, which are our topics here, are both normative issues. However, if you search Google for articles on corporate social responsibility and corporate governance, you'll be confounded by empirical research; it will be harder to find normative papers.

In this conference too, empirical research abounds. Even in this here working group, on "corporate governance, CSR and ESG", there are hardly any papers with a normative point of view.

Admittedly, I am not good for empirical research. I will invite you therefore to shift your focus for a little while, and to discuss with me, not what is, but what ought to be.

2. Corporate governance as a matter of alignment of interests

The academic discussion of corporate governance begins with the agency problem; i.e. the probability that the agent, who is supposed to act for the interest of the principal, has his or her own interest, which is at variance with the principal's interest. (Gstraunthaler et al, 2008). This problem is inherent in the structure of the corporation, with managers managing financial resources provided by the shareholders. What is to stop the managers from acting in their own interests and against the interests of the shareholders? So, from a classical economist's point of view, the idea of corporate governance is mainly about minimizing (if not eliminating) the conflict of interest between managers and shareholders. Or, more accurately, it is about aligning the managers' behaviour with the shareholders' interest, despite the managers' interest being at odds with the latter. For the managers are naturally assumed to ought to serve the shareholders' interest, as agents for the shareholders, in accordance with the idea that the purpose of the corporation is to achieve profit for the shareholders.

This traditional idea, that the purpose of the corporation is to achieve profit for the shareholders, was clear, simple, concise, and suitable as a driving idea, in purpose rationality, to lead to logical conclusions. And it provided a relatively simple test whether the managers did their job.

However, corporate governance nowadays is not only about that. It is also about corporate social responsibility, and about the interests of the stakeholders.

Indeed, the idea of corporate social responsibility had a profound effect on the idea of corporate governance. This is because it brought about a radical shift in the theory of the corporation, regarding its purpose.

The root of the idea of corporate social responsibility was a social demand, that meant a moderate at first limitation: the pursuit of profit must not destroy society. This came with a logical justification: the corporation, and the managers, have a duty to society too. Society has a variety of constituents. And this led to the stakeholders; these

[1] This is actually quite instructive for the concept of ethics too, and its history, which is obviously rooted in the prima facie descriptive idea of habits (mores → morality, ἤθη → ἠθική, and also Sitte → Sittlichkeit).

are also important, on a par with the stockholders. So now, the duty of the managers' is not only to these, but also to customers, workers, and so on.

This is stakeholder theory. According to it, good corporate governance is governance serving all constituents' interests. It is of course still about efficiency, but efficiency to achieve what? Profit for stockholders of course, and cheap but quality products for the consumers, and good pay and humane conditions for the workers…

Do these interests, and purposes, align?

They may. Managers' talk these days is full of "win/win" situations, and "doing well by doing good". But what if they don't? For one would expect to see conflict rather between these interests, and their alignment to be an exception. However, this conflict is conspicuously missing from managers' talk, or from business administration literature.

If we return to the original idea of good corporate governance, which sought to address the conflict between the shareholders' and the managers' interests, we now see that we have multiplied the relevant interests and the conflicts between them. Consequently, it seems to me, that, where the good manager is concerned, we have made his job immensely harder. But where the wicked manager is concerned, his work has become much easier; because in seeking to pursue his personal interest rather than any other stakeholders', he can always find some stakeholders' interest to advance as the rationale for his decision. There is indeed always a win/win situation for him, where the one "win" is his own profit.

3. An imaginary example

So, I will ask you now to imagine a situation, where conflict between interests is at the forefront, rather than hidden in the margins. In the middle of a dire economic crisis, with unemployment on the rise, war caused shortages and natural disasters on top of it all, let us assume a for-profit corporation that has not been hit by the disaster. It is doing very well financially, not only because it happened to make certain choices in the past that turned out well, but also because a great part of its clientele are the obscenely rich, who were not touched apparently by the crisis. And let us assume a suddenly enlightened board of directors, who have decided that, now that society needs it, they want to give. A lot. Not because long term profit is thus expected, but because it is in accordance with their and the corporation's social responsibility. E.g. to alleviate poverty. So, they seek to allocate, say half the corporation's last year's earnings, to this.

Would this be good corporate governance? It would be great state governance probably, as the seven fat cows, seven lean cows ancient myth teaches us; but can we say this in the context of the for-profit corporation? And if not, why not? Aren't the people of society stakeholders too, whose interests the corporation and the corporation's management ought to serve?

Milton Friedman would have repudiated such a proposal, as totally irrational, and even deeply unethical, being an embezzlement in effect of the shareholders' money. It would most certainly be about spending other people's money. But what if the proposal came not in the board of directors, but in the shareholders' assembly? Could this be decided by a majority vote? Shouldn't the minority be allowed to veto such a decision, on the grounds that it is outside the corporation's purpose of existence? But we just said that, in stakeholder theory, this purpose has come to embrace, not just stockholders' profit, but the interests of all other stakeholders too.

Notice here that the actual burden of such a decision to each shareholder would depend on this shareholder's particular circumstances. It would depend for instance, on what percentage of this shareholder's wealth happened to be tied to this corporation; or on the time that this shareholder had planned, or needed, to liquidate. It is conceivable therefore, that there might be shareholders for whom such a decision might amount to economic ruin. It is also quite conceivable, that this decision might be in the actual personal interest of a CEO or controlling shareholder (or both), who just happened to be running for President of the USA.

4. The corporation as a juristic person in law and legal theory

The question whether a decision and a course of action such as this should be possible for a corporation to take is primarily a question for law and legal theory. And it is tied to the more general question what sort of actions a corporation is allowed to take and what sort of actions it is possible for a juristic person to take. Economists may perhaps be excused for having a blind spot, or perhaps a disregard even, for the legal fact that the corporation is a juristic person with its own rights and obligations, which are neither the ones of the stockholders', nor of anybody else's inside the corporation. However, the question whether the managers, or the shareholders may vote towards e.g. allocating a substantial part of the corporation's wealth towards the alleviation of poverty, is first and foremost a question regarding the boundaries of the juristic person itself in general, and of the for-profit corporation itself in particular.

From the point of view of legal theory, this last question about the boundaries of a juristic person is tied to the old question regarding the nature of the juristic person, that was hotly debated in the 19th and the early 20th century, at the time that is of the establishment of the corporation as the dominant institution in economy that we know. The practical impact of that debate (which impact was admittedly forgotten in later times) was precisely the extent to which a juristic person, and therefore a corporation too, may seek to take a course outside the scope of what was established or understood to be its role in accordance with its charter, or even the extent of what was possible for a charter to stipulate.

This debate died out, having led to ideas that were conducive to greater freedom for corporations to act, and less boundaries on their (and their managers', or, at any rate, shareholders') possible decisions. Indeed, the idea seems to have more or less prevailed in legal theory long ago, that juristic persons should be conceived of as real organisms, that are not in effect restricted by their artificiality (if indeed it be thought of as artificiality) in having virtually all

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sorts of rights and obligations. Positive law, for the most part, seems to have allowed for this, throughout most, if not all, legal systems. Interestingly though, in virtually all domestic legal orders, a provision remains regarding the corporation's (or any juristic person's) purpose, which is to be stated in its charter, and entails some boundaries regarding the legality of the managers' or even possibly the shareholders' decisions. With respect to the for-profit corporation, it is normally understood that this purpose is tied to the idea of the achievement of profit, whose beneficiaries are of course the shareholders, each one according to one's share. However, stakeholder theory has had an impact to this as well, with the effect that the idea tends nowadays to be added sometimes, that the legal purpose of the corporation is also to include the various stakeholders' welfare. (British Academy, 2021; Mayer, 2022).

5. The corporation's purpose. Purpose rationality and value rationality.

Still, it seems to me that there is much to be said in favour of the clarity of the original, if out of fashion, driving idea of corporate governance, that the corporation's role, and the corporation's managers' primary duty, is towards the interests of the shareholders. Not in the sense that the interests of other stakeholders should not be taken into account in corporate management, but in the sense that we need a rational standard regarding the managers' mission, that is clearer than stakeholder theory.

We may perhaps find this rational standard if we remind ourselves of the distinction between purpose rationality and value rationality. And also, of the distinction between one's purpose and the efficiency in achieving it, and the constraints and duties that may exist for reasons other than this purpose.

The distinction between purpose rationality and value rationality is normally attributed to Max Weber and his work (Weber, 1922; 1978). Purpose rationality (Zweckrationalität in the German original) is deciding and acting because of a purpose that will be served by the action. It is contrasted to value rationality (Wertrationalität in the German original), which is deciding and acting because of a value that the action itself has. If I am writing a book because I have something to say and I want to express myself, my action is value rational. If I am writing it, so as to finally achieve full professorship, my action is purpose rational. If I am listening to a song, because it is beautiful, I am being value rational. If I am listening to it, in order to learn to sing it, e.g. for tomorrow's talent show, I am being purpose rational. The workings of the corporation towards profit for the shareholders are purpose rational actions.

So, what about the idea that a corporation should also take into account the interests of the stakeholders? What about the effort of the corporation to stand up to its corporate social responsibility?

I would ask you to consider with me the idea that responsibility, and so corporate social responsibility, is not primarily about purposes; it is about values. Responsibility in redressing a wrong that I have done, in seeking to be honest in my transactions, in being there for my students, is not about achieving something else, that is extraneous to my conduct; it is about the value of the conduct itself. To be clear, there may well be numerous goals to be reached through this responsible conduct as well; in redressing the wrong I may also avoid retribution, in seeking to be honest I may nurture a profitable relationship for the future, in being there for my students I may hope for their positive evaluation. However, my conduct is equally responsible or irresponsible, regardless of my attempting to reach these goals or not. From the point of view of purpose rationality, if there is no fear of retribution, there is no reason to redress the wrong that I have done; if I will never see the other guy again, there is no reason to be honest towards him; if I intend to quit my job tomorrow and go live in a Thibet monastery, there is no point in being there for my students today. But these considerations have no bearing to the question whether I acted responsibly or not, nor to the issue what my responsibilities were. For these are a matter of value rationality.

Accordingly, I would suggest that corporate responsibility to society, and to stakeholders, is not about seeking to serve their interests, in order to create more value for the company, or because their interests somehow have a place in the company's goals; it is about the fact that harming them (in order to achieve profit) is wrong. Perhaps it is better to say, not that there are stakeholders, besides stockholders, whose interests the corporation ought to serve too (purpose rationality), but that there is the corporation with its stockholders in the pursuit of profit which is the goal in running a company (purpose rationality), and at the same time there are constraints in the ways of reaching this goal, because of the value that is placed on workers, customers, the natural environment, etc. (value rationality).

I may be driving to a destination; reaching it is my goal. And I may be driving fast, to avoid being late. Still, I must, and I will, make sure that I do not kill that kid who is crossing the road. The kid's life is much more important than my reaching my destination in time. This however does not make the kid and its life my goal; my goal remains my destination.

It is the same with the stakeholders. It is not about how important they are vis a vis the shareholders. Workers may indeed be much more important than shareholders' profit, same as the kid while I was driving. This does not make their welfare a goal of the corporation. The corporation's purpose remains the (less important) profit, in accordance with its specific type of business.

Accordingly, for the most part, corporate social responsibility as well as the welfare of the stakeholders is normally a reason not for positive action, but for refraining, in the pursuit of shareholders' profit, from otherwise efficient profit seeking action, that would damage society and the corporation's stakeholders. However, this should not be taken to mean that corporate social responsibility and consideration of values are solely about constraints and refraining from action. Positive action may be entailed through value rationality in this context too. If while driving I encounter the kid wounded (because run over by someone else), I may be obliged, and I will certainly be justified, to stop and help, thus delaying my reaching my destination. My purpose, my destination, has not changed. There's simply a (greater) value – the kid's life – that takes precedence. On the same footing, if the democratic state, of which the corporation may by analogy be understood to be a citizen, decides to require the corporation to divert its profits to address an exceptional emergency, it may be the corporation's duty to actively involve itself accordingly (rather than drag its feet, or seek ways to avoid it), thus postponing for the time being the achievement of profit. Or, if through the corporation's negligence, a disaster has hit the vicinity of its factories, it may be the corporation's obligation to do everything in its power to alleviate these consequences, rather than mainly seek to cut its losses.

In any case, an important general point to make is that the justification of the corporate socially responsible attitude does not depend on attaining profit through it, or in parallel with it. It is not about win/win. It is primarily about respecting values other than profit. However, respecting values other than profit does not make these into a goal of the corporation. Taking into account the importance of the corporation's stakeholders does not entail that promoting their interests is a goal of the corporation and its managers. Under normal conditions, the sole job of the managers' is to achieve profit for the shareholders, through the business that has been stipulated in the corporate charter; with the caveat that, because of social responsibility, the means to achieve this profit, the means of doing this business, may not entail the harm of society.

So let us return now to our example of the enlightened board of directors seeking to allocate the corporation's resources in the alleviation of poverty. The above should have made clear why such a course of action cannot be reasonably justified by the idea of corporate social responsibility, or by the idea of the importance of stakeholders other than shareholders. Unlike the government, the corporation has no responsibility to alleviate poverty. It seeks profit – not the welfare of the people – but while valuing the welfare of society in which it operates, and thus having a responsibility to refrain from harming it.

Furthermore, it is important in legal theory to revisit the old and forgotten question what a corporation is, in the sense of juristic person. And perhaps to restate the idea that there are limits to what it can and cannot do, as a matter of its artificial nature as an aggregation of capital, or union of persons, serving a limited purpose, which is profit for the shareholders.

At least insofar as we want to keep corporations separate from state government. And unless of course we are fine with allocating society's government or parts thereof to corporations, i.e. to corporate managers.

6. Conclusions

From the above arguments it should follow that the stakeholder theory of corporate governance is misguided, insofar as it is taken to assume that the purpose of the for-profit corporation is to serve the various interests of all stakeholders. The purpose of the for-profit corporation is shareholders' profit. This does not make it more important than considerations of corporate social responsibility, which are value, not purpose rational, and have little to do with the corporation's purpose. They may place constraints on the means of achieving this purpose, regardless of the possibility of alignment of interests. They do not depend on win/win situations and may be valid even if they entail less efficiency in or postponement of the achievement of profit; however, they cannot justify a modification of what the business of the corporation is. Finally, we should revisit the idea of the juristic person that is the corporation, and of the purpose of the juristic person as limiting in legal theory its possibilities of action.

7. Addendum. On Freeman's new story of business.

The stakeholder theory of the corporation is tied up to R. Edward Freeman's work. So much so it seems, that it is practically impossible to speak about this theory, without having to grapple with his writings. In recent years, Edward Freeman has been persuasively advocating a "new story of business" (Freeman, 2017), which is to be contrasted to the "old story of business", and which he argues is more suited to our times following the global financial crisis. Part of this new story of business seems to be a shift from the idea of profit as the business's purpose. This appears to be at odds with our argument here. In what follows I will try to clarify this issue.

Let me start by summarily saying that I am quite sympathetic towards Freeman's view that "profits are not the purpose of business", but rather an outcome of successful business. (Freeman, 2017, p.452-3). I would insist however that profits, through its specific type of business, are the purpose of any for-profit corporation.

The business idea is indeed primary in starting a (successful) business. And it may well be true that "most entrepreneurs start their companies because… "they are on fire about their business idea"". (Freeman, 2017, p.453). However, the entrepreneurs who are on fire about their business idea are not a for-profit corporation and are perfectly free to not create one. Once they have created a for-profit corporation, they are bound by the legal rules that are tied to this form of doing business, which is a juristic person that is separate from them, and which, unlike a human being, was of old conceived as limited in its purpose. These rules have traditionally rested on a cardinal distinction regarding whether the corporation is created for profit or not. This is so for many reasons, but crucially because through the corporation the entrepreneurs will turn to others, indeed to the public, for financing. And it needs to be clear whether the newly created organization is going to be seeking profit, among other things, or not; and whether the shareholders will be entitled to expect to receive profit through the corporation's business, or not. It was thus traditionally understood, on the very foundation of the legal rules instituting these organizations, that each shareholder has some sort of right, to expect that the for-profit corporation stay on a particular course, laid out in the corporation's charter, towards profit. And that the corporation, and its managers (and the shareholding majority too) are not at liberty to act in any way they like in this respect.

Accordingly, corporate governance is about rules entrenching roles within the organization. Rules that entail permissions and prohibitions. And roles according to which managers and employees are expected to act. So, is the role of the manager to pursue his or her own vision of the common good? Is the controlling stakeholder's role to choose any goal he or she sees as valuable? Or are managers and shareholders both, in these capacities of theirs, parts of an organization having a particular purpose according to its charter? According to traditional legal theory, the latter is true. And the real question here is, should we change this? Should we more specifically allow the managers to

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disregard, at least to some extent, this obligation to seek profit, in favour of the common good or of their vision of the common good – as this new story of business seems to advocate?

Freeman says correctly that it is wrong to think that people and companies are entirely self-interested, competitive and greedy. That people want meaning and purpose in their lives and are not merely driven by carrots and sticks. That the traditional in classical economics presentation of people as completely self-interested is flawed. (Freeman, 2017, p.456-7). However, the opposite claim, that people are never self-interested or greedy, is also patently wrong. The thing is that some people are mostly like this, and some people are mostly like that, and most people can be both at times. And although most people will try to do what's best most of the time (at least insofar as they need not work too hard, or sacrifice too much for it), there will always be those who will seek to exploit others for personal interest. Even though it is true that no one wants to be (categorized as) bad, this does not mean that there is no crime in the world; it simply means that the perpetrator will rationalize, or simply avoid confronting the moral implications of his or her actions. In shaping our institutions, we must allow for both eventualities; not rest on one simplistic idea about human nature's being either egoistic or altruistic. And when making rules of law, which are to help minimize conflict and to be used in adjudicating conflict, we have to primarily take into account the possibility of egoism and greed, which are often at the basis of this conflict. In making rules regarding the degrees of freedom that managers of corporations must have in managing other people's money, we have to take into account the fact that there are greedy managers too.

Still, it is the spirit of our times to allow for more and more freedom and power in the hands of corporate managers; and perhaps things will continue to turn in this direction anyway. The perfectly valid ideas of corporate social responsibility, and of the importance of the stakeholders, have also added apparently to this tendency. What I have tried to do here is to show that corporate social responsibility, and the importance of business ethics for every type of business, must not be assumed to necessitate this radical shift from traditional and – might I add – wise legal theory, in what regards the purpose of the for-profit corporation. And truly, I wholeheartedly agree with Freeman that "a sense of values and ethics has to go alongside purpose" (Freeman, 2017, p.461), merely pointing out precisely that values and ethics are not the corporation's purpose, they indeed go alongside purpose.

Is this idea of the separation of the purpose of profit (in purpose rationality) from values and responsibility (in value rationality) in tune with Freeman's "new story of business"? Does it allow for the idea of the importance for business of caring for stakeholder relationships and for the creation of value for all stakeholders? (Freeman, 2017, p.458). Of course, it does. Does it allow for the creative imagination that Freeman says may be utilized once trade-offs are unacceptable? (Freeman, 2017, p.459-60). Absolutely; and in a more radical manner too. Because understanding values as limits to the pursuit of (the purpose of) profit makes trade-offs between the two much more difficult to envision. However, we must add here, that understanding what is real and what is not, what is possible and what may be impossible, is not merely a matter of lack of imagination. It may well be, and often is, a matter of being able to look at the facts of life. When trade-offs are necessary, as, for all the imagination in the world they may well be, we need a clearer sense of each one's role and of what is most valuable, than is afforded by the win/win idea.

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