

# THE NORMATIVE THEORIES OF BUSINESS ETHICS: A GUIDE FOR THE PERPLEXED\*

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## I. Introduction

A charge that is frequently lodged against the practical utility of business ethics as a field of study concerns the apparent failure of communication between the theorist and the business practitioner.<sup>1</sup> Critics of the discipline often point out that business ethicists are usually academics, and worse, philosophers, who speak in the language of abstract ethical theory. Thus, they are accused of expressing their ideas in terms of ‘deontological requirements,’ ‘consequentialist considerations,’ ‘the categorical imperative,’ ‘rule utilitarianism,’ ‘the hedonistic calculus,’ ‘human flourishing’ and other locutions that are essentially meaningless to the ordinary business

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<sup>1</sup>For a famous example of this, see Andrew Stark, *What’s the Matter with Business Ethics?*, 71 HARV. BUS. REV. 38 (1993). See also Thomas Donaldson & Thomas W. Dunfee, *Integrative Social Contracts Theory: A Communitarian Conception of Business Ethics*, 11 ECON. & PHIL. 85, 87 (1995).

person who possesses little or no philosophical training. Business people, it is pointed out, express themselves in ordinary language and tend to resist dealing in abstractions. What they want to know is how to resolve the specific problems that confront them.

To the extent that this criticism is justified, it places the business ethicist on the horns of a dilemma. Without the guidance of principles, ethical discussion is mere casuistry. Thus, general principles are necessary if business ethics is to constitute a substantive normative discipline. However, if the only principles available are expressed in language unfamiliar to those who must apply them, they can have no practical effect. This suggests that the task of the business ethicist is to produce a set of ethical principles that can be both expressed in language accessible to and conveniently applied by an ordinary business person who has no formal philosophical training.

The search for such principles has led to the development of several normative theories that have been specifically tailored to fit the business environment; theories that, for purposes of this article, I shall refer to as the normative theories of business ethics.<sup>2</sup> These theories attempt to derive what might be called “intermediate level” principles to mediate between the highly abstract principles of philosophical ethics and the concrete ethical dilemmas that arise in the business

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<sup>2</sup>I am employing this phrase in an effort to avoid the confusion engendered by referring to strictly normative theories as “theories of corporate social responsibility.” The latter phrase has been used to refer to not only normative theories, which attempt to identify the philosophically verifiable ethical obligations of businesses and business persons, but also to theories that are either purely or partially descriptive or instrumental in nature, such as those that focus on businesses’ or business person’s responsiveness to societal expectations or demands. Indeed, historically speaking, the concept of corporate social responsibility arose as a response to an increasing level of criticism of the business system in general and the power and privilege of large corporations in particular, see Thomas M. Jones. *Corporate Social Responsibility: Revisited, Redefined*, 22 CAL. BUS. REV. 59, 59 (1980), and, to some extent, as a reaction against the stockholder theory, one of the normative theories to be examined in the body of this article. As a result, the theories of corporate social responsibility should probably be seen as a genus of which what I am calling the normative theories of business ethics are a species.

environment. Philosophical ethics must provide human beings with guidance in all aspects of their lives. A normative theory of business ethics is an attempt to focus this general theory exclusively upon those aspects of human life that involve business relationships. By thus limiting its range of application and translating the language of philosophical ethics into the everyday language of the business world, such a theory is specifically designed to provide human beings with ethical guidance while they are functioning in their capacity as business people.

Currently, the three leading normative theories of business ethics are the stockholder, stakeholder, and social contract theories. These theories present distinct and incompatible accounts of a business person's ethical obligations, and hence, at most one of them can be correct. The stockholder theory is the oldest of the three, and it would be fair to characterize it as out of favor with many contemporary business ethicists. To them, the stockholder theory represents a disreputable holdover from the bad old days of rampant capitalism. In contrast, the past decade and a half has seen the stakeholder theory gain such widespread adherence that it currently may be considered the conventionally-accepted position within the business ethics community.<sup>3</sup> In recent years, however, the social contract theory has been cited with considerable approbation and might accurately be characterized as challenging the stakeholder theory for preeminence among normative theorists.<sup>4</sup>

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<sup>3</sup>Evidence for this may be found not only in the inordinately large percentage of business ethics journal articles that discuss the stakeholder theory favorably, but in the increasing number of textbooks that are being written from the stakeholder perspective. *See, e.g.*, RONALD M. GREEN, *THE ETHICAL MANAGER* (1994), JOSEPH W. WEISS, *BUSINESS ETHICS: A MANAGERIAL, STAKEHOLDER APPROACH* (1994), ARCHIE B. CARROLL, *BUSINESS AND SOCIETY: ETHICS AND STAKEHOLDER MANAGEMENT* (1996).

<sup>4</sup>Consider, for example, the recent special issue of *BUSINESS ETHICS QUARTERLY* devoted to the social contract theory. 5 *BUS. ETHICS Q.* 167 (Thomas W. Dunfee ed., 1995).

In this article, I propose to present a contrarian review of these theories. I will suggest that the stockholder theory is neither as outdated nor as unacceptable as it is often made to seem, and, further, that there are significant problems with both the stakeholder and the social contract theories. To do this, I propose to summarize each theory, analyze its supporting rationale, and canvass the chief objections against it. I will then draw a tentative conclusion regarding the adequacy of each theory. Finally, on the basis of these conclusions, I will attempt to suggest what the contours of a truly adequate normative theory of business ethics must be. Before turning to this, however, I feel compelled to say a word about the meaning of the phrase, ‘social responsibility.’

In the business setting, ‘social responsibility’ is often employed as a synonym for a business’s or business person’s ethical obligations. This is unfortunate because this loose, generic use of the phrase can often obscure or prejudice the issue of what a business’s or business person’s ethical obligations truly are. To see why, one must appreciate that the phrase is also used to contrast a business’s or business person’s “social” responsibilities with its or his or her ordinary ones. A business’s or business person’s ordinary responsibilities are to manage the business and expend business resources so as to accomplish the specific purposes for which the business was organized. Thus, in the case of a business organized for charitable or socially beneficial purposes (e.g., nonprofit corporations such as the Red Cross or the Nature Conservancy and for-profit corporations in which the stockholders pass resolutions compelling charitable contributions), it is a manager’s ordinary responsibility to attempt to accomplish these goals. Even when a business is organized strictly for profit, it may be part of a manager’s ordinary responsibilities to expend business resources for socially beneficial purposes when he or she believes that such expenditures

will enhance the firm's long-term profitability (e.g., through the creation of customer goodwill). When the phrase 'social responsibility' is used in contradistinction to this, the claim that businesses or business persons have social responsibilities indicates that they are obligated to expend business resources for socially beneficial purposes even when such expenditures are not designed to help the business achieve the ends for which it was organized.

When 'social responsibility' in this narrow sense is conflated with 'social responsibility' as a synonym for a business's or business person's ethical obligations in general, it groundlessly implies that businesses or business persons do, in fact, have ethical obligations to expend business resources in ways that do not promote the business's fundamental purposes. Since not all theorists agree that this is the case, a definition that carries such an implication should be scrupulously avoided. For this reason, I intend to employ 'social responsibility' to refer exclusively to those ethical obligations, if any, that businesses or business persons have to expend business resources in ways that do not promote the specific purposes for which the business is organized. When the phrase is used in this way, it can make perfect sense to say that a business or business person has no social responsibilities. In fact, the first normative theory of business ethics that I will examine, the stockholder theory, makes precisely this claim.

## II. The Stockholder Theory

The first normative theory of business ethics to be examined is the stockholder theory.<sup>5</sup> According to this theory, businesses are merely arrangements by which one group of people, the stockholders, advance capital to another group, the managers, to be used to realize specified ends and for which the stockholders receive an ownership interest in the venture.<sup>6</sup> Under this view, managers act as agents for the stockholders. They are empowered to manage the money advanced by the stockholders, but are bound by their agency relationship to do so exclusively for the purposes delineated by their stockholder principals.<sup>7</sup> The existence of this fiduciary relationship implies that managers cannot have an obligation to expend business resources in ways that have not been authorized by the stockholders regardless of any societal benefits that could be accrued

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<sup>5</sup>In this article, I intentionally speak in terms of ‘the stockholder theory’ rather than ‘agency theory’ to emphasize that I am discussing a normative theory. ‘Agency theory’ seems to be used ambiguously to refer to both the attempt to produce an empirical description of the relationship between managers and stockholders and the normative implications that would flow from such a relationship. See Norman E. Bowie & R. Edward Freeman, *Ethics and Agency Theory: An Introduction*, in *ETHICS AND AGENCY THEORY* 3, 3-4 (Norman E. Bowie & R. Edward Freeman eds., 1992). In order to avoid this ambiguity in the present context, I employ the label ‘stockholder theory’ to indicate that I am referring strictly to a theory of how businesses or business people should behave.

<sup>6</sup>Historically, the normative theories of business ethics grew out of the literature on corporate social responsibility. As a result, they are often expressed as though they apply only to corporations rather than to businesses generally. This is certainly the case with regard to the stockholder theory. To be adequate, however, a normative theory of business ethics should apply to businesses of all types.

For ease of expression, I intend to follow the convention and employ the terminology of the corporate form in my representation of the theories. However, I will attempt to show how each of the theories may be generalized to apply to other forms of business as well. See *infra* notes 22, 43, 62.

<sup>7</sup>I wish to emphasize again that the stockholder theory is a normative and not a descriptive theory. As such, it asserts not that managers are, in fact, the agents of the stockholders, but that they are ethically obligated to act as though they were.

by doing so. Of course, both stockholders and managers are free to spend their personal funds on any charitable or socially beneficial project they wish, but when functioning in their capacity as officers of the business, managers have a duty not to divert business resources away from the purposes expressly authorized by the stockholders. This implies that a business can have no social responsibilities.

Strictly speaking, the stockholder theory holds that managers are obligated to follow the (legal) directions of the stockholders, whatever these may be. Thus, if the stockholders vote that the business should not close a plant without giving its employees 90 days notice, should have no dealings with a country with a racist regime, or should endow a local public library, the management would be obligated to carry out such a directive regardless of its effect on the business's bottom line. In most cases, however, the stockholders issue no such explicit directives and purchase stock for the sole purpose of maximizing the return on their investment. When this is the purpose for which the stockholders have advanced their money, the managers' fiduciary obligation requires them to apply it to this end. For this reason, the stockholder theory is often imprecisely expressed as requiring managers to maximize the financial returns of the stockholders. The most famous statement of this shorthand description of the stockholder theory has been given by Milton Friedman who ironically refers to this as a "social responsibility." As he expresses it, "there is one and only one social responsibility of business--to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud."<sup>8</sup>

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<sup>8</sup>MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 133 (1962). I should point out that Friedman does not always describe the constraints on the pursuit of profit this precisely. Often, he merely states that businesses should "make as much money as possible while conforming to the

It is important to note that even in this imprecise form, the stockholder theory does not instruct managers to do anything at all to increase the profitability of the business. It does not assert that managers have a moral blank check that allows them to ignore all ethical constraints in the pursuit of profits. Rather, it states that managers are obligated to pursue profit *by all legal, non-deceptive means*.<sup>9</sup> Far from asserting that there are no ethical constraints on a manager's obligation to increase profits, the stockholder theory contends that the ethical constraints society has embodied in its laws plus the general ethical tenet in favor of honest dealing constitute the ethical boundaries within which managers must pursue increased profitability.<sup>10</sup> A significant

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basic rules of society, both those embodied in law and those embodied in ethical custom.” Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES MAGAZINE, September 13, 1970 at 32-33. Of course, when stated this broadly, Friedman's injunction becomes a triviality asserting nothing more than that one should pursue profits ethically. Although this has been the source of much criticism of Friedman's particular expression of the stockholder theory, it need not concern us in the present context. The more specific statement given in the text does define a substantive position worthy of serious consideration, and so, that is the formulation that will be used in this article.

<sup>9</sup>The additional restriction of Friedman's formulation that requires managers to engage solely in open and free competition is usually ignored. In today's regulatory environment, it is not regarded as unethical to lobby the government for favor. In many cases, such activities are necessary as a matter of corporate self-defense.

<sup>10</sup>It may be accurate to characterize the stockholder theory as proposing an “ethical division of labor.” According to the stockholder theory, the nature of the business environment itself imposes a basic duty of honest dealing on business people. However, the theory also claims that for there to be any more extensive restrictions on managers, it is the job of society as a whole to impose them through the legislative process.

It is, of course, true that this approach defines managers' ethical obligations partially in terms of their legal obligations and implies that their ethical obligations will change as the legislation that defines and regulates the business environment changes. This, in turn, implies that the stockholder theory is not self-sufficient, but is dependent upon the political theory (which delimits the scope of the state's power to legislate) within which it is embedded. This dependence does not render the theory unintelligible, however. At any particular point in time, the theory can be understood as asserting that a business or business person must refrain from engaging in deceptive practices and violating the laws of the land *as they exist at that time*.

amount of the criticism that is directed against the stockholder theory results from overlooking these ethical limitations.<sup>11</sup>

For whatever reason, the stockholder theory has come to be associated with the type of utilitarian argument frequently advanced by free market economists.<sup>12</sup> Thus, supporting arguments often begin with the claim that when individual actors pursue private profit in a free market, they are led by Adam Smith's invisible hand to promote the general interest as well. It is then claimed that since, for each individual, "[b]y pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it,"<sup>13</sup> it is both unnecessary and counterproductive to exhort businesses or business persons to act directly to promote the common good. From this it is concluded that there is no justification for claiming that businesses or business persons have any social responsibilities other than to legally and honestly maximize the profits of the firm.

Although this consequentialist argument is the one most frequently cited in support of the stockholder theory, it must be noted that there is another, quite simple deontological argument for it as well. This argument is based on the observation that stockholders advance their money to

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<sup>11</sup>It must be kept in mind at all times that the version of the stockholder theory that asserts that the manager is ethically obliged to increase the company's profits is true only for those for-profit companies in which it is reasonable to interpret the stockholders wishes as the maximization of profit. Whenever the stockholders have indicated that they wish their resources to be used for other purposes, the stockholder theory requires managers to attempt to fulfill those purposes, even if doing so comes at the expense of profits.

<sup>12</sup>See, e.g., Dennis P. Quinn & Thomas M. Jones, *An Agent Morality View of Business Policy*, 20 ACAD. MGMT. REV. 22, 24 (1995); William M. Evan & R. Edward Freeman, *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*, in ETHICAL THEORY AND BUSINESS 75, 77 (Tom L. Beauchamp & Norman E. Bowie eds., 4th ed., 1993).

<sup>13</sup>ADAM SMITH, THE WEALTH OF NATIONS, bk. IV, ch. 2, para. 9.

business managers on the condition that it be used in accordance with their wishes. If the managers accept the money on this condition and then proceed to spend it to accomplish social goals not authorized by the stockholders, they would be violating their agreement and spending other people's money without their consent, which is wrong.<sup>14</sup>

The stockholder theory has been subjected to some harsh criticism by several of the leading business ethicists working today. It has been described as an outmoded relic of corporate law that even the law itself has evolved beyond,<sup>15</sup> as containing a "myopic view of corporate responsibility" that is unfortunately held by a significant number of business practitioners, and, more pointedly, as "corporate Neanderthalism . . . with morally pernicious consequences,"<sup>16</sup> and as "not only foolish in theory, but cruel and dangerous in practice" and misguided "from its nonsensically one-sided assumption of responsibility to his pathetic understanding of stockholder personality as *Homo economicus*."<sup>17</sup> For a significant number of theorists, the stockholder theory is introduced into discussion not as a serious candidate for the proper ethical standard for the

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<sup>14</sup>This argument can be expressed in more philosophically sophisticated language by stating that one who breaches an agreement that induced another to deal with him or her is treating the other merely as a means to his or her own ends, and is thus violating the Kantian principle of respect for persons.

It is useful to note that Friedman himself offers this deontological argument in support of the stockholder theory, not the utilitarian argument described previously. See Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, *supra* note 8. See also FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 8, at 135.

<sup>15</sup>See Evan & Freeman, *supra* note 12, at 76-7; Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, 20 ACAD. MGMT REV. 65, 81-2 (1995).

<sup>16</sup>THOMAS DONALDSON, THE ETHICS OF INTERNATIONAL BUSINESS 45 (1989).

<sup>17</sup>ROBERT C. SOLOMON, ETHICS AND EXCELLENCE 45 (1992).

business environment, but merely as a foil for other, putatively more enlightened normative theories.

At least part of the explanation for this harsh treatment seems to be the stockholder theory's association with the utilitarian supporting argument described above. Few contemporary business ethicists have the kind of faith in the invisible hand of the market that neo-classical economists do. Most take for granted that a free market produces coercive monopolies, results in damaging externalities, and is beset by other instances of market failure such as the free rider and public goods problems, and thus cannot be relied upon to secure the common good.<sup>18</sup> Accordingly, to the extent that it is associated with this line of economic reasoning, the stockholder theory becomes tarred with the brush of these standard objections to laissez faire capitalism.

It should be pointed out, however, that it is not necessary to join the debate over the theoretical viability of laissez faire to demonstrate the vulnerability of the utilitarian defense of the stockholder theory. This is because contemporary economic conditions are so far removed from those of a true free market as to render the point essentially moot. Regardless of the adequacy of the stockholder theory in a world of ideal markets, the world in which we currently reside is one where businesses may gain competitive advantages by obtaining government subsidies, tax breaks, protective tariffs, and state-conferred monopoly status (e.g., utilities, the Baby Bells, cable television franchises); having health, safety or environmental regulations written so as to burden small competitors; and otherwise purchasing governmental favor. In such a world, it is extremely unlikely that the pursuit of private profit will truly be productive of the public good. There is

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<sup>18</sup>Evan & Freeman, *supra* note 12, at 77-8.

ample reason to be suspicious of such a claim in an environment in which 65 percent of the chief executive officers of the top 200 Fortune firms come to Washington, D.C. at least once every two weeks.<sup>19</sup>

It is important to note that the fact that the utilitarian argument for the stockholder theory may be seriously flawed does not mean that the theory is untenable. This is because the deontological argument for the theory, which has frequently been overlooked, is, in fact, the superior argument. To the extent that it has received serious consideration, the primary objection against it seems to consist in the contention that it is not wrong to spend other people's money without their consent *as long as it is being done to promote the public interest*.<sup>20</sup> This contention is usually bolstered by the observation that this is precisely what democratic governments do all the time (at least, in theory). Since such action is presumably justified in the political realm, so the objection goes, there is no reason to think that it is not equally justified in the business realm.

There are two serious problems with this objection, however. The first is that it misses the essential point of the argument. As stated above, this argument is deontological in character. It is based on an underlying assumption that there are certain principles of conduct that must be observed regardless of the generalized benefits that must be foregone by doing so. One of the most fundamental of these principles states that individuals must honor the commitments they

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<sup>19</sup>See James D. Gwartney and Richard E. Wagner, *Public Choice and the Conduct of Representative Government*, in *PUBLIC CHOICE AND CONSTITUTIONAL ECONOMICS* 3, 23 (James D. Gwartney and Richard E. Wagner eds., 1988).

<sup>20</sup>This highly telescoped formulation of what is, in truth, a considerably more sophisticated consequentialist argument is employed strictly in the interest of conciseness. The fuller articulation it deserves must await a more detailed consideration of the stockholder theory than the present overview of the normative theories of business ethics permits.

voluntarily and knowingly undertake. Hence, the essence of the argument is the claim that it is morally wrong to violate one's freely-assumed agreement to use the stockholders' resources only in specified ways even though society could be made a somewhat better place by doing so. To assert that a manager may violate his or her agreement with the stockholders whenever doing so would promote the public interest is simply to deny this claim. It is to declare that one's duty to advance the common good overrides one's duty to honor one's agreements, and that the moral quality of one's actions must ultimately be judged according to a utilitarian standard. While some ethicists argue that the principle of utility is indeed the supreme ethical principle, this is far from obviously true, and any contention that merely assumes that it is cannot serve as a compelling objection to a deontological argument.

The second problem is that the objection is based on a false analogy. The assumption that democratic governments are morally justified in spending *taxpayers'* money without their consent to promote the general interest does not imply that businesses or business persons are justified in spending *stockholders'* money without their consent for the same reason. Consider that once the citizens have made their required contribution to governmental efforts to benefit society, all should be equally entitled to the control of their remaining assets. Should a citizen elect to invest them in a savings account to provide for his or her children's education or his or her old age, a banker who diverted some of these assets to other purposes, no matter how worthy, would clearly be guilty of embezzlement. For that matter, should the citizen elect to use his or her assets to purchase a new car, go on an extravagant vacation, or even take a course in business ethics, a car dealer, travel agent, or university that failed to deliver the bargained-for product in order to provide benefits to others would be equally guilty. Why should it be any different if the citizen

elects to invest in a business? At least superficially, it would appear that citizens have a right to control their after-tax assets that is not abrogated merely because they elect to purchase stock and that would be violated were business managers to use these assets in unauthorized ways. If this is not the case, some showing is required to demonstrate why not.

Of course, these comments in no way establish that the stockholder theory is correct. The most that they can demonstrate is that some of the objections that are frequently raised against it are ill-founded. Other, more serious objections remain to be considered.<sup>21</sup> However, they do suggest that the cavalier dismissal the stockholder theory sometimes receives is unjustified, and that, at least at present, it should continue to be considered a serious candidate for the proper normative theory of business ethics.<sup>22</sup>

### **III. The Stakeholder Theory**

The second of the leading normative theories of business ethics is the stakeholder theory. Unfortunately, ‘stakeholder theory’ is somewhat of a troublesome label because it is used to refer to both an empirical theory of management and a normative theory of business ethics, often

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<sup>21</sup>For two examples, see *infra* p. 37.

<sup>22</sup>As mentioned previously, see *supra* note 6, because of its historical association with debate over *corporate* social responsibility, the stockholder theory is expressed in language that suggests the corporate form, e.g., stock, stockholders. Despite this, the stockholder theory can be applied to all forms of business. In its generalized form, the theory would simply state that managers are ethically obligated to use business resources that have been advanced to them under condition that they be used for specified purposes to accomplish only those purposes. Thus, whether the managers are officers of a public corporation funded by stockholders, managing partners of a limited partnership funded by the limited partners, or sole proprietors funded by investors, they are obligated to use the business’s resources in accordance with the agreements they entered into with the stockholders, limited partners, or investors.

without clearly distinguishing between the two.<sup>23</sup> As an empirical theory of management, the stakeholder theory holds that effective management requires the balanced consideration of and attention to the legitimate interests of all stakeholders,<sup>24</sup> defined as anyone who has “a stake in or claim on the firm.”<sup>25</sup> This has been interpreted in both a wide sense that includes “any group or individual who can affect or is affected by the corporation,” and a more narrow sense that includes only “those groups who are vital to the survival and success of the corporation.”<sup>26</sup> It is perhaps more familiar in its narrow sense in which the stakeholder groups are limited to stockholders, customers, employees, suppliers, management, and the local community. Thus, as an empirical theory, the stakeholder theory asserts that a business’s financial success can best be achieved by giving the interests of the business’s stockholders, customers, employees, suppliers, management, and local community proper consideration and adopting policies which produce the

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<sup>23</sup>Unlike ‘agency theory,’ however, the phrase ‘stakeholder theory’ cannot be avoided.

Various attempts have been made to clarify the distinction between the normative and non-normative variants of the stakeholder theory. For example, Kenneth Goodpaster distinguishes non-normative “strategic stakeholder synthesis” from normative “multi-fiduciary stakeholder synthesis.” Kenneth E. Goodpaster, *Business Ethics and Stakeholder Analysis*, 1 BUS. ETHICS Q. 53 (1991). Recently, Thomas Donaldson and Lee Preston have further clarified the situation by identifying and distinguishing three different “types” of stakeholder theory; descriptive/empirical, instrumental, and normative. See Donaldson and Preston, *supra* note 15, at 69-73.

For purposes of simplicity and because in this article I will not be commenting on the distinction between the descriptive/empirical and instrumental versions of the theory, I will employ the term ‘empirical’ in a generic sense to refer to the non-normative versions of the stakeholder theory.

<sup>24</sup>See R. E. FREEMAN, *STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH* (1984); Donaldson and Preston, *supra* note 15, at 71.

<sup>25</sup>See Evan & Freeman, *supra* note 12, at 76.

<sup>26</sup>*Id.* at 79. See also E. Freeman & D. Reed, *Stockholders and Stakeholders: A New Perspective on Corporate Governance*, in *CORPORATE GOVERNANCE: A DEFINITIVE EXPLORATION OF THE ISSUES* (C. Huizinga ed., 1983).

optimal balance among them.<sup>27</sup>

When viewed as an empirical theory of management designed to prescribe a method for improving a business's performance, the stakeholder theory does not imply that businesses have any social responsibilities. In this sense, it is perfectly consistent with the normative stockholder theory since what is being asserted is the empirical claim that the best way to enhance the stockholders' return on their investment is to pay attention to the legitimate interests of all stakeholders. The essence of the stakeholder theory of *management* is that stakeholder management is required for managers to successfully meet their fiduciary obligation to the stockholders. For the purposes of this article, however, we are concerned with the stakeholder theory not as an empirical theory of management, but as a normative theory of business ethics.

When viewed as a normative theory, the stakeholder theory asserts that, regardless of whether stakeholder management leads to improved financial performance, managers *should* manage the business for the benefit of all stakeholders. It views the firm not as a mechanism for increasing the stockholders' financial returns, but as a vehicle for coordinating stakeholder interests and sees management as having a fiduciary relationship not only to the stockholders, but to all stakeholders. According to the normative stakeholder theory, management must give equal consideration to the interests of all stakeholders<sup>28</sup> and, when these interests conflict, manage the

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<sup>27</sup>This corresponds to Goodpaster's strategic stakeholder synthesis and Donaldson and Preston's instrumental stakeholder theory. See *supra* note 23.

<sup>28</sup>In stating that management must give *equal* consideration to the interests of *all* stakeholders, I am not ignoring the work being done to distinguish among different classes of stakeholders. See, e.g., Max B.E. Clarkson, *A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance*, 20 ACAD. MGMT. REV. 92, 105-8 (1995). On this point, it is essential to distinguish between the stakeholder theory as a normative theory of business ethics on the one hand and as either a theory of corporate social responsibility or a theory

business so as to attain the optimal balance among them. This, of course, implies that there will be times when management is obligated to at least partially sacrifice the interests of the stockholders to those of other stakeholders. Hence, in its normative form, the stakeholder theory does imply that businesses have true social responsibilities.

The stakeholder theory holds that management's fundamental obligation is not to maximize the firm's financial success, but to ensure its survival by balancing the conflicting claims of multiple stakeholders. This obligation is to be met by acting in accordance with two principles of stakeholder management. The first, called the principle of corporate legitimacy, states that "the corporation should be managed for the benefit of its stakeholders: its customers, suppliers, owners, employees, and the local communities. The rights of these groups must be ensured and, further, the groups must participate, in some sense, in decisions that substantially affect their welfare."<sup>29</sup> The second, called the stakeholder fiduciary principle, states that "management bears a fiduciary relationship to stakeholders and to the corporation as an abstract entity. It must act in the interests of the stakeholders as their agent, and it must act in the interests of the corporation

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of management on the other. See *supra* note 2 and the material immediately preceding this note. For purposes of either evaluating a business's responsiveness to societal demands or describing effective management techniques, it can make perfect sense to distinguish among different classes of stakeholders. However, given the arguments that have been provided in support of the stakeholder theory as a normative theory of business ethics (to be discussed below), it can not. The logic of these arguments, whether Kantian, Rawlsian, or derived from property rights, makes no allowance for stakeholders of differing moral status. Each implies that all stakeholders are entitled to equal moral consideration. In my opinion, this represents a major difference between the normative and non-normative versions of the stakeholder theory, and one that is likely to generate confusion if not carefully attended to.

<sup>29</sup>Evan & Freeman, *supra* note 12, at 82.

to ensure the survival of the firm, safeguarding the long-term stakes of each group.”<sup>30</sup>

The stakeholder theory enjoys a considerable degree of approbation from both theorists and practitioners. In fact, it is probably fair to say that the stakeholder theory currently enjoys a breadth of acceptance equal to that the stockholder theory was said to have enjoyed in the past. To some extent, this may result from the fact that the theory seems to accord well with many people’s moral intuitions, and, to some extent, it may simply be a spillover effect of the high regard in which the empirical version of the stakeholder theory is held as a theory of management. It is clear, however, that the normative theory’s widespread acceptance does not derive from a careful examination of the arguments that have been offered in support of it. In fact, it is often remarked that the theory seems to lack a clear normative foundation.<sup>31</sup>

An argument that is frequently cited in support of the stakeholder theory is the one offered by Ed Freeman and William Evan in their 1988 article.<sup>32</sup> That argument asserts that management’s

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<sup>30</sup>*Id.* Clearly, this is Goodpaster’s multi-fiduciary stakeholder synthesis. See *supra* note 23.

This feature of the normative stakeholder theory immediately gives rise to the objection that it is based on an oxymoron. Given the meaning of the word ‘fiduciary,’ it is impossible to have a fiduciary relationship to several parties who, like the stakeholders of a corporation, have potentially conflicting interests. Further, even if this did make sense, placing oneself in such a position would appear to be unethical. For example, an attorney who represented two parties with conflicting interests would clearly be guilty of a violation of the canon of ethics.

This objection clearly deserves a fuller treatment than it can be given in a footnote. However, because the purpose of the present work is limited to the critical examination of the arguments offered in support of the three main theories of corporate social responsibility, an attempt to fully evaluate the theories’ adequacy would clearly be beyond its scope. Hence, a more detailed examination of this objection must be deferred until a later time.

<sup>31</sup>See, e.g., Donaldson and Preston, *supra* note 15, at 72, who point out that in most of the stakeholder literature “the fundamental normative principles involved are often unexamined.”

<sup>32</sup>Evan & Freeman, *supra* note 12. This was not the earliest attempt to provide a normative grounding for the stakeholder theory. See, e.g., Thomas M. Jones & Leonard D. Goldberg, *Governing the Large Corporation: More Arguments for Public Directors*, 7 *ACAD.*

obligation to the stakeholders can be derived from Immanuel Kant's principle of respect for persons. This fundamental ethical principle holds that every human being is entitled to be treated not merely as a means to the achievement of the ends of others, but as a being valuable in his or her own right; that each person is entitled to be respected as an end in himself or herself. Since to respect someone as an end is to recognize that he or she is an autonomous moral agent, i.e., a being with desires of his or her own and the free will to act upon those desires, the principle of respect for persons requires respect for others' autonomy.

Freeman and Evan apply this principle to the world of business by claiming that businesses are bound to respect it as much as anyone else. Thus, businesses may not treat their stakeholders merely as means to the business's ends, but must recognize that as moral agents, all stakeholders are entitled "to agree to and hence participate (or choose not to participate) in the decisions to be used as such."<sup>33</sup> They then claim that it follows from this that all stakeholders are entitled to "participate in determining the future direction of the firm in which they have a stake."<sup>34</sup> However, because it is impossible to consult with all of a firm's stakeholders on every decision, this participation must be indirect. Therefore, the firm's management has an obligation to "represent" the interests of all stakeholders in the business's decision-making process. Accordingly, management is obligated to give equal consideration to the interests of all stakeholders in developing business policy and to manage the business so as to optimize the balance among these

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MGMT. REV. 603 (1982). However, it does appear to be the first effort to derive the stakeholder theory directly from a widely accepted principle of philosophical ethics. This apparently accounts for the widespread attention it has commanded among the commentators.

<sup>33</sup>*Id.* at 78.

<sup>34</sup>*Id.* at 76.

interests.

The main problem with this argument is that there is a gap in the reasoning that leads from the principle of respect for persons to the prescriptions of the stakeholder theory. It may readily be admitted that businesses are ethically bound to treat all persons, and hence all stakeholders, as entities worthy of respect as ends in themselves. It may further be admitted that this requires businesses to treat their stakeholders as autonomous moral agents, and hence, that stakeholders are indeed entitled “to agree to and hence participate (or choose not to participate) in the decisions to be used”<sup>35</sup> by the business. The problem is that this implies only that no stakeholder may be forced to deal with the business without his or her consent, not that all stakeholders are entitled to a say in the business’s decision-making process or that the business must be managed for their benefit.

It is certainly true that respect for the autonomy of others requires that one keep one’s word. To deceive someone into doing something he or she would not otherwise agree to do would be to use him or her merely as a means to one’s own ends. For this reason, the principle of respect for persons requires businesses to deal honestly with all of their stakeholders. This means that businesses must honor the contracts they enter into with their customers, employees, suppliers, managers, and stockholders and live up to any representations they freely make to the local community. However, it is simply incorrect to say that respect for another’s autonomy requires that the other have a say in any decision that affects his or her interests. A student’s interests may be crucially affected by what grade he or she receives in a course as may a Republican’s by the decision of whom the Democrats nominate for President. But the autonomy

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<sup>35</sup>*Id.* at 78.

of neither the student nor the Republican is violated when he or she is denied a say in these decisions.

An adherent of the stockholder theory could point out that employees (including managers), suppliers, and customers negotiate for and autonomously accept wage and benefit packages, purchasing arrangements, and sales contracts, respectively. It does not violate their autonomy or treat them with a lack of the respect they are due as persons to fail to provide them with benefits in excess of those they freely accept. However, if managers were to break their agreement with the stockholders to use business resources only as authorized in order to provide other stakeholders with such benefits, the managers would be violating the autonomy of the stockholders. Therefore, the stockholder theorist could contend that not only is the stakeholder theory not entailed by the principle of respect for persons, but to the extent that it instructs managers to use the stockholders' money in ways they have not approved, it is, in fact, violative of it.

Perhaps because of the problems with this argument, efforts have recently been made to provide a more adequate normative justification for the stakeholder theory. Indeed, Freeman and Evan have themselves offered an alternative argument that claims that changes in corporate law imply that businesses consist in sets of multilateral contracts among stakeholders that must be administered by managers.<sup>36</sup> Asserting that “all parties that are affected by a contract have a right to bargain about the distribution of those effects,”<sup>37</sup> they then apply a Rawlsian “veil of ignorance”

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<sup>36</sup>R. Edward Freeman & William Evan, *Corporate Governance: A Stakeholder Interpretation*, 19 J. BEHAV. ECON. 337 (1990).

<sup>37</sup>*Id.* at 352.

decision procedure to deduce that “fair contracting” requires that all stakeholders be entitled to “participate in monitoring the actual effects of the firm on them,”<sup>38</sup> i.e., have a say in the business’s decision-making process.

Unfortunately, this argument seems to have even more problems than the one it replaces. In the first place, Rawls’ decision procedure was specifically designed to guide the construction of the basic structure of society and it is at least open to question whether it may be appropriately employed in the highly specific context of business governance issues. Further, deriving ethical conclusions from observations of the state of the law comes dangerously close to the classic fallacy of assuming that what is legally required must be ethically correct. More significantly, however, this new argument seems to suffer from the same defect as its predecessor since the assumption that all parties that are affected by a contract have a right to bargain about the distribution of those effects is virtually equivalent to the earlier argument’s problematic assumption that all parties affected by a business’s actions have a right to participate in the business’s decision-making process. As in the earlier argument, this is the assertion that must be established, not assumed.<sup>39</sup>

Another recent attempt at justification has been undertaken by Donaldson and Preston

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<sup>38</sup>*Id.* at 353.

<sup>39</sup>The unsupported and counter-intuitive assumption that people are ethically entitled to a say in any decision which affects their interests appears to lie at the heart of most attempts to ground the stakeholder theory, and can be found even in those that predate the ones presently under consideration. For an early example of this, consider Jones and Goldberg’s 1982 assertion that “if legitimacy centers on the consent of the governed, the legitimacy of corporate decisions made by managers would hinge on the willingness of people *affected* by these decisions to recognize the right of the managers to make them. Because several groups *are affected* by managerial decisions, legitimacy depends on acceptance of this authority by several types of ‘stake holders.’” Jones & Goldberg, *supra* note 32, at 606 (emphasis added).

who claim to base the stakeholder theory on a theory of property. After asserting that the stockholder theory is “normatively unacceptable,”<sup>40</sup> they contend that because 1) property rights must be based on an underlying principle of distributive justice, 2) among theorists, “the trend is toward theories that are pluralistic, allowing more than one fundamental principle to play a role,” and 3) “all critical characteristics underlying the classic theories of distributive justice are present among the stakeholders of a corporation,” it follows that “the normative principles that underlie the contemporary theory of property rights also provide the foundation for the stakeholder theory as well.”<sup>41</sup> However, because the authors have failed to provide any specification for what “the contemporary theory of property rights” is, this can be regarded as, at best, a preliminary sketch rather than a fully developed justificatory argument. Further, because premise 1 is open to serious

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<sup>40</sup>Donaldson and Preston, *supra* note 15, at 82. The rationale underlying this claim is, at best, somewhat murky. The sentence which immediately follows it is: “Changes in state incorporation laws to reflect a ‘constituency’ perspective have already been mentioned.” *Id.* Professor Donaldson has assured me that this is not intended as an appeal to the ethical authority of the law, but rather to the normative reasons behind the change in the law as indicated by the article’s next sentence: “The normative basis for these changes in current mainstream legal thinking is articulated in the recent American Law Institute report, *Principles of Corporate Governance* (1992).” *Id.* However, the sections of the ALI report that the authors cite state nothing more than that corporate officials are *legally permitted* to take ethical considerations into account even where doing so would not enhance corporate profit or shareholder gain and that they are “subject to the same ethical considerations as other members of society.” *Id.* This, however, is wholly consistent with the stockholder theory which asserts that corporate managers are not only legally permitted, but *ethically required* to restrict the means by which they seek to carry out the instructions of their stockholder principals to those which fall within the ethical boundaries set by the law and the principles of honest dealing and open and free competition. The ALI report is indeed inconsistent with the claim that corporate managers should pursue profit by any means without regard to legal or ethical constraints. It hardly needs repeating, however, that this is not the claim made by the stockholder theory, but that of the straw man the theory’s opponents trot out to stand in its stead. At any rate, it is entirely unclear how the comments cited by Donaldson and Preston provide any support for the assertion that the stockholder theory is normatively unacceptable.

<sup>41</sup>Donaldson and Preston, *supra* note 15, at 82-4.

question,<sup>42</sup> premise 2 seems to confuse academic opinion with evidence of truth, and premise 3 seems, at first glance, to be wholly unconnected to the conclusion, much work remains to be done before this argument can serve as an adequate basis for the stakeholder theory.

In sum, the lacunae in each of these supporting arguments suggest that, despite its widespread acceptance, the normative version of the stakeholder theory is simply not well-grounded. At this point, its adequacy as a normative theory of business ethics must be regarded as open to serious question.<sup>43</sup>

#### **IV. The Social Contract**

The third normative theory of business ethics, the social contract theory, really comprises a family of closely related theories and, in some ways, is still in the process of formation.<sup>44</sup>

However, in its most widely accepted form, the social contract theory asserts that all businesses are ethically obligated to enhance the welfare of society by satisfying consumer and employee

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<sup>42</sup>Philosophers such as Robert Nozick would not accept this contention nor would anyone who argues from a classical liberal perspective. Further, as a matter of purely historical fact, the assertion is clearly false.

<sup>43</sup>Like the other theories, the stakeholder theory is expressed in language suggesting the corporate form. However, the theory is clearly perfectly general. Whether the business concerned is a corporation, partnership, or sole proprietorship, the business's stakeholders, those who are vital to its survival and success, can be identified. The stakeholder theory requires the managers to manage the business for the benefit of these stakeholders, regardless of the business's form.

<sup>44</sup>Professors Thomas Donaldson and Thomas Dunfee have recently introduced a complex and highly sophisticated version of social contract theory that they call Integrative Social Contracts Theory (ISCT). See Thomas Donaldson & Thomas W. Dunfee, *Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory*, 19 ACAD. MGMT. REV. 252 (1994). The authors are presently in the process of developing a book length exposition of this theory. Although this theory is beyond the scope of the present work and hence will not be directly addressed, it should be noted that ISCT constitutes an attempt to marry the individual social contract theories of Donaldson and Dunfee, both of which are addressed. Therefore, to some extent, the comments made in this article may be extrapolated to apply to ISCT as well.

interests without violating any of the general canons of justice.<sup>45</sup> Because the specific nature of this obligation can best be appreciated in the context of the theory's derivation, let us turn our attention immediately to the theory's supporting rationale.

The social contract theory is based on the traditional concept of a social contract, an implicit agreement between society and an artificial entity in which society recognizes the existence of the entity on the condition that it serves the interests of society in certain specified ways. As a normative theory of business ethics, the social contract theory is explicitly modeled on the political social contract theories of thinkers such as Thomas Hobbes, John Locke, and Jean-Jacques Rousseau. These political theorists each attempted to imagine what life would be like in the absence of a government, i.e., in the "state of nature," and asked what conditions would have to be met for citizens to agree to form one. The obligations of the government toward its citizens were then derived from the terms of this agreement.

The normative social contract theory of business ethics takes much the same approach toward deriving the social responsibilities of businesses. It begins by imagining a society in which there are no complex business organizations, i.e., a state of "individual production," and proceeds by asking what conditions would have to be met for the members of such a society to agree to allow businesses to be formed. The ethical obligations of businesses toward the individual members of society are then derived from the terms of this agreement. Thus, the social contract theory posits an implicit contract between the members of society and businesses in which the members of society grant businesses the right to exist in return for certain specified benefits.

In granting businesses the right to exist, the members of society give them legal

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<sup>45</sup>See THOMAS DONALDSON, CORPORATIONS AND MORALITY ch.2 (1982).

recognition as single agents and authorize them to own and use land and natural resources and to hire the members of society as employees.<sup>46</sup> The question then becomes what the members of society would demand in return. The minimum would seem to be “that the benefits from authorizing the existence of productive organizations outweigh the detriments of doing so.”<sup>47</sup> In general, this would mean that businesses would be required to “enhance the welfare of society . . . in a way which relies on exploiting corporations’ special advantages and minimizing disadvantages”<sup>48</sup> while remaining “within the bounds of the general canons of justice.”<sup>49</sup>

This generalization may be thought of as giving rise to a social contract with two terms: the social welfare term and the justice term. The social welfare term recognizes that the members of society will be willing to authorize the existence of businesses only if they gain by doing so. Further, there are two distinct capacities in which the members of society stand to gain from businesses: as consumers and as employees. As consumers, people can benefit from the existence of businesses in at least three ways. First, businesses provide increased economic efficiency by maximizing the advantages of specialization, improving decision-making resources, and increasing the capacity to use and acquire expensive technology and resources. Second, businesses provide stable levels of output and channels of distribution. And third, they provide increased liability resources from which to compensate injured consumers. As employees, people can benefit from

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<sup>46</sup>See DONALDSON, CORPORATIONS AND MORALITY *supra* note 45, at 43. The specific description of the social contract theory that follows is taken from this source.

<sup>47</sup>*Id.* at 44.

<sup>48</sup>*Id.* at 54.

<sup>49</sup>*Id.* at 53.

the existence of businesses by receiving increased income potential, diffused personal legal liability for harmful errors, and the ability to participate in “income-allocation schemes . . . detached from the vicissitudes of [their] capacity to produce.”<sup>50</sup> However, businesses can also have negative effects on consumers and employees. People’s interests as consumers can be harmed when businesses pollute the environment and deplete natural resources, undermine the personal accountability of its constituent members, and misuse political power. People’s interests as employees can be harmed when they are alienated from the product of their labor, suffer from lack of control over their working conditions, and are subjected to monotonous and dehumanizing working conditions. These, then, constitute the respective advantages and disadvantages that businesses can provide to and impose upon society. Therefore, when fully specified, the social welfare term of the social contract requires that businesses act so as to 1) benefit consumers by increasing economic efficiency, stabilizing levels of output and channels of distribution, and increasing liability resources; 2) benefit employees by increasing their income potential, diffusing their personal liability, and facilitating their income allocation; while 3) minimizing pollution and depletion of natural resources, the destruction of personal accountability, the misuse of political power, as well as worker alienation, lack of control over working conditions, and dehumanization.

The justice term recognizes that the members of society will be willing to authorize the existence of businesses only if businesses agreed to remain within the bounds of the general canons of justice. Admittedly, precisely what these canons require is far from settled. However, since there seems to be general agreement that the least they require is that businesses “avoid

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<sup>50</sup>*Id.* at 48-9.

fraud and deception, . . . show respect for their workers as human beings, and . . . avoid any practice that systematically worsens the situation of a given group in society,”<sup>51</sup> it is reasonable to read the justice term as requiring at least this much.

In general, then, the social contract theory holds that managers are ethically obligated to abide by both the social welfare and justice terms of the social contract. Clearly, when fully specified, these terms impose significant social responsibilities on the managers of business enterprises.

The social contract theory is often criticized on the ground that the “social contract” is not a contract at all. To appreciate the nature of this criticism, let us borrow some terminology from the legal realm. The law recognizes three types of contracts: express contracts, implied contracts, and quasi-contracts. An express contract consists in an explicit agreement made in speech or writing. In this case, there is a true meeting of the minds of the parties that is expressly memorialized through language. An implied contract consists in an agreement that is manifested in some other way. For example, continuing to deal with another party under the terms of an expired contract can imply an agreement to renew or, perhaps more familiarly, failing to return an invoice marked ‘cancel’ following a trial membership can imply a contract to buy four books in the next twelve months. As with express contracts, in such cases, there is a true meeting of the minds. However, in implied contracts, that agreement is manifested through action rather than language. A quasi-contract, on the other hand, consists in the legal imposition of a contractual relationship where there has been no meeting of the minds because such is necessary to avoid injustice. For example, a doctor who expends resources aiding an unconscious patient in an emergency situation

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<sup>51</sup>*Id.* at 53. This last requirement is apparently intended as an antidiscrimination provision.

is said to have a quasi-contract for reasonable compensation even though there was no antecedent agreement between the parties. In quasi-contracts, the law acts as though there has been a meeting of the minds where none in fact exists in order to do justice.

Critics of the social contract theory point out that the social contract is neither an express nor an implied contract. This is because there has been no true meeting of the minds between those who decide to form businesses and the members of the society in which they do so. Most people who start businesses do so by simply following the steps prescribed by state law and would be quite surprised to learn that by doing so they had contractually agreed to serve society's interests in ways that were not specified in the law and that can significantly reduce the profitability of the newly formed firm.<sup>52</sup> To enter a contractual arrangement, whether expressly or by implication, one has to at least be aware that one is doing so. Thus, the critics maintain that the social contract must be a quasi-contract, which is merely a fiction rather than a true contract.

This objection is not very distressing to social contract theorists, however. They freely admit that the social contract is a fictional or hypothetical contract, but go on to claim that this is precisely what is required to identify managers' ethical obligations. As Thomas Donaldson has put it, "if the contract were something *other* than a 'fiction,' it would be inadequate for the purpose at hand: namely revealing the moral foundations of productive organizations."<sup>53</sup> What the social contract theorists are admitting here is that the moral force of the social contract is not derived

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<sup>52</sup>Indeed, many entrepreneurs forum-shop, electing to go into business in the state whose legal regime appears least burdensome to them. Such individuals would clearly be shocked to be told that regardless of which state they chose, they had agreed to abide by the restrictions described by the social contract theory.

<sup>53</sup>THOMAS DONALDSON, *THE ETHICS OF INTERNATIONAL BUSINESS* 56 (1989).

from the consent of the parties. Rather, they are advancing a moral theory that holds that “[p]roductive organizations should behave *as if* they had struck a deal, the kind of deal that would be acceptable to free, informed parties acting from positions of equal moral authority . . .”<sup>54</sup>

This seems perfectly adequate as a response to the objection. It does suggest, however, that much of the psychological appeal of the social contract theory is based on a confusion. This is because a great deal of the theory’s appeal to ordinary (philosophically untrained) business practitioners derives from their natural, intuitive identification of contract terminology with consent. To the extent that the language of contract suggests that one has given consent, it has a strong emotive force. People generally accept consent as a source of moral obligation, and this is especially true of the business practitioner who makes contracts every day and whose success or failure often turns on his or her reputation for upholding them. Most people would agree that when one voluntarily gives one’s word, one is ethically bound to keep it. Thus, business practitioners as well as people generally are psychologically more willing to accept obligations when they believe they have consented to them. By employing contract terminology when consent plays no role in grounding the posited social responsibilities of business, the social contract theory inappropriately benefits from the positive psychological attitude that this terminology engenders. For this reason, it is not unreasonable to suggest that the social contract theory trades upon the layperson’s favorable attitude toward consent with no intention of delivering the goods.

This, of course, casts no aspersions on the theory’s philosophical adequacy. However, the admission that the social contract is actually a quasi-contract does provide good reason to believe that the social contract theory has not been adequately supported. Once consent has been

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<sup>54</sup>*Id.* at 61.

abandoned as the basis for the posited social responsibilities, the acceptability of the social contract theory rests squarely on the adequacy of the moral theory that undergirds it. This theory asserts that justice requires businesses and business managers to behave as though they had struck a deal “that would be acceptable to free, informed parties acting from positions of equal moral authority.”<sup>55</sup> This may be correct, but it is not patently so. It is far from obvious that justice demands that managers behave *as if* they had made an agreement with hypothetical people, especially when doing so would violate real-world agreements made with actual people (e.g., the company’s stockholders). It seems equally reasonable to assert that justice demands only that managers abide by the will of the people as it has been expressed by their political representatives in the commercial law of the state, or perhaps merely that they deal honestly with all parties and refrain from taking any illegal or harmful actions. Until the theory of justice on which the social contract theory rests has been fully articulated and defended, there is simply no reason to prefer it to any other putative normative theory of business ethics.<sup>56</sup> At present, therefore, this version of the social contract theory cannot be regarded as established.

There is, however, another version of the social contract theory that is genuinely consent-

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<sup>55</sup>*Id.*

<sup>56</sup>Because this version of the social contract theory appears to be based on what is essentially a Rawlsian theory of justice, this task would indeed be a formidable one. It would require an examination not only of the relative merits of a Rawlsian conception of justice as opposed to Nozickian and other conceptions, but also of whether such a conception is appropriate in the present limited realm of application. However, once consent has been abandoned as the basis for the social contract, there seems to be no avoiding this. Currently, the best that can be said about this version of the social contract theory is that it is, at most, as well established as John Rawls’ theory of justice.

based and thus cannot be criticized on this ground.<sup>57</sup> This version asserts that the business enterprise is characterized by a myriad of “extant social contracts,” informal agreements that embody “actual behavioral norms which derive from shared goals, beliefs and attitudes of groups or communities of people.”<sup>58</sup> These extant social contracts are not quasi-contracts, but true agreements which, although sometimes express, are usually “implied from [sic] certain characteristics, attitudes and patterns of the group”<sup>59</sup> and “represent the view of the community concerning what constitutes proper behavior within the confines of the community.”<sup>60</sup> According to this version of the theory, whenever the extant social contracts pass a “filtering test,” i.e., are found not to be violative of the tenets of general ethical theory, they give rise to “genuine ethical norms” that managers are ethically obligated to obey.

There is nothing patently objectionable about this version of the social contract theory. However, it is so underdeveloped that it is difficult to know what to make of it. For example, it is not clear whether the theory contains an implicit norm against entering into social contracts that give rise to incompatible obligations or are incompatible with obligations that arise from one’s

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<sup>57</sup>See Thomas W. Dunfee, *Business Ethics and Extant Social Contracts*, 1 BUS. ETHICS Q. 23 (1991).

<sup>58</sup>*Id.* at 32.

<sup>59</sup>*Id.* In fact, there is some question whether all extant social contracts are true agreements since it is claimed that consent is implied by “merely enjoying the benefits of the community or even engaging in transactions within the realm of the community.” *Id.* This raises the thorny problem of how one can be said to consent to an agreement without being aware one is doing so. However, because any attempt to resolve this point is beyond the scope of the current work, I will assume for purposes of the present discussion that all extant social contracts are true, consent-based agreements.

<sup>60</sup>*Id.* at 33.

earlier voluntary agreements. If it does, the theory seems to collapse into the stockholder theory which instructs managers to deal honestly with others and honor all agreements *that do not violate their antecedent voluntary agreement to use the stockholders' resources only as authorized*. If it does not, it seems to prescribe a host of incompatible obligations.<sup>61</sup> Furthermore, because the filtering test has not been specified, this version of the social contract theory reduces to the claim that one is obligated to abide by the informal agreements one has entered into as long as doing so is ethically acceptable. Although this does not say nothing, it says very little. For example, if the filtering test places primacy on a deontological obligation to honor one's agreements, the theory becomes coextensive with the stockholder theory and implies that businesses have no social responsibilities. However, if it places primacy on the principle of utility, the theory may produce a set of social responsibilities very much like that prescribed by the stakeholder theory. Finally, if it prescribes a general obligation to behave as though one had made an agreement with perfectly rational, self-interested, free and equal hypothetical people, the theory might produce a set of social responsibilities equivalent to those prescribed by the earlier version of the social contract theory. As this diversity of outcome suggests, in its present skeletal form, this version of the social contract theory is of, at best, limited usefulness.<sup>62</sup>

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<sup>61</sup>This may be an unfair characterization. The theory contemplates the possibility of one simultaneously belonging to several communities with incompatible social contracts and asserts that such conflicts must be resolved on the basis of an unspecified "priority rule." (It should be noted that, like the filtering test discussed below, as long as the priority rule remains unspecified, it is impossible to fully evaluate this theory.) However, the theory does not seem to address the situation in which one has entered into incompatible agreements within a single community. It is the latter point that I am presently addressing.

<sup>62</sup>As was the case with the stakeholder theory, although the social contract theory is sometimes expressed in the language of the corporation, it clearly applies to businesses generally. Under a social contract approach, the members of society authorize the existence of not merely

## V. Conclusion

In this article, I have subjected each of the three leading normative theories of business ethics to critical examination. I have argued that the stockholder theory is not as obviously flawed as it is sometimes supposed to be and that several of the objections conventionally raised against it are misdirected. I have also suggested that the deontological argument in support of the stockholder theory is not obviously unsound, although I have admittedly not subjected this argument to the scrutiny that would be necessary to establish its soundness. Further, I have argued that the supporting arguments for the stakeholder theory are significantly flawed and that the social contract theory either has not been adequately supported or is too underdeveloped to be useful. Thus, I have suggested that the amount of confidence that is currently placed in the stakeholder theory and is coming to be placed in the social contract theory is not well founded.

Although it may appear surprising given these conclusions, I do not view this article as a brief for the stockholder theory. Rather, I view it as a compass that can point us in the direction of a truly adequate normative theory of business ethics. I should add, however, that I also believe it points to a serious difficulty that must be overcome in order to arrive at any such theory.

To see what I mean, I would ask you to consider that all three normative theories share a common feature; they all either explicitly or implicitly recognize the preeminent moral value of individual consent. The stockholder theory is explicitly based on consent. The ethical obligations it posits are claimed to derive directly from the voluntary agreement each business officer makes on accepting his or her position to use the stockholders' resources strictly in accordance with

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corporations, but businesses of any form. Thus, all businesses are bound by the terms of the social contract. As a matter of fact, Donaldson's early version of the theory was expressed in perfectly general terms, speaking not about corporations, but about "productive organizations."

their wishes. Similarly, the stakeholder theory is at least implicitly based on consent. The ethical obligation it places on business officers to manage the firm in the interest of all stakeholders is supposed to derive from the claim that every stakeholder is entitled to a say in decisions that affect his or her interests, which itself contains the implicit recognition of each individual's right to control his or her own destiny.<sup>63</sup> Finally, consent resides at the heart of the social contract theory as well. This is clear with regard to the extant social contract variant of the theory in which the manager's ethical obligations are explicitly based on consent. However, even the hypothetical social contract variant indirectly recognizes the moral significance of consent. For although it derives managers' ethical obligations from a depersonalized, morally sanitized, hypothetical form of consent, there would be no reason to cast the theory in terms of a contract at all if consent were not recognized as a fundamental source of ethical obligation.

The fact that all three normative theories of business ethics rely on the moral force of individual consent should come as no surprise given a proper understanding of what a business is, i.e., "a voluntary association of individuals, united by a network of contracts"<sup>64</sup> organized to achieve a specified end.<sup>65</sup> Because businesses consist in nothing more than a multitude of

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<sup>63</sup>I have argued in the body of this article that there is, in fact, no ethical entitlement to have a say in any decision that affects one's interests and that the attempts of stakeholder theorists to derive one from Kant's principle of respect for persons, Rawls' theory of justice, and a contemporary theory of property rights have been unsuccessful. However, assuming *arguendo* that the stakeholder theorists are correct and that such an entitlement does exist, it would certainly imply that individuals are ethically entitled to control their own lives.

<sup>64</sup>Robert Hessen, *A New Concept of Corporations: A Contractual and Private Property Model*, 30 HASTINGS L.J. 1327, 1330 (1979).

<sup>65</sup>This is as true of corporations as it is of any other type of business organization. The claim that a corporation is a "creature of the state," endowed by the government with special privileges not available to other freely-organized forms of business is asserted so frequently that it

voluntary agreements among individuals, it is entirely natural that the ethical obligations of the parties to these agreements, including those of the managers of the business, should derive from the individual consent of each. Clearly, any attempt to provide a general account of the ethical obligations of businesses and business people must ultimately rely on the moral force of the individual's freely-given consent.<sup>66</sup>

Recognizing this tells us much about what an adequate normative theory of business ethics must look like. If businesses are merely voluntary associations of individuals, then the ethical obligations of business people will be the ethical obligations individuals incur by joining voluntary associations, i.e., the ordinary ethical obligations each has as a human being plus those each has voluntarily assumed by agreement. Just as individuals do not take on ethical obligations beyond those they agree to by joining a chess club, a political party, or a business school faculty, so too individuals do not become burdened with unagreed upon obligations by going into or joining a business. There is no point in time at which the collection of individuals that constitutes a business

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is typically regarded as a truism. That this is not, in fact, the case, is amply demonstrated by Robert Hessen in the article cited in the immediately preceding note. I heartily recommend it to those unfamiliar with the history and law of corporations.

I should add that I am not claiming either that the idea of a business as a network of contracts is a new or original insight (its long lineage is indicated by the source I cite in support of it in the immediately preceding note) or that it commands universal acceptance. I am suggesting, however, that it is an accurate characterization of the ethical nature of business, and further, that support for it can be found in the centrality of consent to each of the three previously examined theories. I am also suggesting that it is an observation that deserves more consideration than it has yet received from those working on the normative theories of business ethics.

<sup>66</sup>In this context, I am clearly referring to actual, as opposed to hypothetical or tacit, consent. Hypothetical or tacit consent is, in fact, not consent at all, but the presumption of consent where none has actually been given. It follows that in describing a business as a voluntary association of individuals united by a network of contracts, the contracts being referred to are actual interpersonal agreements, not hypothetical social contracts.

is magically transformed into a new, separate and distinct entity that is endowed with rights or laden with obligations not possessed by the individual human beings that comprise it.

This implies that an adequate normative theory of business ethics must capture the ethical obligations generated when an individual voluntarily enters the complex web of contractual agreements that constitutes a business. Of the three theories I have examined, the stockholder theory comes closest to achieving this because it focuses on the actual agreement that exists between the stockholders and managers. It is woefully incomplete, however, because it 1) does not adequately address the limits managers' ordinary ethical obligations as human beings place on the actions they may take in the business environment, and 2) entirely fails to address the managerial obligations that arise out of the actual agreements made with the non-stockholder participants in the business enterprise.<sup>67</sup> Of course, recognizing these deficiencies of the stockholder theory also highlights the essential difficulty in constructing a satisfactory normative theory of business ethics; the need to generalize across the myriad of individual contractual agreements that are the constituent elements of the business.

Can an adequate consent-based normative theory of business ethics be devised? Can the ethical obligations arising from the agreements that characterize the typical business as well as those that individuals carry with them when they enter the business venture be captured in a manageable set of principles expressed in language accessible to the ordinary business person? Considering the differing nature of the relationships and agreements involved in a business of any

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<sup>67</sup>It may be more precise to say that the stockholder theory fails to address the obligations arising out of those agreements *that are not inconsistent with the managers' antecedent agreement with the stockholders*. However, it is at least arguable that what should be done when managers have made inconsistent commitments is itself an issue that would have to be addressed by an adequate normative theory of business ethics.

complexity, devising such a set of principles may appear to be a daunting, if not hopeless, task.<sup>68</sup>

Nevertheless, I believe the present survey indicates that this is a challenge that must be undertaken if a supportable normative theory of business ethics is to be devised. Undertaking this challenge, however, must remain the project of another day.<sup>69</sup>

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<sup>68</sup>This may well be an understatement. Given the wide variety of enterprises that are described by the word ‘business,’ from the smallest closely-held family business to the largest publicly-traded multinational conglomerate, and from the most mission-oriented nonprofit to the most bottom-line-oriented entrepreneurial venture, it is reasonable to doubt whether this term has a definite enough referent for the construction of a general normative theory of business ethics to even be possible. If it does not, we will simply have to content ourselves with the recognition that ethically proper behavior necessarily depends on the particular agreements the actor has entered into, and leave it at that.

<sup>69</sup>Actually, some promising preliminary steps in meeting this challenge have already been taken by Professors Dennis Quinn and Thomas Jones in their article *An Agent Morality View of Business Policy*, *supra* note 12. This may serve as a useful starting point for those who believe that an adequate general normative theory of business ethics can, in fact, be formulated.