

Resolved: That Corporations Should Be Accountable Only to their Shareholders

Remarks made to the Canadian Centre for Ethics &
Corporate Policy
In Toronto on April 2, 1997
Terence Corcoran, Columnist, The Globe And Mail

Thank you very much. I consider it a special honour to have been invited to participate in this debate, although I do have the feeling of being the sole atheist at the annual meeting of the Canadian Church for Corporate Governance. So I don't expect it to be easy to win you over, especially since I'm debating against such a formidable opponent as Carol Hansell.

I've been looking around for various techniques to win you over. One possibility is to imitate Jeremy Rifkin. All of you know Mr. Rifkin, I assume, since he is something of a fellow traveller in the cause of turning the free market capitalist system into a happy camp called the new social economy.

I had the misfortune of acting as a one-man panel during Mr. Rifkin's recent visit to Toronto, where he spoke to a convention room of thousands. The first thing he did was enlist audience participation. he did it with a trick question: How many of you, he asked, have lost or know somebody who has lost a job in the last few years?

Now the trick to the question is that, in the normal course of economic activity, 2 out of every 10 people lose their job every three years. That's a fairly routine event in the labour markets. At the same time, everybody personally knows at least 20 people. Statistics will tell you that, therefore, there's a 99 per cent chance that everybody knows somebody who has lost a job.

So when Jeremy Rifkin asked his audience to raise hands if they knew somebody who had lost a job, he wasn't taking any risks. He knew in advance what the response would be. Everybody raised a hand. And from that moment on, he had everybody munching on his theories about the end of work, as if the unanimous answer to his question proved that the global labour force was collapsing in the new post-market-era of general joblessness.

Well, if it works for Jeremy Rifkin, maybe it will work for me.

Let me ask you this question: How many of you for work profit -making corporations or have clients that are profit_making corporations?

Now the second question is: How many of you have investments in, personally or through pension funds, profit-making corporations.

See, it's working. I've got most of you in my hip pocket already.

Now the third question is: How many of you would rather be working for government?

This is a very serious subject. Since I know most of you are also very familiar with the questions related to corporate responsibility, and we have limited time, I'm going to cut quickly to the major issues.

The Question:

The question to be debated as it's posed in the program is: Should corporations be accountable only to their shareholders. My answer to the question is affirmative. Companies should only be accountable to the shareholders.

Now I also want to put the question into a context and rephrase it somewhat, to make it a more accurate reflection of what I think we are really talking about. The proper statement of the issue is: Should the government by law force companies to be accountable to others besides shareholders.

I think that's what the proposal really is. The key point here is whether corporate law should be changed to impose new purposes on the corporation.

Now I argue that there should be no changes to current law that would force companies to broaden their focus to include any group other than shareholders - or impose any purpose other than to maximize profits.

Those who would change the corporation would make managers accountable to a broader range of people generally called stakeholders - an ambiguous concept that has no real meaning. Stakeholders can be employees, customers, creditors, politicians - just about anybody.

Indeed, one definition of stakeholder actually does include virtually everybody.

Quote: Persons or groups that have, or claim, ownership, rights or interests in a corporation and its activities past, present or future. Such claimed rights may be legal or moral, individual or collective.

By that definition, everybody is a stakeholder in everything.

I'll return to the subject of stakeholder corporations in a minute.

Let me begin with a broad review of an important issue that is never touched on by proponents of the stakeholder concept of the corporation.

Aside from good economic reasons for retaining shareholder control and profit as the only focus. There are also good political and moral reasons.

What I am proposing here is the individual rights case for the shareholder controlled corporation.

Usually, people who want to expand the corporate focus to stakeholders claim that it is appropriate to do so because, after all, a corporation exists because it is a creature of government, created by government for the social purpose of managing parts of the economy.

It is also said that societies allow corporations to exist, and they will only continue to exist so long as they fulfil society's needs.

I reject that idea, because it's not an accurate reflection of the history of corporations, or of the principles. The right to organize a corporation is an extension of the rights of individuals to associate, and to agree among themselves to invest their money and to act as a group under conditions that they devise and accept.

Now the fact that it is necessary to register the corporation, and the fact that there are laws in existence that set some terms and limits on the corporation, does not take away from the underlying principle: The rights of a corporation are an extension of the individual rights of the shareholders.

The government does not control who sets up corporations. Incorporation is a right. It is for all intents and purposes an automatic event, not much different than getting a marriage licence or buying a piece of property, a real estate transaction. You don't need government permission to form a corporation.

The role of the government is limited. It provides a basis or a framework for people to exercise their individual rights, for investors to put their money, and a structure that allows people to trade their investments, knowing what the general boundaries are.

What a corporation does, how it's organized and managed, what its purpose is, all these things are up to shareholders and managers.

What the shareholder -controlled corporation does is assign managers the task of running the corporation along the general lines set out by law and as determined by the shareholder.

The corporation does not exist as a charter or licence or special allowance granted by the king or the government.

As an extension of individual rights, corporations do not exist to fulfil society's needs - any more than I exist to fulfil society's needs. Government does not control me, nor

should it be allowed to control what I do as an individual in association with other individuals in forming corporations.

The fact that corporations do fill society's needs is a result of the corporate structure, not its purpose. Indeed, the corporation has produced the great abundance of wealth and economic well being we now take for granted. And it will continue to if its not destroyed.

Now I want to say a few words about stakeholders and the stakeholder concept of the corporation.

What does it mean to be a stakeholder in a corporation? Absolutely nothing. Everything you do makes you a stakeholder. I took a taxi here, therefore I'm a stakeholder in Co-op Cab. I own a Nissan car, therefore I am a Nissan stakeholder. At this moment I am a stakeholder in the King Edward Hotel. I am a stakeholder in The Globe and Mail, the Ontario Newspaper Union, the Government of Ontario, insurance companies and mutual funds companies. I read the Toronto Star and the Financial Post, there I am a stakeholder. I shop at Loblaws, the Bay...it doesn't end because it doesn't mean anything.

If you look at stakeholders from the other end of the spectrum, from management's point of view, you can collect the stakeholders into familiar categories: customers, employees, etc. But managers already do that. They pay extremely close attention to all the elements of their business as they try to maximize profits. If they fail here, they will not generate profits.

But managers do not and cannot run their business as if all the people they employ or serve, or an army of outside special interest groups, are equal to the shareholder and owners.

A corporate manager who acts on the principle that managers are answerable to all stakeholders, rather than to shareholders, is no longer managing a corporation. If we ignore the distinctive property rights and individual rights of shareholders, and the crucial role that profit maximization plays in fulfilling those rights, then we are talking about some other kind of economic institution.

Call them non-profit enterprises, co-operatives, managed enterprises, crown corporations - but they are not private property corporations. Any institution that is a stakeholder-first institution should carry a warning label on its annual report: this is not a profit maximizing institution run for the benefit of shareholders. It is a social institution run for the benefit of all stakeholders in society. Shareholders are advised that their property is being used for non-profit making activities.

Propose a solution for those of you who believe that corporations should be managed on the basis of social performance rather than just profit performance. Maybe we could introduce a new law that would formally outline the legal basis of stakeholder corporations. Investors who wanted to invest in such corporations would know clearly what they are buying.

We could have the Royal Stakeholders Bank of Canada, or the Bre-X Gold Stakeholders Corporation - each operating under the stakeholder principles of aiming for average returns rather than maximum returns, favouring unionized employees and affirmative hiring policies, or whatever social objectives are deemed important.

If you can raise investor interest with that concept, then fine. But a stakeholder corporation is a different concept from the shareholder corporation. Leave the shareholder corporation alone.

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Carol Hansell, Partner, Davies, Ward & Beck

Let me first say that, in my remarks, I propose to steer off the customary argument that taking the interests of the corporation's stakeholders into account is in the best long term interests of the corporation and will ultimately maximize shareholder value. I recognize that this is the easiest path to compromise between those who believe that corporations should be accountable only to their shareholders and the people who Mr. Corcoran refers to as "stakeholder capitalists". However, the "easiest path to comprise" does not make for an interesting debate.

I will argue instead that corporations should take into account the interests of stakeholders other than shareholders whenever it believes that it is the right thing to do. My argument runs as follows:

1. Members of a society have responsibility to those who have a stake in their conduct.
2. A corporation, while an artificial construct, is a member of society. Inasmuch as it enjoys certain rights and privileges, it must also accept the responsibilities associated with being a member of society.
3. Taking the interests of other stakeholders into account is not inimical to setting as the purpose of the corporation the maximization of shareholder value or to pursuing that purpose.

Ethical Framework

Each of us here today conducts ourselves in accordance with some type of ethical framework - whether unconsciously or as a result of deep introspection. Let me just pause for a minute and explain what I mean by "ethical framework" and let me start by acknowledging that, although it may seem a bit odd for a director of the Centre for Ethics, I am always a bit uncomfortable with the word "ethics". For most of us, this is a value laden term often introduced into discussions by people speaking with an air of moral superiority. All I mean by "ethical framework" in this context is a person's code of conduct, established with reference to that person's touchstones of "right" and "wrong".

Some of our conduct is prescribed for us by law but, much as we tend to feel over regulated, the law governs our conduct only at the extremes. Clearly much of our behaviour is dictated by personal interest and by professional or other responsibilities. However, underlying much of the ethical framework within which each of us lives, is our

sense of responsibility as a member of society. We treat each other in a certain way because we understand implicitly that we must take the interests of others into account if we are to live together as members of the same society. Let me be very clear about this. My argument here today is based in large part on the premise that we have some obligation to one another. My argument must fail if the truth is that we have no responsibility to those who are affected by our actions and that we are free to pursue our own self interest, to the extent that it is not specifically prohibited by law.

I suspect that there are very few of us would admire a person if the most we could say about their conduct is that it is always "technically legal". However, we tend to be more concerned about the conduct of some members of society than about others. Power and influence bring with them higher expectations in terms of conduct. This is perhaps best illustrated by the expectations we have of our politicians. Conduct on the part of a private citizen that might pass unnoticed provokes a different reaction if the person involved holds high political office. I don't think this is necessarily because we impose different standards on different people - we simply believe that we are entitled to demand something different of politicians because we have a "stake" in their conduct.

Corporation as Person

Let us now move to the corporation. The corporation is a person for most purposes that I can think of. The corporate law in fact states:

A corporation has the capacity and, subject to this Act, the rights, powers and privileges of a natural person. A corporation, like individual members of society, operates within an ethical framework - whether that framework has simply evolved over time or whether it is the result of careful deliberation. If a corporation, had the same "rights, powers and privileges" that I have, it must surely also have the same responsibilities to society. A corporation cannot expect to reap the benefits of being a member of a society and then declare itself to be immune from the responsibilities associated with membership. If this is so, then the "ethical framework" of any corporation must require it to consider how its affecting others. Anyone who is affected by a corporation's actions has a stake in those actions and is therefore generally referred to as a "stakeholder".

Corporations that hold a great deal of power and influence will have a broader base of stakeholders - there will be considerably more pressure on that corporation to consider the interests of others. This is not inappropriate, in the same way that it is not inappropriate for us to be interested in what is motivating our politicians.

Let me make this point clear as well. I am not saying that the conduct of the corporation must be dictated by the interests of its stakeholders - any more than I think that my conduct must be dictated by the interests of those who have a stake in my actions. I am suggesting only that it is incumbent upon the corporation, as it is incumbent on me, to understand who its stakeholders are, what their interests are and to act responsibly towards those stakeholders.

What does "acting responsibly" mean? As with many other issues, the answer is only clear at the extremes. Most of us can imagine scenarios in which we would consider the actions of a corporation so offensive from society's perspective that there would be no corporate self interest that could justify the action in question. On the other hand, few of us would suggest that a corporation feel constrained by its "ethical framework" from closing a plant if the result of not doing so would be to drive the company into bankruptcy and all of its workers onto the unemployment lines.

While the appropriate response in some situations will be clear, it is when the clouds of gray descend upon a discussion that an ethical framework which is accepted by the decision makers in an organization is critical.

Maximizing Shareholder Value

There are very few boards (although I think that there are a few) that would say that the corporation's purpose is anything other than to maximize shareholder value. That is something of a motherhood statement - and raises a number of other questions. What does "shareholder value" mean? Does it mean return on equity in the short term? The way in which we tend to focus on quarterly results suggests that this might be the case - and it is clearly what some shareholders mean by "maximizing shareholder value". Other shareholders may be more concerned with long term results. As I noted at the outset, the argument is often made that the interests of other stakeholders are generally consistent with the corporation's long term results. Whether or not this is the case, the corporation must itself determine - through its board of directors and management - what its objectives are and how it will achieve them.

Since most of us accept the profit motivation as being an appropriate one for the corporation, the corporation's ethical framework becomes relevant in the context of the corporation trying to determine how it will achieve its objectives. I argue that the corporation must consider the interests of all of its stakeholders when it acts and cannot be focussed only on shareholder return. To return to the analogy to the individual, the fact that someone may retain me as a lawyer to achieve a particular result does not mean that I am bound to achieve that result for them at any cost to others who are affected by my actions. Both the Rules of Professional Conduct and my own ethical framework will guide my actions. Similarly, the fact of a person investing in the equity of a corporation does not mean that the corporation is bound to maximize the return on that equity at any cost to its other stakeholders.

Let's take downsizing as an example again. "Whether" downsizing is necessary may not always be a black and white issue - but where it is, the question will become "how" this course of action will be carried out - "how" the corporation will act towards its employees and the community while it is taking the action it believes is necessary.

I said at the outset that corporations should take into account the interests of stakeholders other than shareholders whenever it believes that to do so is just the right thing to do. The argument that corporations have no brain, no heart and no soul and so cannot be dealt

with as human members of society has been dismissed by the courts throughout this century. The corporation's board of director is accepted as being the "directing mind" of the corporation. I share the view of many that this mind must turn itself to the corporation's ethical framework and the conduct of the corporation within that framework.