Objections to Friedman's Shareholder/Stockholder Theory

<u>1. Legal ≠ Morally Permissible:</u> Almeder offers several criticisms of Friedman's claim that the only obligation of businesses is to increase profit (within the constraints of the law). He begins by pointing out a number of incidents where corporations have done seemingly horrible things in the name of profit maximization—and that all of these things were **legal**. For instance, they have dumped toxic chemicals into water supplies, and sold defective tires on automobiles that killed hundreds of individuals.

But, "legal" is not synonymous with "morally permissible"—at least, it certainly is not so for *individual people*. PEOPLE have obligations above and beyond what the law requires of them. The question is: Do BUSINESSES have a duty to go above and beyond the call of the law; do they have any additional MORAL obligations which they are required to uphold?

<u>2. Justifications for Shareholder/Stockholder Theory:</u> Almeder reminds us that people like Friedman cite several reasons as justifications for their views on the conduct of business. Here are two of them:

- (1) The greatest public good is in fact best promoted by allowing businesses to go wholly unhindered by morality in their pursuit of profit. So, to ask them to do otherwise actually ends up FAILING to maximize the public good—it "subverts" the goal of best promoting the good of society.

- (2) There is no general agreement upon what our moral obligations ARE—indeed, there is not even a consensus regarding whether there ARE any objective moral obligations. Therefore, it would not make sense to require businesses to uphold moral laws that may not even exist.

<u>3. Objections to Claim (1):</u> Friedman claims that unrestrained businesses engaging in the sole endeavor of profit maximization will inevitably promote the greatest social good. Almeder questions this claim. It is not at all clear, he says, that this will in fact happen.

For instance, in the world of today, businesses HAVE to some extent been permitted to pursue profit unchecked—and yet there have still been many atrocities committed in the name of profit. (And keep in mind that this true EVEN THOUGH we DO have a lot of laws in place which to some extent restrict the conduct of businesses). For instance, recall several examples from both the lecture and the textbook: Selling carcinogenic baby pajamas to mothers in other countries, continuing to sell defective tires that led to hundreds of deaths even after it was known that the tires were defective, and dumping toxic chemicals into the local habitat or water supply.

The conclusion is that, when businesses are allowed to solely pursue profit, they do NOT end up maximizing the well-being of the community as a whole.

4. Objections to Claim (2): Many claim that, since there is no general agreement about the nature of morality and moral truth, businesses should not be subject to it. But, this claim seems mis-guided. Surely we can all agree, Almeder says, that killing an innocent human being for no reason other than to profit by it is morally wrong. Even if we could demonstrate that several people would be made better off killing one innocent person, the killing still does not seem to be justified. But, this is exactly what businesses do.

Murder for Money: Almeder gives an example of an automotive company trying to decide whether or not to recall a defective product which is causing the deaths of several drivers. Often, they will NOT recall the product if they believe that the amount of money they will have to pay in lawsuits to the injured victims (or dead victims' families) will be less than the cost of recalling the product altogether. But, they WILL recall the product if they believe the cost of the lawsuits WILL add up to more than the cost of the recall. The fact that it is morally wrong to cause the deaths of the customers NEVER enters into the decision process. It does not even count as a reason in favor of recalling the product. So, for businesses, decisions are based MERELY on profit.

Almeder considers another example of a business dumping hazardous chemicals into a water supply, which results in the deaths of many innocent people. What is the benefit? The shareholders of the company are made better off, and perhaps (to some lesser extent) employees and customers of the company enjoy some small good as a result of the company's success. But, this is at the expense of the lives of several innocent victims.

Is such a practice justified? First, we can ask: Would it be morally permissible for an individual PERSON to do this? If not, then why would it be morally permissible for a BUSINESS to do this? Is there any morally relevant difference (between when a PERSON causes the death of someone for profit and when a BUSINESS causes the death of someone someone for profit?) which justifies the action in one case but not the other? Almeder does not think so. According to Almeder, businesses that behave like this are basically committing "**murder for money**".

We might consider Almeders' argument to be what is called an "argument by analogy", such as the following:

1. Murdering an innocent person for money is morally wrong.
2. But, certain business conduct committed in the name of profit (e.g., dumping toxins into a water supply in order to save money) is morally analogous to murdering an innocent person for money.
3. Therefore, certain business conduct committed in the name of profit is morally wrong.

Topic Suggestion: Objections to Friedman: Consider cases such as dumping hazardous chemicals into the water supply, selling baby clothing known to contain carcinogens, or selling tires known to be defective—all of which lead to the deaths of innocent people, but are justified in the name of profit.

Ask: Are these actions morally analogous to the act of an individual person murdering someone for money? Why or why not?

When thinking of this issue, it may help to first ask, "Is it permissible for an individual PERSON to do these things?" Then ask, "Is it permissible for a BUSINESS to do these things?" Finally, ask, "Is there any difference between individual people and businesses which is morally relevant in such a way as to make the action permissible in one case (people) but not the other (businesses)?"

Stakeholder Theory

1. Stakeholder Theory: Freeman argues that the duty of managers within a corporation is not to "shareholders" or "stockholders" (i.e., people who own shares of the corporation, and stand to gain financially from it), but rather to what he calls "stakeholders".

> **Stakeholder:** A stakeholder of a business is someone who has ANY stake whatsoever in the goings-on of a business. This means that ANYONE AFFECTED by the actions of that business has a stake (an interest) in what that business does. So, this includes not only shareholders, but also employees, customers, suppliers, and often even the entire community.

This view is essentially the same as that of shareholder/stockholder theory (which say that businesses are obligated to look out for the best interest of their stockholders), except that stakeholder theory takes a much **wider view** regarding who has a stake in the goings-on of a company. Consider:

Shareholder/Stockholder Theory: This theory states that the STOCKHOLDERS are the ones who have an interest in what a business does (since they stand to profit from it), and so each business's obligations are to THEM.

Stakeholder Theory: This theory points out that people who own stock in a business are NOT the ONLY people who stand to gain or lose something when businesses make decisions. For, each business's decisions will potentially affect the well-being of MANY more people than just the stockholders (for instance, businesses often regularly affect the well-being of their employees, their customers, and the community as a whole). So, each business's obligations are to ALL of those people.

Consider what is at stake for each of the following groups of people:

• <u>Stockholders:</u> Their money is at stake. Those who own shares of stock in a company stand to lose money if that business does poorly.

• <u>Employees:</u> Their jobs, and therefore their very livelihood, is at stake. Additionally, their well-being is at stake. Those who work for a company stand to lose their source of income if a business does poorly. If the business treats their employees poorly, or puts them in danger, they also stand to lose their well-being or happiness.

• <u>Suppliers:</u> Their money, and their success or failure are at stake. If the company that a supplier sells their supplies to does poorly, then the supplier will also do poorly.

• <u>Customers:</u> Their needs and their well-being are at stake. For instance, depending upon how a business is run, and what products they offer, the needs of the customers will or will not be met. Additionally, if a business engages in immoral practices such as false advertising or selling hazardous or defective products, the customers may be harmed by this.

• <u>The Local Community:</u> The economic and personal well-being of the members of a local community are at stake. Communities receive tax money and the availability of jobs due to the presence of local businesses. Additionally, other factors surrounding local businesses may affect the local community. For instance, if a local business is polluting the local water supply, or negatively affecting the air quality with pollutants, then the local community stands to suffer because of this. On the other hand, if local businesses spend money to fund local parks, day-care services, etc., then the community stands to benefit even further from the presence of that business.

The conclusion: In light of the fact that ALL of the above are affected by the decisions of a business, Freeman concludes that business have obligations to ALL of the above. In short, businesses have duties to all of its **stakeholders**; i.e., all of the people who have a stake in the decisions and conduct of a business.

2. The Presumption of Non-Egoism: Notice that Freeman is presuming that businesses have obligations to other parties beyond themselves. This is clearly NOT ethical egoism. Recall that egoism stated that individuals only have obligations to maximize their OWN well-being. In contrast, Freeman's claim is that businesses have duties to maximize the well-being of others, IN ADDITION TO the business itself.

What ethical view is this pre-supposing? It seems that Freeman's view could actually be compatible with TWO of the moral views we looked at: Utilitarianism OR moderate deontology. Recall:

Utilitarianism: The view that we are morally obligated to maximize the well-being of **everyone affected by our actions**.

Moderate Deontology: The view that we have various moral obligations, and among these are (1) Non-maleficence, or the **duty to not harm others**, and (2) Beneficence, or the **duty to benefit others**.

Either of these moral views would give the conclusion that businesses have duties to look out for the well-being of others beyond the business itself (e.g., employees, customers, and the local community).

3. Establishing the Rules of the Game: Once it is established that Businesses do in fact have obligations to ALL of their stakeholders, the question arises: "What sort of rules can we put in place to guide businesses to fulfill these obligations?" Freeman suggests six principles. They are:

1. The Principle of Entry and Exit: Any contract with the business must have clear language about the creation, termination, and renegotiation between the business and the other party. This is so that every stakeholder can know that a contract exists between the business and

all stakeholders, and also so that they can know what is expected of them.

2. <u>The Principle of Governance:</u> Any change to the contract between the business and its stakeholders must be unanimously consented by all stakeholders. This is to ensure that all stakeholders are considered fairly.

3. <u>The Principle of Externalities:</u> If there is a contract between two stakeholders that negatively affects a third stakeholder, the third stakeholder has the right to enter negotiations to ensure that an agreement exists that does not harm them. This is to ensure that any negative effect or cost incurred by any stakeholder is a fair one.

4. <u>The Principle of Contracting Costs:</u> All participating stakeholders must contribute to the cost of creating, changing, maintaining the contract.

5. <u>The Agency Principle:</u> Each stakeholder must work towards the interest of all stakeholders.

6. <u>The Principle of Limited Immortality:</u> Decisions shall be made with the assumption that the business will continue to exist into the future (since he continued existence of the business is in all of the stakeholder's interests).

<u>Conclusion:</u> The end result is that each business would have an obligation to consider the interests of ALL stakeholders, and furthermore an obligation to PROMOTE the interests of these stakeholders. And finally, the stakeholders would have the right to take action against the business if it fails to fulfill these obligations.

<u>Topic Suggestion: Stakeholder Theory:</u> Freeman is certainly correct when he recognizes that businesses often affect more than just their owners or stockholders. Can you think of an example of a business that you know of (personally, or in the news) that affected either its employees, its customers, or its local community in either a positive or a negative way? Feel free to share some personal story from your own life.

Note: Please complete "Reading Quiz for Week 7" at this time if you have not already done so.