

Articles

ARE CORPORATIONS SOCIALLY RESPONSIBLE?

IS CORPORATE SOCIAL RESPONSIBILITY DESIRABLE?

by

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This essay addresses two questions. The first, in Part One, deals with whether corporate managers have any scope to look beyond the traditional goal of profit maximization in the interests of the shareholders to other socially responsible objectives.

It is submitted that it is appropriate to examine constraints on management since they are the group which makes the effective decisions for the corporation. They are, in effect, its mind.¹

In the course of Part One, various mechanisms that act as a constraint on management deviation from the profit maximization principle are examined. It is the submission of this paper that, acting together, these devices serve to eliminate nearly all discretion to pursue non-profit maximizing objects.

Part Two deals with the normative question of whether corporations *should* engage in Corporate Social Responsibility (hereinafter referred to as CSR) at the expense of profits. After briefly canvassing the arguments in favour of CSR, the rest of Part Two deals with the economic, practical and - most compellingly - the political arguments against it.

Part One

(a) Introduction

What is Corporate Social Responsibility? (CSR). Any discussion of the

¹ Gordon, BLJ 'The Corporation and Economists' conceptions of the firm' in KE Lindgren, HH Mason et al (eds) *The Corporation and Australian Society*, Sydney 1974 125.

subject must at least begin with a working definition.

Crudely put, the notion of CSR involves the expenditure of company resources at the discretion of management on doing "good works" for the community (like sponsoring community projects or funding charities) or on refraining from doing "bad works" (like polluting rivers or raising prices) instead of deploying those resources towards the end of profit maximization. Dessler² views CSR as a catch phrase for the role that companies are expected to play in treating the assorted ills of the community.

Such a role does not entail corporations abandoning the pursuit of profit altogether - merely that the company should accept marginal returns on expenditure that are lower than the returns available from some alternative expenditures. In other words, it is argued that companies should be satisfied with making less profit (not that they necessarily forgo all profit) as the diminished returns will be more than offset by the net social benefits.³

Manne points out⁴ that for corporate behaviour to be classified as truly "socially responsible", it must be voluntary. He notes that many corporate activities that are proudly cited by management as being evidence of a new attitude by business towards its "responsibility" to the community cannot really be attributed to altruism. A good recent example of this sort of phenomenon was the replacement of chlorofluorocarbon propellants in aerosol packages. Although the manufacturers claimed it to be an example of their environmental sensitivity, the move was actually mandated by the simple commercial reality that demand for aerosols containing CFC's had slipped dramatically, and that it was in the interests of their profitability to make the change to hydrocarbons. This illustrates the importance of distinguishing between the rhetoric of CSR, and the reality of much corporate activity.

In light of the foregoing, it seems that Engel provides the most useful working definition of CSR: it

'denotes the obligations and inclinations, if any, of corporations organized for profit, voluntarily to pursue social goals that conflict with their presumptive shareholder desire to maximize profit'.⁵

(b) Separation of Ownership and Control

Ever since Berle and Means' seminal work of the 1930's 'The Modern Corporation and Private Property',⁶ it has largely been accepted that

2 Dessler, G *Management Fundamentals* (4th ed) Reston Virginia 1985 462.

3 Manne HG, Wallich HC, *The Modern Corporation and Social Responsibility* Washington DC 1972 4.

4 Ibid 5.

5 Engel DL.

6 Berle AA, Means GC, *The Modern Corporation and Private Property*, New York NY 1968

ownership and control in large corporations are effectively separated. In the physical sense, there are simply too many shareholders to effectively participate in the management of the company. The problem of numbers is accentuated by the fact that the shareholdings will tend to be widely scattered, none of which will be large enough to allow its holder to exercise any real control over the company.⁷

The apparent powerlessness of shareholders has been accompanied by the phenomenon of shareholder passivity (which will be discussed more fully below in the context of agency costs). Put simply, shareholder passivity is brought about by the fact that stockholders have neither the resources, the competence, nor the inclination to take part in the management of the company.⁸

Berle and Means hypothesized that this divorce of ownership and control would leave management free to run the company as it saw fit. In particular, they felt it would give managers greater discretion to exercise in favour of community interests,⁹ instead of being slaves to the shareholders' interests as required by the traditional view.¹⁰

According to Posner and the other traditionalists, however, the result envisaged by Berle and Means does not necessarily follow from the undoubted dichotomy between ownership and control.¹¹ It is their view (and, it is submitted, the more correct view) that managers retain little if any discretion which may be exercised for purposes apart from profit maximization.¹²

(c) Agency Costs

The traditionalists support their view as to the discretion of management with reference to the concept of agency costs.

As suggested above, shareholders will not normally become involved in the day-to-day affairs of the company. Instead, they hire professional managers to act on their behalf. The corporate officers are thus the agents of the company (and through it, the shareholders).¹³

It should be noted that the characterisation of the relationship between the

7 Klein WA, Coffee JC, *Business Organisation and Finance - Legal and Economic Principles* Westbury NY 1988 104.

8 Brudney V, 'Corporate Governance, Agency Costs and the Rhetoric of Contract' (1985) 85 *Columbia L Rev* 1403 1403.

9 Engel DL, 'An Approach to Corporate Social Responsibility' in Posner RA, Scott KE (eds) *Economics of Corporation Law and Securities Regulation*, Boston Mass 1980 11.

10 Berle AA Jr, 'Corporate Powers as Powers in Trust' (1931) *Harv L Rev* 1145 1149.

11 Posner RA, *Economic Analysis of Law* (3rd ed) Boston Mass 1986 384.

12 DeAlessi L, 'Private Property and Dispersion of Ownership in Large Corporations' in Posner & Scott op cit 32.

13 Easterbrook FH, Fischel DR *Takeover Bids, Defensive Tactics and Shareholders Welfare* (hereinafter cited as 'Takeover Bids') (1981) 36 *Bus Law* 1733 1735.

stockholders and company on the one hand, and the managers on the other as an agency relationship is not without its critics. Brudney¹⁴ argues that conceptualizing the relationship as principal-agent tends to mask an erosion in the only real control, fiduciary duty. Clark¹⁵, too, challenges the use of the agency concept on the basis that the principals here do not retain the power to control and direct the activities of the agent. While there is some force in Clark's criticism (see *John Shaw & Sons (Salford) Ltd v. Shaw*)¹⁶, it remains true that shareholders retain a loose control over their agents by way of elections, supplemented by Court-enforceable fiduciary duties. While the agency analogy may not be a perfect one, it is submitted that it holds good for our purposes.

As with any agency relationship, there are certain costs involved. These arise primarily because the interests of the agent and those of the principal never fully converge. Owners of firms are presumed to be value maximizers. Since they stand to reap the gains from everything that they do (and, conversely, bear the costs of their every action), it follows that they will work hard to minimize costs and maximize gains.¹⁷

Managers, however, are not generally owners. Adam Smith anticipated that 'being the managers rather of other people's money than of their own', professional managers could not be trusted to exercise the same vigilance in looking after the company's affairs as they would if it was their own enterprise.¹⁸ This reflects the reality that because all of the benefits of his work enure to someone else, a manager is less motivated towards doing his job of advancing the principal's best interests.¹⁹

Typically, the manager will appropriate to himself some of the gains that would otherwise go to the owners through an increase in prerequisite.²⁰ Alternatively, he may (as a member of a management team) seek to shirk his allocated work load.²¹ Jensen and Meckling also suggest that there will be less incentive to innovate ie - managers become risk averse.²² It is reasonable to assume that the diversion of resources for the purposes of social responsibility would also occur.²³ The decline in the value of the firm brought about by this behaviour makes up a large component of agency

14 Brudney V, op cit 1432.

15 Clark RC 'Agency Costs versus Fiduciary Duties' in Pratt JW, Zeckhauser RJ (eds) *Principals and Agents: the Structure of Business*, Cambridge Mass 1985.

16 (1935) 2 KB 113.

17 Jensen MC, Meckling WH, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Jnl of Fin Eco* 305 308.

18 Hadden T, *Company Law and Capitalism* (2nd ed) London 1977 27.

19 Easterbrook FH, Fischel DR 'The Proper Role of a Target's Management in Responding to a Tender Offer' (hereinafter cited as 'Proper Role') (1981) 94 *Harv L Rev* 1161 1170.

20 Jensen MC, Meckling WH 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' in Posner and Scott, op cit 42.

21 Alchian AA, Demsetz H 'Production, Information Costs, and Economic Organisation', in Posner and Scott, op cit 14.

22 Jensen and Meckling, op cit, in Posner and Scott, ibid 43.

23 Engel, op cit 7-8.

COST.²⁴

Not surprisingly, the owners of a firm seek to minimize these costs because gains diverted by management are gains denied to them. To eliminate such costs, however, they have to monitor the managers' behaviour. Monitoring can be a costly process. The principal may also incur so called "bonding" costs - expenditure to guarantee that the agent will not engage in behaviour that harms the principal or ensures that the principal will be compensated if it is harmed. Monitoring and bonding costs, as well as the residual cost described above, make up the total agency costs of a firm.²⁵

There are a number of different internal and external monitoring mechanisms available to the shareholder which are designed to place downwards pressure on agency costs. The stockholders rely on these mechanisms to save them the time and expense of monitoring the behaviour of management themselves.

Amongst the most basic of these mechanisms are the formal controls that are often built into company articles of association. In particular, the Companies Code requires the appointment of an independent auditor²⁶ whose job it is to report and comment on company accounts and records.²⁷ This report, along with the accounts and director's report, must be laid before the annual general meeting.²⁸ Budget restrictions might also be included in the articles, and (notwithstanding the decline in the doctrine of ultra vires) a statement of purposes could be formulated.²⁹

Another control placed on the power of management is the power of shareholders to vote in a general meeting. As noted above, shareholders have little ability to control in any immediate sense the behaviour of managers,³⁰ however, they do retain substantial powers. The most important of these is the power to hire and fire members of the board.³¹

The practical effect of this power is substantially diminished by the phenomenon of shareholder passivity. In larger companies, the great majority of shareholders do not even turn up to the annual general meeting, let alone take part in a vote for seats on the board.³²

Proxy voting was introduced to overcome this lack of shareholder participation. The proxy was designed to be an absentee vote, making it

24 Jensen and Meckling, *op cit* in Posner and Scott, *op cit* 43-44.

25 *Ibid* 39-40.

26 Section 280, *Companies Code (NSW)* 1981.

27 Section 285, *ibid*.

28 Section 275, *ibid*.

29 Jensen and Meckling, *op cit*, in Posner and Scott, *op cit* 43.

30 But see *Marshall's Value Gear Co Ltd v Manning, Wardle & Co Ltd*, (1909) 1 Ch 267.

31 For example, see Table A, Regs 57(2), 62.

32 *The Responsibilities of the British Public Co'*, Final Report of the Company Affairs Committee, Confederation of British Industry, London 1973 10-11.

easier for shareholders to become involved in monitoring management. In practice, however, the proxy has not encouraged participation.

The phenomenon of shareholder passivity means that almost no one is sufficiently motivated to organize an effective campaign that will actually succeed in winning a vote at a general meeting. The cost of informing and organizing the large number of dispersed shareholders can be quite prohibitive. The cost is accentuated by the fact that management will actively oppose any vote if it feels threatened - the whole process degenerates into a proxy battle in which managers can call on the company's resources, while shareholders are left to their own means.³³

Signs of change have accompanied the rise of big institutional investors. As large shareholders, they have the influence and resources to more effectively organize a successful vote. They also have an incentive in that they cannot readily sell out of a stock due to the size of their holding. While in the past institutional investors have manifested the same characteristics of passivity exhibited by their smaller brethren, the performance of some institutional investors (for example, the AMP Society's role in the Bond Corporation restructuring) suggests a more active role in the future.³⁴

Even so, the chances of actually winning a proxy battle remain slim. Nonetheless, the vote does play an important function as a disciplinary mechanism for management, albeit not in quite the way that it was originally intended: it allows issues to be brought into the public forum. This forces management to defend its decisions in public and might actually embarrass them into changing course.³⁵ It is also fair to say that managers are sensitive to allegations that they ride roughshod over powerless shareholders. As a result, they may be more responsive in an effort to show that they are listening.³⁶

Nonetheless, the history of the proxy vote would tend to suggest that the calls for greater shareholder democracy are misplaced. Shareholders are simply not interested in getting involved, even when it is made easier for them. They prefer to sell their shares if they are dissatisfied with management performance (see the discussion of Market for Corporate Control, below). This may be a good thing from the point of view of efficiency in that it would be very difficult for managers to effectively run the company if they had continued interference from large numbers of shareholders.³⁷

Shareholders also have the power to mount legal challenges to certain

33 Conard AF, *Corporations in Perspective*, Mineola NY 1976 340.

34 Ibid 342.

35 Chamberlain NW, *The Limits of Corporate Responsibility*, New York NY 1973 192-193.

36 Ibid 204.

37 Posner, *op cit* 384.

types of managerial behaviour. A member of the company can bring a derivative suit against management for breach of fiduciary duty. Of particular relevance for our purposes, a member can challenge the use of powers by managers for an improper purpose (that is, an act that is not bona fide for the benefit of a company as a whole).³⁸

On its face, the law has taken a quite strict approach to activities by corporations that do not render a clear benefit to the company. In *Parke v. Daily News Ltd*,³⁹ the proceeds of the sale of a company's main asset were distributed amongst all of the employees who were made redundant by the sale. The Court held that, while no doubt socially responsible, the act was not done for the purposes of the company and was therefore disallowed.

The decision in *Parke* followed the famous dicta of Bowen LJ in *Hutton v. West Cork Railway Company*,⁴⁰

The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.⁴¹

More recent Canadian cases (such as *Teck Corporation Ltd v Millar*)⁴² have suggested a loosening of the Court's attitude towards socially responsible acts - the Court in *Teck* suggested that social responsibility could be justified since it was in the shareholders' interests.⁴³ Notwithstanding this more liberal approach, the law in Australia remains as it was stated in *Hutton*.

The potentially powerful impact of these cases on directors' discretion to engage in CSR is ameliorated somewhat by the difficulties in bringing an effective Court action both because of the complications inherent in a derivative suit, and because of a very liberal application of the business judgment rule which has the effect of insulating management decisions from effective challenge.⁴⁴ Nonetheless, the fear of court challenge does impose some form of restraint on management.

These internal monitoring mechanisms, however, are all quite costly from the disinterested shareholders' point of view. A far preferable alternative is to rely on external mechanisms. These come in various forms.

One of the most obvious of the external monitoring mechanisms is competition in the product market. In competitive markets, profit margins of

38 See *Ngurli Ltd v McCann* (1953) 90 CLR 425 at 438, per Williams, Fullagar and Kitto JJ.

39 (1962) Ch 427.

40 (1883) 23 Ch D 654.

41 Ibid at 671.

42 (1973) 33 DLR (3rd) 288.

43 Ibid at 313 per Berger J.

44 Easterbrook FH, Jarrell GA, 'Do targets gain from defeating tender offers?' (1984) 39 NYUL Rev 277-278.

firms are so slim that they simply cannot afford to engage in CSR. It is axiomatic that, in these circumstances, 'a sustained commitment to any goal other than profitability will lead to bankruptcy unless collusion is permitted.'⁴⁵ The firm is completely at the mercy of the sovereign consumer in that it must minimize costs in order to stay price competitive.⁴⁶

Proponents of CSR point out that many of our product markets are not perfectly competitive (although they conveniently obscure the fact that a great many are substantially competitive).⁴⁷ They observe that big corporations often possess market power, and conclude from that that the classical economist's assumptions about competition in the market place are inappropriate.

The staunchest traditionalists accept that there is no such thing as perfect competition in practice.⁴⁸ Nonetheless, they contend that most markets are still broadly competitive (workable or effective competition)⁴⁹ and that they still ensure that any substantial diversion from the goal of profit maximization will lead to higher costs and an impaired performance in the market.⁵⁰

The admittedly increased concentration of product markets has led to the emergence of a new constraining force. Big companies are now faced with the countervailing power of big suppliers, bigger customers, super unions, lobby groups and government. They all act as a check on corporate activities and serve to limit discretion.⁵¹

Another external monitoring mechanism can be found in the shape of a market for managerial labour services. Managers recognize that their personal success is tied to the success of their firm. Their salaries and emoluments, their future career prospects, and their power, all depend on their performance. Performance is still judged by the standard of profitability of the enterprise.⁵² The looming threat of bankruptcy, with its potentially devastating impact on a manager's employment prospects and his standing with his peers, serves as the ultimate incentive to manage with an eye on the bottom line.⁵³ Such an attitude does not allow for displays of corporate largesse.

The profit-measured performance of individual managers can be

45 Engel, op cit in Posner and Scott, op cit 68.

46 Posner RA 'Power in America: the role of the large Corporation' in Weston JP (ed) *Large Corporations in a Changing Society*, New York NY 1974 92.

47 Mason ES, 'The Apologetics of Managerialism' (1958) 31 *Jnl of Bus* 1 10.

48 Friedman M, *Capitalism and Freedom*, Chicago, Ill 1966 120.

49 Mason ES (ed) *The Corporation in Modern Society*, Cambridge Mass 1959 7-8.

50 Drucker PF, *The Concept of the Corporation*, New York NY 1964 205.

51 Mason 'The Apologetics of Managerialism', op cit 8.

52 Hetherington JAC 'Fact and legal theory: shareholders, manager and Corporate Social Responsibility' (1969) 21 *Stan LRev* 248 266.

53 Posner, op cit 383.

compared to that of other potential managers in the employment market.⁵⁴ Thus, the market becomes a monitor - managers feel compelled to maximize profit (which implies minimizing opportunities for CSR) in order to keep their jobs. Ironically, the competition amongst potential managers increases as firms get bigger and accrue more market power - in a monopoly where there is only one employer, the competition amongst potential managers for a job is much more fierce than when there are more employers. Thus, any decrease in competition in a product market can be offset by increased competition in the labour market, with the result that agency costs stay lower.⁵⁵

At the same time, internal monitoring occurs as lower level managers seek to advance. In order to get promotion, they have to show their performance to be superior to that of their colleagues and potentially superior to that of their bosses.⁵⁶ While senior managers get to control their own appointments, they are themselves governed by the profit standards because if they promote on any basis other than performance, their capacity as managers will be reflected on in an adverse light.⁵⁷

Creditors also serve to monitor the performance of agents. Creditors do not look favourably on inefficient managerial behaviour when assessing whether to lend a company money. They are interested in ensuring that their loan will be repaid. Accordingly, they will insist on maximum profitability, which leaves little scope for CSR.⁵⁸ One need only look at the role of creditors in the recent collapse of Hooker Corporation to see just how active creditors can be as monitors.

Capital markets play an even greater monitoring role. In order to raise equity capital, a firm must first convince participants in the market that it represents a good investment. Investors, however, are assumed to be intelligent and rational, searching for stocks that provide the best prospects for capital appreciation and high dividends.⁵⁹ They generally operate under the impression that companies are managed with a view to maximizing profit on their behalf.⁶⁰ The reality is that for the investor, profit is the primary consideration when making the decision to buy. If a firm cannot provide a competitive return which is predicated on its ability to maximize profits then the investor will find somewhere else to put his money. Corporations are compelled to maximize profit (and thus minimize cost) or face the prospect

54 Alchian, Demsetz, op cit, in Posner and Scott op cit 18.

55 Jensen, Meckling, op cit 329.

56 Fama EC, 'Agency problems and the theory of the firm', in Posner and Scott, op cit 59.

57 Brudney, op cit 1421.

58 Barzel M, Smith RM, 'The one best system? A political analysis of Neo-Classical Institutional Perspectives on the Modern Corporation', in Samuels WJ, Miller AS (eds) *Corporations and Society: Power and Responsibility*, New York NY 1987 82.

59 Rostow EV 'To Whom and for what ends is corporate management responsible', in Mason *The Corporation in Modern Society*, op cit 48.

60 Brudney, op cit 48.

of being starved of capital.⁶¹

The effectiveness of the capital markets as a monitoring mechanism is dependent upon broad acceptance of the efficient capital markets hypothesis. This hypothesis contends that the current price of securities in the market place is the result of the interaction of all of the buyers and sellers in the market, acting on any and all information about stocks that is available to them.⁶² The price of shares, in other words, reflects the 'collective wisdom of all traders about the value of the stock'.⁶³ Information to the effect that management is diverting profits from shareholders towards its own notion of social responsibility will be accurately reflected in the firm's stock price.⁶⁴

The Efficient Capital Markets hypothesis also underlies what is perhaps the most effective external monitoring mechanism of them all: the market for corporate control. If managers are not maximizing profits, then the market value of the stock will fall. As the stock becomes cheaper, it becomes more attractive to an outside bidder such as an individual or company who feels that he can get a better rate of return from the target company's assets than can the existing management.⁶⁵ To that end, he will be prepared to pay a premium (an amount above the market price) that is necessary to convince shareholders to sell. This premium can be offset by making bigger profits out of the existing assets of the target company by reason of the implementation of a superior management strategy which reduces agency costs.⁶⁶

The profits to be made from obtaining control of inefficiently managed resources (thereby reducing the agency cost) act as an incentive for bidders to very carefully monitor the performance of firms on the stock market. In this way, bidders carry out the task of monitoring management for the shareholders.⁶⁷

The mere threat of a takeover (and the loss of power that that implies) is enough to induce managers to reduce agency costs and thereby maximize profits in order to keep share prices high - the only sure way to keep bidders at bay.⁶⁸

61 Davis W, *'It's no sin to be rich'*, London 1976 168.

62 Harrington WD 'If it aint broke, don't fix it: the legal propriety of defences against hostile takeover bids' *1983 34 Syracuse L Rev* 977 981.

63 Easterbrook and Fischel 'proper role', op cit 1166.

64 Jarrell GA, Bradley M, 'The Economic effects of Federal and State Regulation of Cash tender offers' (1980) *23 Jnl of L and Eco* 371 380-381.

65 Holl P, 'Control type and the market for Corporate Control in large US Corporations' in Posner and Scott, op cit 205.

66 Bradley M, 'Interfirm tender offers and the Market for Corporate Control' (1980) *Jnl of Bus* 345 375.

67 Easterbrook, Fischel, 'Takeover bids', op cit 1736-1737.

68 Booth RA, 'Is there any valid reason why target managers oppose tender offers' (1987) *14 Sec Reg LJ* 43 49.

Thus, it can be seen that with all the external and internal disciplinary mechanisms acting on managers to maximize efficiency and thereby constraining management diversion of corporate resources, there is little scope for CSR.

How, then, does one explain all of those corporate activities which bear the hallmarks of CSR? As suggested in Part I(a), these activities are often motivated by different objectives merely cloaked in the mantle of CSR.⁶⁹

Managers are very quick to point to evidence of their social responsibility in the shape of affirmative action programmes, antipollution measures, and donations to charity. Indeed, many business executives honestly believe that it is their role to enhance the wellbeing of the community through socially responsible behaviour.⁷⁰

In reality, many activities are undertaken for reasons that have little to do with altruism, as the CFC example in Part I(a) suggests. Managers undertake what is in many instances a cynical cost-benefit analysis and conclude that it would be cheaper in the long run to voluntarily expend corporate resources on an apparently social object than it would be to let government become involved and impose expensive regulation, or risk a consumer boycott.⁷¹ Much CSR activity can be put down to publicity campaigning by corporations seeking to make themselves appear more human to their consumers.⁷² This activity is really guided by a desire for maximum profits, not altruism.

Accordingly, it is submitted that managers in fact have very little discretion to engage in CSR. In Part Two, it will be considered whether they should exercise what discretion they have (if any!) towards being socially responsible.

Part Two

(a) Introduction

For the traditionalists, the appropriate role of a corporation was always simple and clearcut. The corporation was

'an association of stockholders formed for their private gain and to be managed by its Board of Directors solely with that end in view'.⁷³

69 Friedman M, 'An Economist's Protest', Glen Ridge, NJ 1972 182.

70 Dodd EM, 'For whom are Corporate Managers trustee?' (1932) 45 *Harv L Rev* 1145 1153-4.

71 Ackerman RW, Bauer RA, *Corporate Social Responsiveness - the modern dilemmas*, Reston Virginia 1976 8.

72 Hetherington, *op cit* 278

73 Dodd 'For whom are Corporate Managers trustees', *op cit* 1146-1147.

The powers of the corporation were 'exercisable only for the ratable benefit of all the shareholders'.⁷⁴ Crudely put, the object was to maximize profits so as to give shareholders the best possible return.⁷⁵

This objective was not an absolutely unqualified one, however: it was always pursued subject to the law, and consideration was given to ethical principles generally regarded as being relevant to the conduct of the business.⁷⁶ Apart from these constraints, though, the manager was free to pursue the object of profit maximization.

The proponents of CSR do not view the role of business in such a narrow light. The development of large-scale industry has made corporations into 'repositories of power, the biggest centres of non-governmental power in our society'.⁷⁷ It is argued that business corporations have a social as well as an economic dimension since they have the power to affect the lives of many their employees, their customers and the community generally.⁷⁸ Keith Davis argues that economic decisions have social consequences,⁷⁹ and that corporations should be expected to conduct themselves in a responsible fashion just as any other citizen possessed of such power would be expected to behave.⁸⁰

Other arguments are advanced in favour of CSR: for example, it is suggested that by devoting resources to the fight against social ills, the community in which the firm operates will be a better place in which to do business as the social environment will be more conducive to commerce, with happier and healthier customers, easier recruiting, less crime and so on.

Another line of argument suggests that by acting in a socially responsible fashion, business might forestall costly government intervention (although it is unclear, on the definition adopted in Part One, that this really qualifies as CSR since it is not strictly speaking voluntary).⁸¹

In the end analysis, however, the main argument is always that business has vast resources at its disposal, which should not be devoted exclusively for the benefit of stockholders, but rather for the benefit of the wider community and its various constituent groups.⁸² This broader view of

74 Berle and Means, op cit 220.

75 Blumberg PI, *Corporate Responsibility in a changing society*, Boston Mass 1972 1.

76 Eisenberg MA 'Corporate legitimacy, conduct and governance - two models of the corporation' (1983-4) *Creighton L Rev* 1 6.

Abram Chayes 'The Modern Corporation and the rule of Law' in Mason, op cit 25.

78 Dobb 'For whom are corporate manager trustees?', op cit 1157.

79 Davies K 'Five propositions for Social Responsibility' in GA & JF Steiner (eds) *Issues in Business and Society* (2nd ed) New York NY 1977 182.

80 Steiner GA & JF (eds) *Issues in Business and Society* (2nd ed) New York NY 1977 182.

81 Dessler, op cit 464.

82 Schreuder M 'The social responsibilities of business' in C Van Dam, LM Staffaert (eds) *Trends in Business ethics*, Boston Mass 1978 78.

corporate responsibility is based on the assumption that business is consuming resources belonging to society, and is therefore expected to use such resources in society's interest.⁸³

As explained in Part One, it is the contention of this paper that business resources are not readily available to the cause of CSR. In Part Two, the arguments against such an expenditure of resources (were it possible) are canvassed under three broad headings: economic, practical and political.

(b) Economic Arguments Against CSR

In every society, some form of a rationing system is required to distribute finite resources amongst the unlimited demands of the members of the community. Rationing systems come in many shapes. During World War Two, for example, many domestic goods were distributed by means of administrative fiat. This system was quite inefficient due to the lack of information about consumer wants. In the free enterprise economy that is common to most parts of the Western world, the chosen means of rationing is the price mechanism.⁸⁴

Profit plays a central role in the operation of the price mechanism. It is the presence of (or potential for) profit, or its absence, that determines the distribution of resources in a free market. Profit serves as a vital source of information for producers.⁸⁵

The efficacy of the price mechanism rests on the assumption that firms will actually heed the signals provided in the form of profit. A profit maximizing firm does this and it results in optimum efficiency in the use of resources, and cheaper and more plentiful goods and services for the consumer. A socially responsible firm, however, would only follow those signals up to a point. The inevitable result is a trade-off in efficiency and the more limited availability of goods and services (which will affect their price). In more extreme cases, ignoring profit will lead to scarcities, queues and black markets.⁸⁶

One must ask the question: what do we want from an economic system? The question is of fundamental importance since the manner in which a society chooses to distribute its scarce resources will shape its very nature.⁸⁷ Drucker suggests that the proper object of an economic system 'is the satisfaction of the economic wants of the individual'.⁸⁸ If one accepts that object (which implies the supply of goods in adequate amounts and at reasonable prices),⁸⁹ then the test of the system lies in the efficiency with

83 Davis, op cit 201.

84 Drucker, op cit 201.

85 Ibid.

86 Farmer RN, Dickerson-Hogue W 'Corporate Social Responsibility' Chicago Ill 1973 16.

87 Schreuder, op cit 74.

88 Drucker, op cit 203.

89 Terry WH *The Corporation and the Economy*, Santa Barbara Cal 1959 10.

which it satisfies individual's wants.⁹⁰ For the reasons explained above, on this test a policy of profit maximization is clearly superior to a policy of "social responsibility".

In short, CSR is fundamentally subversive of the capitalist free enterprise system - a system that has so successfully done the job of satisfying the material needs of the community.⁹¹ Certainly, there are those in the community who are satisfied with material possessions and feel that our economic system should be prepared to trade off efficiency for social responsibility. Farmer and Hogue argue that such persons are in a small minority with most members of society still wanting the material benefits that maximized economic growth provides.⁹² Nor do they wish, it must be said, to bear the costs of socially responsible behaviour.⁹³ ...These costs must be met somehow, and that will usually be done by passing it on to consumers in the form of higher prices, a form of tax that is usually regressive.⁹⁴

Another oft-promoted aim of an economic system is social integration. Drucker argues that the price mechanism in a free enterprise system

'endows the economic self-interest of the individual with social efficiency and effectiveness'.⁹⁵

In other words, the self-interest of individuals can be made to coincide with the larger interests of the community.⁹⁶ The vice of greed, according to Bernard Mandeville, 'places a desire in each person to acquire more benefits'.⁹⁷ In pursuing this objective, it is argued, new ideas are synthesized, new products are invented and better methods of satisfying the needs and wants of the community are developed. This leads to economic growth, increased efficiency in the use of resources and rising employment - all of which are public benefits.⁹⁸ Man's desire to serve his own self-interest by pursuing profit will lead to a more efficient use of limited resources which will produce the greatest benefit for the total community.⁹⁹

This is Adam Smith's 'Invisible Hand' at work and the hand is moved by profit. To diminish the emphasis on profit will leave the invisible hand that much less effective.¹⁰⁰ The results for the economy of such a course are

90 Mason, 'The apologetics of managerialism', op cit 9.

91 Dessler, op cit 463.

92 Farmer, Dickerson-Hogue, op cit 12.

93 Chamberlain, op cit 75.

94 Posner, op cit.397.

95 Drucker, op cit 214.

96 Abt CC, *The Social Audit for Management*, New York NY 1977 156.

97 Gibson KR, 'Corporate Social Responsibility: anti-thesis of classical capitalism' (1985) *10 Okla City U L Rev* 343 387.

98 Ibid 367.

99 Silverstein D, 'Managing Corporate Social Responsibility in a changing legal environment' (1987) *25 A Bus L J* 523 535.

100 Rostwon, op cit, in Mason, op cit 65.

potentially disastrous: if there is less profit, then there will be less capital investment with obvious consequences for economic growth.¹⁰¹ The costs of CSR being passed on to consumers results in higher prices, meaning inflation and uncompetitive exports.¹⁰² Further, as profit is the reward for risk, diminished profits will lead to less innovation.¹⁰³ Less profit means a smaller tax base, and less revenue for the government.¹⁰⁴

Berle makes the point that shareholders both directly, and indirectly through financial institutions constitute a high percentage of the total population. A policy of profit maximization will thus benefit a lot of people; conversely, de-emphasis of profit will hurt them.¹⁰⁵

Thus, it can be seen that society as a whole benefits on balance from a policy of profit maximization, and suffers in net terms by the pursuit of other goals. As Friedman suggests, business best serves society by sticking to its economic role.¹⁰⁶

(c) Practical Arguments

There are numerous practical objections to CSR. One of these stems from the difficulty of defining precisely what the term social responsibility means in practice.

Hayek suggests that the term social purpose is so nebulous as to be useless in practice. Identifying the appropriate recipients for corporate largesse is at best problematical. The danger is that managers might be able to extend the definition to virtually any purpose that they fancy.¹⁰⁷

Managers, in particular, are not equipped to identify appropriate objects for CSR, quite apart from the definitional laxity. They are trained in the art of business, not social welfare. They do not possess the specialist skills necessary to identify social purposes (if they can be identified!) nor do they possess the allocational skills required to effectively apply the company's resources.¹⁰⁸ Further, such a process would conflict with the corporate culture of most companies. For the reasons stated in Part One, most managers are orientated towards making money, and it goes against the grain to give it away.¹⁰⁹

101 Davis W, 'It's no sin to be rich', op cit 167.

102 Farmer, Dickerson-Hogue, op cit 16.

103 Hadden, op cit 28-29.

104 *The Responsibilities of the British Public Co'* op cit 7.

105 Merrick E, Dodd AA, Berle 'Corporations' Cambridge Mass 1966 54.

106 Friedman M 'The Social Responsibility of Business to increase its profits' in Steiner, op cit 172.

107 Hayek FA, 'The Corporation in a democratic society: in whose interests ought it and will it be run?' in Ansoff HI, 'Business Strategy' Harmondsworth 1969 230.

108 Hetherington, op cit 279.

109 Chamberlain, op cit 202.

There is no recognised measurement standard by which the efficacy or otherwise of CSR activities can be judged. When goals are purely economic, assessing the performance of the company (and of its management) is simply a matter of looking at the bottom line.¹¹⁰ But if money is spent on social objectives with no indication for the shareholders as to whether they are getting value for money, the stock market's job of valuing the shares becomes that much harder. This impairs capital market efficiency.¹¹¹

CSR is arguably an inefficient way of addressing social problems in that business's approach is likely to be ad hoc, and uncoordinated. Corporations, although part of a larger business network, are still independent units. They find it difficult to co-operate and marshal resources so that they may be applied in an efficient way to address problems.¹¹²

There is also the question of how much CSR individual corporations should undertake. There is no practical guide as to what share of its profits a company should devote to social objects.¹¹³ Corporations can't be left in limbo in this fashion.

(d) Philosophical Objections to CSR

A number of arguments of a broadly philosophical nature are advanced in opposition to CSR. The central argument is an essentially political one and sits squarely in the liberal-democratic tradition of concern about restraint on the exercise of power.

The proponents of CSR and the traditionalists agree that corporations possess great power, although they disagree on the extent of freedom to exercise that influence. The CSR advocates are concerned to see that power is used for good. The traditionalists' emphasis is different, however: they are concerned to see that the power not be exercised for bad purposes, especially given the difficulties (discussed above) of defining what is good.

On the traditionalist view, the corporation serves a strictly limited purpose - making maximum profits. Hayek suggests that so long as corporate power is directed towards a specific purpose, no one need have any fear of its misuse.¹¹⁴ If the end is clear, and the standard of performance readily applied, then any divergence from pursuit of that end for undesirable purposes can be readily checked.

Profit is a black-and-white standard; equity is not. Whatever its other shortcomings, profit maximization at least serves as an enforceable and

110 Farmer, Dickerson-Hogue, *op cit* 13.

111 Hetherington, *op cit* 279-280.

112 Chamberlain, *op cit* 7.

113 Friedman 'An Economist's protest', *op cit* 180.

114 Hayek, *op cit*, in Ansoff, *op cit* 226.

coherent standard.¹¹⁵ Dodd argued that, until 'a practical and enforceable alternative scheme of responsibilities to someone else' can be developed, it is too dangerous to abandon or even weaken the profit maximization goal.¹¹⁶

Without a distinctive performance criterion, enforcing accountability becomes much harder. Managers would effectively be left at large in their exercise of power.

The existence of centres of uncontrolled power has always been feared in a democratic society, even when those who possess that power profess to use it for the public good. The concern is that their conception of what is "good" may not accord with that of the public.¹¹⁷

Examples abound of damaging actions of corporations in defiance of the profit maximization principle in the name of the public good. During the Vietnam War, the Dow Chemical Company continued to produce napalm, notwithstanding the fact that it was unprofitable, because management considered the action to be 'morally and politically desirable'.¹¹⁸

Similarly, in Weimar Germany, many powerful industrialists saw it as their patriotic duty to actively support the one man whom they sincerely believed could lead their economically debilitated country into a new period of prosperity. One need not catalogue the horrors of World War Two to illustrate the folly of their social responsibility.¹¹⁹

Perhaps the best illustration of the argument is provided by Henry Ford. In pursuing profit, Ford created new methods of production which led to a cheaper, more accessible car which created employment and economic growth along the way. Yet in the name of social responsibility, he resisted production of the self-starting car on the grounds that it would allow women to drive alone.¹²⁰ He also financed the virulently anti-Semitic Dearborn Independent newspaper because he believed that Jews were tearing at the nation's moral and social fabric.¹²¹

The argument is best summed up by Milton Friedman, who said that

'In a free society, it is hard for good people to do good, but that is a small price to pay for making it hard for 'evil' people to do 'evil', especially since one man's good is another man's evil'.¹²²

115 Levitt T, 'The dangers of Social Responsibility' (1958) 36 *Harv Bus Rev* 41 43.

116 Dodd, Berle, op cit 53.

117 Chamberlain, op cit.192.

118 Ibid 191.

119 Farmer, Dickerson-Hogue, op cit 11.

120 Ackenman, Paver, op cit 7.

121 Friedman M, Goldston E, 'The Responsible Corporation: Benefactor or Monopolist', *Fortune*, Nov 1973 56.

122 Friedman M, 'An Economist's Protest', op cit 181.

This argument implies recognition of separate and distinct roles for business and government. Friedman, Lodge and others argue that the process of identifying social objects should be a public one. They suggest that 'value setting is the function of politics, not of private business.'¹²³ In the same way, they perceive the process of expending resources upon those values as a public function, best left to public bodies.¹²⁴

The same argument applies to imposing the costs of social responsibility. Friedman suggests that by spending money on social objectives, executives are effectively imposing a tax on shareholders (in the form of reduced dividends) and customers (in the form of higher prices) and employees (in the form of lower wages). In his view, taxing is a public function that ought to be performed by public officials.¹²⁵

The power to act in the public interest ought to be confined to the government. Governments are accountable to the community for their actions, and are subject to established procedures controlling the exercise of their powers.¹²⁶ They are far better suited to the business of managing the welfare of society than are corporations.

This raises the possibility that if business seeks to embrace social responsibility, governments as the elected guardians of public interest will feel compelled to exercise more control over corporations. At best, increased government intervention would serve as an impediment to the fulfilment of the corporation's economic role. At worst, however, the two systems of government and business would ultimately converge as the role distinctions broke down. The result would be a monolithic and potentially despotic corporatist state.¹²⁷

In short, in a democratic society, the business of business should be business alone, not social engineering. The public functions of identifying and pursuing social objectives ought to be left to publicly elected officials, not privately appointed ones.¹²⁸ While the political process may often be a frustratingly cumbersome way of achieving the same result, it has the virtue of being democratic.¹²⁹

Another line of argument is advanced by Keith Gibson who characterizes the calls for a diminution in the role of profit as a return to the Dark Ages. Gibson explains that economic (and consequently political) activity was seriously stunted during the Dark Ages by the emphasis on frugality and modesty in preference to the pursuit of profit. Inspired by the Church,

123 Ackerman, Bauer, *op cit* 7.

124 Friedman, 'Capitalism & Freedom', *op cit* 133-134.

125 *Ibid* 170.

126 Buchanan S, 'The Corporation and the republic', New York NY 1958 22.

127 Hayek, *op cit*, in Ansoff, *op cit* 238.

128 Friedman M, 'An Economist's Protest', *op cit* 180.

129 *Ibid* 181.

businessmen were exhorted to charge a fair price for goods, and to seek no more return than was necessary to live.¹³⁰ The result of this phenomenon was social and economic stagnation. It was not until the Reformation - when profit became respectable once again that significant economic or political progress was made.¹³¹

The Reformation brought an increased emphasis on individualism. Inseparably connected to this philosophy was the role of private property. One of the fundamental objections to CSR is that it involves managers who, according to Hayek, are only trustees of the stockholders' wealth,¹³² spending someone else's money for purposes unconnected with the business's objectives.¹³³

Friedman suggests that a corporation is merely an instrument of the shareholders who own it, and should not be regarded as having special responsibilities merely because it has taken on corporate form.¹³⁴ The fact of incorporation should not invest the property held by the corporation with some sort of public obligation that does not apply to an individual's property.¹³⁵

Moreover, any acts of social responsibility that consume resources effectively deprive individual stockholders of the chance to be socially responsible themselves. Posner argues that the shareholders are the appropriate ones to expend resources on charitable contributions, political donations and the like. It is their prerogative to give individually, since it is their property. For corporations, Friedman's mooted 'Eleventh Commandment' should apply:

"Thou shalt do good at your own expense."¹³⁷

A great deal of criticism of business behaviour and the pursuit of maximum profits can in fact be explained by prejudice. The public always needs its objects of loathing - whether they be Freemasons, Jews, parking policemen or big corporations.¹³⁸ Many intellectuals engage in business bashing because it conforms to their agenda of undermining free markets.¹³⁹

It is ironic that the very behaviour that they despise is nurtured by CSR. As suggested earlier, the only firms that were in a position to pursue 'socially responsible' objectives at the expense of profits are those with significant

130 Gibson, op cit 353.

131 Ibid 357.

132 Hayek, op cit, in Ansoff, op cit 226.

133 Friedman 'An Economist's Protest' op cit 179.

134 Friedman 'Capitalism & Freedom', op cit 135.

135 Dodd 'For whom are corporate managers trustees', op cit 1146.

136 Posner, op cit 397.

137 Friedman and Goldston, op cit.

138 Posner, op cit, in Weston, op cit 103.

139 Davis W, 'It's no sin to be rich', op cit. 163.

market power.¹⁴⁰ To advocate CSR necessarily implies support for monopolists, oligopolists and uncompetitive markets at the expense of consumers - one of the same groups to whom corporations supposedly owe a social responsibility.

In the end analysis, then, it is submitted that business should confine itself to fulfilling its economic function. One is reminded of the Biblical injunction against serving two masters the company that seeks to pursue profit and do 'good works' at the same time is likely to do neither very well.

Moreover, the potential for abuses of power is more limited when there is a strictly defined object and recognized criterion of performance against which management can be measured. profit maximization performs this function. Until the concept of social responsibility can be defined with equivalent precision, it is simply too dangerous to release corporate management from the profit maximization leash.

(d) Conclusion

It is submitted that (for the reasons outlined in Part One) corporations have, at the most, only limited opportunities for pursuing CSR. Further (for the reasons outlined in Part Two), it is submitted that corporations should not engage in CSR.

All this does not mean that corporations are free to trample all over the community's social interests in the pursuit of profit. Non-voluntary social responsibility, where corporations are compelled to behave in a certain fashion in response particularly to consumer concerns, guarantees responsiveness of business.¹⁴¹

Moreover, there is always the option of enforcing social responsibility by external regulation by government. Whatever the merits of government intervention, it is at least the product of a democratic process: the community can pick its social goals for itself, then decide how they are to be pursued. Corporations should not be left to do this themselves.¹⁴² Whenever the pursuit of profit happens to produce socially undesirable results, their behaviour can be modified by external pressure. In the context of a liberal, democratic free enterprise society, this is the far superior alternative.¹⁴³

140 Mashaw JL, 'Corporate Social Responsibility: comments on the legal and economic context of a continuing debate' (1984) 3 *Yale L & Pol'y Rev* 114 119.

141 Chamberlain, op cit 18.

142 Hayek, op cit 18.

143 Engel, op cit 59.