

Shareholder Primacy, Corporate Social Responsibility, and the Role of Business Schools

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Abstract This paper examines the shareholder primacy norm (SPN) as a widely acknowledged impediment to corporate social responsibility and explores the role of business schools in promoting the SPN but also potentially as an avenue for change by addressing misconceptions about shareholder primacy and the purpose of business. We start by explaining the SPN and then review its status under US and UK laws and show that it is not a likely legal requirement, at least under the guise of shareholder value maximization. This is in contrast to the common assertion that managers are legally constrained from addressing CSR issues if doing so is inconsistent with the economic interests of shareholders. Nonetheless, while the SPN might be muted as a legal norm, we show that it is certainly evident as a *social norm* among managers and in business schools—reflective, in part, of the sole voting rights of shareholders on corporate boards and of the dominance of shareholder theory—and justifiably so in the view of many managers and business academics. We argue that this view is misguided, not least when associated with claims of a purported legally enforceable requirement to maximize shareholder value. We propose two ways by which the influence of the SPN among managers might be attenuated: extending fiduciary duties of executives to non-shareholder stakeholders and changes in business school teaching such that it covers a plurality of conceptions of the purpose of the corporation.

Keywords Corporate social responsibility · Shareholder primacy · Shareholder value maximization · Business schools · Corporate law · Fiduciary duties · Benefit corporations

The shareholder primacy norm (SPN) is the part of a manager's legal fiduciary duty that requires managers and company directors to make decisions on behalf of the corporation that further the interests of shareholders. It has been treated as a major obstacle to corporate social responsibility (CSR) because it is said to hinder managers from considering the interests of other corporate stakeholders besides shareholders (Boatright 1994; Campbell 2007; Dodd 1932, Evan and Freeman 2003; Hinkley 2002; Phillips et al. 2003; Stout 2012; Testy 2002). More recently, in light of the 2008 global financial crisis, the legitimacy of managerial focus on shareholder wealth maximization has also been questioned from quarters not usually associated with the advocacy of CSR (e.g., *Financial Times* 2009) as well as activists forming part of the Occupy Wall Street movement.¹

While there are many definitions of CSR, the EU has advanced a widely disseminated definition of CSR as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with stakeholders on a voluntary basis. It is about enterprises deciding to go beyond the minimum legal requirements and obligations stemming from collective agreements in order to address societal needs” (COM/

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¹ “Occupy Wall Street is a diffuse group of activists who say they stand against corporate greed, social inequality and the corrosive power of major banks and multinational corporations over the democratic process” (see *New York Times*: http://topics.nytimes.com/top/reference/timestopics/organizations/o/occupy_wall_street/index.html and <http://occupywallst.org/about/> (accessed 29 April 2013).

2006/0136/final). It is clear from this base definition that CSR can be at odds with the SPN, at least if managers act to meet obligations to non-shareholder stakeholders (beyond legal requirements and collective agreements) and in doing so are acting contrary to shareholders' interests. Accordingly, the legitimacy of the SPN is at the core of what has been called the "basic debate" in business ethics: whether corporations should be managed for the primary benefit of shareholders or for a wider constituency of stakeholders (Agle and Mitchell 2008; Smith 2003).

The SPN most typically finds expression in Shareholder Value Maximization (SVM). If one starts from the assumption that the interests of shareholders lie in maximizing their return on investment, then this results in a prescription to managers to maximize shareholder value. This does not necessarily preclude CSR, but it does make it conditional on SVM. Accordingly, van Marrewijk (2003, p. 102) offers five distinct and specific interpretations of CSR, of which his "profit driven" interpretation is clearly the most compatible with the SVM: "the integration of social, ethical and ecological aspects into business operations and decision-making provided it contributes to the financial bottom line." In contrast, his "caring" interpretation of CSR "consists of balancing economic, social, and ecological concerns, which are all three important in themselves." Similarly, Garriga and Mele (2004, p. 53) identify four categories of CSR theories (instrumental, political, integrative, and ethical), of which instrumental includes those theories under which SVM "is the supreme criterion to evaluate specific corporate social activity."

The SPN does not necessarily preclude attention to CSR that would not be maximizing shareholder value. If the interests of shareholders are primary, then their interests will decide what goal the corporation should pursue, whether it is SVM or something else. In this vein, Vermaelen (2011) has observed that absent a "business case" for CSR, a company should make it clear in advance to investors that its objective is not simply to make money but also to do good and thereby attract the right investor clientele. He has proposed "CSR equity carve-outs" (e.g., Exxon forming an alternative energy subsidiary that can attract investors interested in alternative energy for non-economic as well as economic reasons). Unilever, under CEO Paul Polman, has taken a different approach in adopting its Sustainable Living Plan, by doing away with earnings guidance and quarterly reporting and telling hedge funds they are not welcome as investors (Ignatius 2012). However, the idea is similar insofar as it suggests that investors be put on notice that the firm is taking a long-term view on value creation.

Clearly, the legitimacy of the SPN has an important bearing on the goal of the corporation and whether it

should be a vehicle for the pursuit of shareholder interests (Friedman 2001; Jensen 2002) or for managing stakeholder interests (Freeman et al. 2007; Freeman et al. 2010). Walsh (2004, p. 349) has highlighted the critical importance of this question: "Since the rise of the first corporations 2,000 years ago, we have been trying to develop a theory of the firm that explains and guides firm behavior... This is arguably the most important theoretical and practical issue confronting us today." Events leading up to the 2008 financial crisis lend yet more weight to this claim.

The large-scale destruction of shareholder value accompanying the financial crisis casts doubt on the extent to which managers in practice give shareholders primary consideration, at least in financial institutions. Former US Federal Reserve Chairman Alan Greenspan (2009) has recognized that the risk management of these institutions rested on the premise that the enlightened self-interest of their managers and owners would ensure their long-run health and this premise clearly proved false. Some commentators blamed the crisis on SVM specifically, with Jack Welch, the former General Electric's CEO, calling it the "dumbest idea in the world" (*Financial Times* 2009). Skapinker (2009), noting that people like simple stories, observed: "A common justification for the shareholder value movement was that it provided managers with a clear view of what their purpose was. Suggesting that they serve other stakeholders too... was held to be too vague and confusing." While multiple explanations have been offered for the crisis, the legitimacy of shareholder primacy certainly has come into question, as has the teaching of business schools (e.g., Floyd et al. 2013; Holland 2009; *Economist* 2012; Podolny 2009; Smith and Van Wassenhove 2010), as well as the system of regulation and the incentives and constraints governing the pursuit of shareholder interests.

Long before the crisis, business ethics as an academic field was disapproving of the shareholder primacy of the so-called Shareholder Theory of Milton Friedman, who asserted that the social responsibility of business is "to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game" (2001, p. 55). Instead, Stakeholder Theory (Freeman 1984; Freeman et al. 2010; Phillips 2003), the dominant theory in business ethics, if not a paradigm for CSR (McWilliams and Siegel 2001), views the primary purpose of the corporation as being a vehicle to manage stakeholder interests, with profit as one consideration among others. Shareholder theory and stakeholder theory are not necessarily incompatible (Freeman et al. 2010). However, if SPN is a dominant norm among managers, this has implications for the shape that stakeholder theory can take, as well as for CSR.

Descriptively, if shareholder primacy expressed as SVM (i.e., consistent with Friedman's shareholder theory) is the dominant model of practice, then it is little surprise that

CSR advocates are disappointed with corporate social performance and charge companies with “greenwashing” (e.g., *New Scientist* 2010; Polaris Institute 2007). To a large extent, we know already that this model of shareholder primacy as SVM often predominates. Indeed, it seems that the view that the purpose of the firm is something other than maximizing shareholder value has yet to gain widespread acceptance within the academy, let alone within business (Jones 2010; Stout 2012).

In answer to the normative question, if the SPN expressed as SVM is the better, more legitimate model, this has profound implications for CSR. This need not be understood as a death blow to CSR, but it does mean that CSR should be seen primarily from a strategic perspective rather than a moral perspective, and that CSR activities should be justified through “business case” reasoning (e.g., Porter and Kramer 2006, 2011). Caring, synergistic and holistic interpretations of CSR (van Marrewijk 2003) would have little practical import in most business contexts. Nevertheless, it is not the aim of this paper to answer whether SVM or its proposed alternatives are *normatively* preferable.

The aim of this paper is to examine the *descriptive* grounds for adherence to the SPN, with specific attention to its efficacy as a legal and social norm for management and the basis by which it can serve as an impediment to CSR. Thus, we start by exploring the descriptive grounds for the SPN, and based on this descriptive understanding—and given the extensive criticism of the SPN—we move on to explore potential avenues for attenuating the SPN.

We maintain that the SPN is mute as a legal norm while operative as a social norm, in part because shareholders are afforded sole voting rights for the board of directors. A number of corporate governance suggestions are considered for addressing the primacy of shareholders and we suggest that extending managerial fiduciary duties beyond shareholders is the most promising of these avenues. We also investigate the role of business schools not only in promoting the SPN but also potentially as an avenue for change by addressing misconceptions about shareholder primacy and the purpose of business. We argue that business school advocacy of the SPN is misguided, at least where it relies on claims of a purported legally enforceable requirement to maximize shareholder value. We propose instead that business schools teach a plurality of theories regarding the purpose of corporations, portraying the spectrum of theories available, including Shareholder Theory, Stakeholder Theory, and social contract theory.

Explication of the SPN

We first consider the SPN as a legal norm in the common law systems of the United States and the United Kingdom.

We maintain that the SPN is not legally enforceable due to the business judgment rule as well as legal enactments that specifically allow managers to consider the interests of a wider group of stakeholders. Second, we consider whether the SPN is effective as a social norm among managers. We maintain that even though normative pressures are mounting on managers from non-shareholder constituencies, the SPN is still relied upon by managers because it is reinforced by the *structure* of corporate law (i.e., the sole voting rights of shareholders) as well as systems of remuneration that tie managerial incentives to shareholder interests. We conclude that although the SPN has its origins in corporate law, the SPN today is not a legally enforceable norm, but it is still very much alive as a social norm among managers. Moreover, while managers are no longer likely to be legally prevented from engaging in CSR that might be inconsistent with shareholder interests, the incentive structures that guide corporate behavior are still geared toward shareholder primacy.

The SPN as a Legal Norm

Corporate laws in the U.S. and the U.K., comprising both common law and statutory law, is structured to ensure that corporations work in the interests of shareholders. However, this primacy of shareholders has not been formally identified in statutory law (Fisch 2006). Thus, the SPN is a development of common law, and debate about its efficacy is as a norm stemming from judicial decisions. Common law provides the clearest articulation of shareholder primacy in the court cases specifying that managers and directors owe fiduciary duties to shareholders and must make decisions that are in their best interests (Smith 1998). The most famous articulation of the norm comes from the 1919 case of *Dodge v. Ford Motor Co.*, wherein Chief Justice Ostrander said:

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among shareholders in order to devote them to other purposes.

This fiduciary duty in part consists of a duty of loyalty and a duty of care to shareholders (Clark 1985). “Loyalty” implies not only that managers should promote the interest of shareholders but also that they should not put themselves in a position where their interests might conflict with those of the shareholders. An example would be if a director

stood to benefit directly from a corporate contract. “Care” implies that managers are expected to make decisions that ordinary, prudent individuals in a similar position would make under similar circumstances for the benefit of shareholders (Clark 1985; Paine 2006). The primacy of shareholders is manifest in that they are, in the normal course of business, the sole corporate constituency to be granted fiduciary protection by the courts (Fisch 2006).

Dodge v. Ford is often cited by advocates of shareholder primacy. However, Cornell law professor Lynn Stout (2012) suggests that it is widely misunderstood. First, it is not a case about a public corporation: “It was a case about the duty a controlling majority shareholder (Henry Ford) owed to the minority shareholders (Horace and John Dodge) in what was functionally a closely held company—a different legal animal altogether” (Stout 2012, p. 26). Second, Justice Ostrander’s remark was just that; as Stout (2012, p. 26) observes: “This remark... was what lawyers call “mere dicta”—a tangential observation that the Michigan Supreme Court made in passing, that was unnecessary to reach the court’s chosen outcome or “holding.” It is holdings that matter in law and create binding precedent for future cases.”

The judicial development of the SPN has a long history, dating back well before it became operative in the courts in the 1830s (Smith 1998). Much current interest in the SPN stems from the flourishing advocacy of CSR, with progressive legal scholars, as well as business ethicists and corporate directors, viewing the SPN as a major impediment to managers including the interests of stakeholders other than shareholders in their decision making (Testy 2002). For much of the nineteenth century, this analysis was probably correct. However, with the subsequent development of the business judgment rule in common law and more recent statutory developments, managers today have significant discretion in addressing non-shareholder interests (Marens and Wicks 1999; Stout 2012). Thus, Smith (1998, p. 280) concludes that “application of the shareholder primacy norm to publicly traded corporations is muted by the business judgment rule.”

Stout (2012, p. 30) suggests that the 1986 case, *Revlon, Inc. v. MacAndrews & Forbes Holdings*, is the only significant modern case “where a Delaware court has held an unconflicted Board of Directors liable for failing to maximize shareholder value.” But she adds that this case ruling, while often cited by advocates of shareholder wealth maximization along with *Dodge v. Ford*, is also misunderstood, and is the exception that proves the rule. Revlon’s Board planned to take Revlon private; thus “it is only when a public corporation is about to stop being a public corporation that directors lose the protection of the business judgment rule and must embrace shareholder wealth as their only goal” (Stout 2012, p. 31). In contrast, Stout

cites the 2011 case of *Air Products, Inc. v. Airgas, Inc.*, wherein the Delaware court ruled in favor of the Airgas board of directors, which had refused a takeover offer from Air Products at \$70 a share when Airgas was trading at \$40–50 a share. As a memorandum from law firm Skadden (2011, p. 3) explains, the judge “was “constrained” to follow Delaware Supreme Court precedent, holding clearly that a law-trained Court must not substitute its business judgment for that of the board.”

The business judgment rule is the presumption that directors have not breached their fiduciary duty of care—so called because it relieves the court of any duty to make evaluations of the business judgment of a director. For example, if a board of directors decides to donate a million dollars of corporate resources to the Japanese Earthquake Relief Fund of the Red Cross, shareholders might try to sue the directors personally for using corporate funds in a manner that does not further shareholder interests. But the business judgment rule relieves the court from considering whether or not the donation is a good business decision (and it might be, if favorable publicity were to result): evaluating the quality of business decisions is difficult and this is not the primary competence of the courts. In effect, the rule makes the fiduciary duty of care unenforceable because courts will not consider the quality of business decisions which would otherwise be the primary evidence for lack of care (Cohn 1983).

Shareholders rarely succeed in derivative suits against directors on claims of a breach of care. It is generally only the duty of loyalty that courts will consider, when derivative suits are brought against directors. However, evaluating whether directors acted in bad faith is also difficult to determine because most business decisions seen as unfavorable to shareholders can be rationalized to seem reasonable at the time they were made. Thus, courts primarily consider whether any self-dealing has occurred when evaluating breaches of loyalty. Heracleous and Lan (2010, p. 24) comment:

... when directors go against shareholder wishes—even when a loss in value is documented—courts side with directors the vast majority of the time. Shareholders seem to get this. They’ve tried to unseat directors through lawsuits just 24 times in large corporations over the past 20 years; they’ve succeeded only eight times. In short, directors are to a great extent autonomous.

Fiduciary duties developed in common law have been explicitly defined by the incorporation statutes of most states in the U.S. For example, the Model Business Corporation Act (2002) prepared by the American Bar Association and adopted by 24 states (but not Delaware) says (section 8.42 Standards of Conduct for Officers): “An

officer, when performing in such capacity, shall act: (1) in good faith; (2) with the care that a person in a like position would reasonably exercise under similar circumstances; and (3) in a manner the officer reasonably believes to be in the best interests of the corporation.”

Thus, item 1 states the duty of loyalty, item 2 states the duty of care, and item 3 can be interpreted as referring to something akin to the SPN. Whether or not “the best interests of the corporation” includes non-shareholder interests is not entirely clear. Millon (1991, p. 228) writes that “corporate law has avoided such puzzles by, for the most part, equating the duty to the corporation with a duty to act in the best interest of its shareholders.” But this does not per se exclude directors from considering the interests of non-shareholders. In Delaware, where 56 % of US corporations are registered (Eisenberg 2000) and which is generally considered to have the most shareholder friendly statutes, there is no explicit statutory requirement that managers should only consider the interests of shareholders in their decision making.

Moreover, most states have adopted “non-shareholder constituency statutes” that explicitly allow managers to consider the interests of non-shareholder constituencies when making decisions (McDonnell 2004; Orts 1992). Pennsylvania was the first to adopt such a statute in 1983, with states such as New York and Nevada having followed suit (Delaware, however, has not). These statutes do not *require* managers to consider the interests of non-shareholders, but they make explicit that managers are not prohibited from doing so. As Orts (1992, p. 133) concludes: “Some argue that the statutes do not go far enough—employees and other interests should be granted “codetermination” status with their own representatives on the board or standing to enforce independent claims against the corporation. Others respond that the statutes go too far, conferring to corporate management unaccountable power, removed from such necessary constraints as hostile takeovers. In any event, constituency statutes once again move the debate surrounding corporate governance beyond the interests of shareholders alone.”

The American Law Institute’s (1994, p. 55) *Principles of Corporate Governance* also provides considerable latitude for managers to act beyond the apparent dictates of the SPN. Section 2.01 states: “Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business: (1) Is obliged, to the same extent as a natural person, to act within the boundaries set by law; (2) May take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and, (3) May devote a reasonable amount of resources to public welfare, humanitarian, educational and philanthropic purposes.” This consensus document has been regularly cited and relied upon by US courts.

The U.K. has also seen the introduction of statutes that explicitly allow managers to consider the interests of multiple stakeholders. The 1985 Companies Act stated that directors must take into account the interests of employees when performing their functions for the company and that this is to be regarded as a fiduciary duty owed to the company. Under the 2006 Companies Act, directors are further required to take into account the interests of other stakeholders such as suppliers, customers, the community, and the environment. However, as in the U.S., the act does not give non-shareholder stakeholders the right to challenge decisions of directors in court if they feel their interests have not been taken into account. While this suggests directors still only have fiduciary duties to shareholders, they are now also at liberty to take into consideration the interests of a wider constituency of stakeholders.

Thus, potential common law restrictions on managerial discretion for considering non-shareholder interests have largely disappeared; the SPN is muted by the business judgment rule and recent statutory provisions in most US states and the U.K. explicitly allow managers to consider non-shareholder constituencies in their decision making. Stout (2012, p. 31) observes as follows:

The business judgment rule thus allows directors in public corporations that plan to stay public to enjoy a remarkably wide range of autonomy in deciding what to do with the corporation’s earnings and assets. As long as they do not take those assets for themselves, they can give them to charity; spend them on raises and health care for employees; refuse to pay dividends so as to build up a cash cushion that benefits creditors; and pursue low-profit projects that benefit the community, society, or the environment. They can do all these things even if the result is to decrease—not increase—shareholder value.

We may then justifiably question the claim that managers are legally bound to disregard non-shareholder interests that conflict with those of shareholders. As Stout concludes: “SVM is a managerial choice, not a managerial obligation.” Progressive legal scholars and others are correct in pointing out the importance of the SPN, but not as a *legal* norm. There are good reasons to think that managers follow the SPN, not because they are legally bound to do so, but because the SPN is a *social* norm in the business community.

The SPN as a Social Norm

Anderson (2000, p. 170) defines a social norm as “a standard of behavior shared by a social group, commonly

understood by its members as authoritative or obligatory for them.” Cialdini and Trost (1998, p. 152) specify that social norms “guide and/or constrain social behavior without the force of laws.” We maintain that managers as a social group, both within and between corporations, are generally guided by a social norm of shareholder primacy.

Business schools teach as part of the “Theory of the Firm” that profit maximization is the purpose of the corporation in society and that it is the duty of managers to pursue this end on behalf of shareholders as their agents (Gentile 2004; Ghoshal 2005). West (2011) affirms that this is not only true of business schools but also law schools, and that many of these institutions have no required courses that explore alternative purposes of business. West (2011, p. 18) observes that “some law and business professors mistakenly are training future lawyers and corporate leaders that corporations have no authority to do good or benefit society other than its shareholders.” Of course, these social norms can have profound effects: “what is taught in classes and how students internalize information have consequences for society, government, and business” (West 2011, p. 18).

Smith and Van Wassenhove (2010) write as follows: “In most business schools, SVM is the leitmotif of finance teaching and implicit throughout the rest of the curriculum.” Consequently, when their students get jobs in the corporate world they are working to an implicit assumption of shareholder primacy—an assumption often reinforced, at least for more senior executives, by compensation packages tied to the share price.² Dobson (1999, p. 69) suggests they “will have had drummed into them that the ultimate objective of all activity within the firm is the maximization of shareholder wealth.” Diminished moral responsibility accompanies this, according to Ghoshal (2005). Various commentators (e.g., Gardiner 2009; Holland 2009) have suggested that a disproportionate focus on SVM by business schools was a contributory factor in the 2008 financial crisis.

There are signs of change. Four out of five executives surveyed by the consulting firm McKinsey (2006, p. 1) thought that “generating high returns for investors should be accompanied by broader contributions to the public good.” However, almost 90 % of respondents said they were motivated to champion social or environmental causes by profitability or improving public relations. Although many executives think that they should consider the

interests of non-shareholder stakeholders, this appears to mostly hold true when they do not conflict with shareholder interests and in particular when both go hand in hand.

While the SPN is prevalent among managers, there may be other, potentially countervailing norms. For example, championing CSR and environmental friendliness may be emerging as a social norm among managers in many corporations. Nonetheless, some surveys suggest that the US managers believe the law requires them to maximize shareholder wealth and hinders them from pursuing interests that conflict with shareholder interests (Gentile 2004; Rose 2007). Managers may believe they are following a legal norm, but it would seem that they are following a social norm which they believe is legal because of its pervasiveness in business.³ Nevertheless, we maintain that the social norm of shareholder primacy is reinforced by the *structure* of corporate law which is geared toward shareholder primacy: shareholders exert control over the corporation primarily through their legal right to elect and dismiss directors.

The fiduciary duties imposed on managers in common law are due to early judicial depictions of their relationship with shareholders as one of trust (e.g., Berle 1931, 1932). Managers were considered *trustees* for the shareholders who were the *owners* of the corporation. However, the corporation was legally separated from its shareholders in the mid-nineteenth century and considered to own itself, whereas shareholders were considered to own shares as a separate form of property (Pickering 1968). Despite the legal separation of the corporation from its shareholders in terms of ownership, important features of the structure of corporate law that came with the earlier depiction remained, both in terms of fiduciary duties and more importantly in terms of voting rights of shareholders.

Because shares generally confer voting rights to shareholders, which gives them the power to elect and dismiss the board of directors, there is a real sense in which the directors of the corporation act as agents representing the interests of the shareholders; quite simply, if they do not they may be dismissed (Kraakman et al. 2004). Shareholders may not have the type of direct control necessary for a legal characterization of a principal–agent relationship, but they do have sufficient indirect control for that

² This was further reinforced in 1993 by a congressional change to the US tax code that capped the tax deductibility of top management compensation not qualified as “performance based” (primarily interpreted as profitability). The purpose was to limit executive compensation perceived as being “excessive,” although research suggests that the law has had little effect on executive compensation in practice (Rose and Wolfram 2002).

³ That managers *believe* that the SPN is legally enforceable might be interpreted as something more than a social norm. Although legal action against corporate management for breaching the SPN is unlikely to be successful, the threat of such action might act as a reinforcement of the SPN. This does not make the SPN a legal norm as such a managerial belief is based on a misinterpretation of the law. However, this misinterpretation reinforces the SPN as a *social norm* because managers *believe* that they are legally required to follow the SPN.

characterization to be made more generally.⁴ For example, the academic literature on agency costs typically describes managers as agents of the shareholders (Clark 1985). Although the threat of dismissal/non-reelection to the board is real, it should be acknowledged that it rarely happens in practice in large public corporations (Benz and Frey 2007). However, there are usually other incentive structures in place that aim to align shareholder interests with those of top management; for example, the issuing of shares or stock options and payment of bonuses tied to corporate financial performance. Voting rights matter even in this context because it is common practice for shareholders to approve top management's remuneration by voting. The legal power of shareholders to vote for the board of directors and their remuneration helps in perpetuating the SPN as a social norm, not as a principle of law likely to be upheld in court.

The preceding analysis of the SPN as a social norm suggests that, in practice, managers work in the primary pursuit of shareholder interests because: (a) they believe it is their legal duty, if not a moral duty (Vermaelen 2009); (b) they fear being dismissed by the board if they do not; and, (c) they are often incentivized by remuneration that is tied to shareholder interests. With this norm and the associated set of beliefs and incentives in place, it is not surprising that managers also believe that they should not engage in CSR that might be inconsistent with shareholder interests. Having established this, we turn to exploring several measures that might change the dominance of the SPN as a social norm. First, there is the possibility for change in the sole voting rights of shareholders, a substantive change in corporate governance that would also influence beliefs about shareholder primacy. Second, by tackling belief systems more directly, we explore further the role of business schools in promoting SVM and how changes in business school teaching could portray several

alternative views of the purpose of the corporation. Finally, we explore the likely effectiveness of these suggestions.

Extending Voting Rights to Non-shareholder Stakeholders

Given our argument about the structure of corporate law underpinning managerial beliefs about shareholder primacy as a legal norm and reinforcing its status as a social norm, it is appropriate to consider first whether there might be changes in corporate governance such that non-shareholder stakeholders have a greater say if not voting rights at board level. In fact, numerous authors over the years have suggested consideration be given to non-shareholder stakeholders in corporate governance, particularly by the board of directors. However, the problem proves to be somewhat intractable.

The suggestions come in a variety of forms and with various justifications. Galai and Wiener (2008) suggest that management "allocation" of board seats to a broader group of stakeholders, primarily employees, can reduce agency costs for corporations. Chilosi and Damiani (2007) suggest that stakeholder representatives on the board may be chosen by employees or appointed by trade unions or government authorities. Bonnafous-Boucher (2005) presents a "proprietaryist" view where stakeholders are encouraged to buy shares and obtain voting rights as shareholders.⁵ And Evan and Freeman (2003) suggest on normative grounds that stakeholders be given voting membership on the board, and furthermore, that stakeholders should demand voting membership on pragmatic grounds in order to have their interests properly represented (Freeman and Evan 1990). Common to all these conceptions of stakeholder consideration is that none of them articulates how non-shareholder stakeholders (beyond employees) are to be identified, or how such stakeholders are to vote for their board representatives when such a view is advocated.⁶

The reason why no one has suggested how to appropriately operationalize stakeholder voting rights for board representation is that there are significant practical difficulties to be overcome. These difficulties come primarily in

⁴ Long ago, Berle and Means (1932) argued that shareholders of public corporations with dispersed shareholdings had lost their de facto control to corporate managers because of diluted voting power. More recent times have seen a return of more concentrated voting power of shareholders based primarily on three developments: (1) Since the days of Berle and Means, the composition of ownership on the stock market has shifted from a majority ownership by individual shareholders to a majority ownership of institutional shareholders (Davis 2008; Blume and Keim 2012), which has led to more effective voting power when a greater concentration of a corporation's shares are held by an institution. (2) The rise of Institutional Shareholder Services (ISS), which is a proxy advisory firm for institutional investors advising how they should vote with their shares as well as often voting on their behalf. ISS dominates the market for such services, and its rise has led to a greater concentration of shareholder voting power. (3) In 2010, the Securities and Exchange Commission (SEC) introduced a "proxy access" rule designed to make it easier for shareholders to get their own nominees onto corporate boards (although a Federal Appeals Court has since blocked the rule, the SEC has yet to revive it).

⁵ This suggestion does not so much solve the problem as avoid it. For example, it implies that employees, who have a stake in the corporation qua employees, should become shareholders so that they can have their interests as employees considered qua shareholders. Also, there is no reason why employees' ability to obtain stock stands in any proportion to their stake qua employees.

⁶ German corporate law provides employees with board representation for corporations above a certain size (number of employees). This is made possible because employees are easily identifiable individuals, while other stakeholder groups with more transactional relationships with the corporations do not lend themselves to such easy and relevant identification.

two forms. First, how do we identify who the relevant stakeholders are? Are we concerned with relevant stakeholder organizations, groups, or individuals? Are suppliers and customers relevant stakeholders if they make a single transaction or should they have a working relationship over time in order to have a relevant stake? Also, who is meant to represent “society” as a stakeholder? Second, how do stakeholders vote for their representatives on the board? Does each member of a stakeholder organization get to vote on board decisions or does only the organization as a whole get a vote? Is the size of the stakeholder organization important? Should all stakeholders’ votes receive equal weight or do some groups have priority interests? Thus, in abstract, the idea of stakeholder representation on corporate boards is appealing; in practice, it is difficult to realize. Beyond the representation of employees (as we see in German corporate governance), it may be that stakeholder consideration at board level must rely on a broader conception of the role of the board.

Extending voting rights for the board beyond shareholders (and employees) is mired with so many difficulties as to seem unfeasible in practice. Several authors (e.g., Schrenk 2006) have suggested that the legal fiduciary duty of board members should be extended beyond shareholders to encompass a wider constituency of stakeholders (recognizing that boards already have obligations to employees). This seems like the most feasible augmentation to corporate governance for weakening the SPN (as a social norm) as it does not extend voting rights but only fiduciary duties to non-shareholder stakeholders. However, extending board fiduciary duties beyond shareholders only makes sense if non-shareholder stakeholders also obtain a legal right to challenge board decisions in court, like shareholders can. For example, the UK Companies Act 2006, requires directors to consider the interests of a wider group of stakeholders but does not provide stakeholders with a legal remedy by which to challenge board decisions.

Another avenue has been pursued by B Lab, an American non-profit organization that has created a certification standard for the so-called B-Corporations. As we discuss further below, a business that wishes to be a B-Corporation is required to include stakeholder considerations in its incorporation statutes. By augmenting the incorporation statutes in this way it provides shareholders with the ability to seek legal redress if executives have not properly taken stakeholder interests into account. This allows shareholders to seek legal redress for the interests of stakeholders, but does not enable such rights for stakeholders themselves.

Charging directors with a duty without corresponding legal stakeholder rights calls into question whether stakeholders would have their interests represented in practice. Extending stakeholders’ rights to legal remedy suffers from

the same problem of identifying relevant stakeholder groups beyond shareholders. There is, however, an important difference. Decisions about how and to whom board voting rights should be extended needs to be done prior to such a scheme being implemented, while decisions regarding relevant beneficiaries of fiduciary duties can be delegated to the courts to decide on a case by case basis. Courts in the common law system need not tackle the insurmountable problem of deciding who all stakeholders are with relevant stakes for all corporations, but can instead address each specific concern for each stakeholder, for each company, as they arise in court cases. In this manner, who are the relevant stakeholders and what their relevant concerns are will be settled as substantial case law is built up over time.

Thus, some expansions in stakeholder influence on boards and in courts are certainly conceivable, but it is far from a ready or easy solution to the problem of shareholder primacy. That said, this is a direction for further research.

Benefit Corporations

Clark and Babson (2012, p. 838) observe: “It is against the paradigm of shareholder primacy that benefit corporation statutes have been drafted.”⁷ Their article elaborates on this rationale and provides an account of the distinctive features of benefit corporations and how they are intended to operate in practice. There are three major provisions in benefit corporation legislation that are consistent from state to state and represent distinctive features of benefit corporations (Clark and Babson 2012, pp. 838–839):

A benefit corporation: (1) has the corporate purpose to create a material, positive impact on society and the environment; (2) expands fiduciary duty to require consideration of nonfinancial interests; and (3) reports on its overall social and environmental performance as assessed against a comprehensive, credible, independent, and transparent third-party standard.

They stress that benefit corporations are intended to make profits for shareholders, “but the way in which that profit is to be made is through the conduct of business in a socially and environmentally responsible way” (Clark and Babson 2012, p. 819). There are several benefits to being a benefit corporation beyond this explicit and validated commitment to a social and environmental purpose, including making the business more attractive to various

⁷ Clark has drafted all of the benefit corporation legislations enacted or introduced, at least till the publication of this article.

stakeholders, especially customers and potential investors, by distinguishing the business as truly committed to social responsibility when many other companies might be suspected of greenwashing.

Benefit corporation legislation does not extend voting rights to non-shareholder stakeholders. It does, however, *require* that these stakeholders are considered by the corporation and this is a designated fiduciary duty of its directors.⁸ This is distinct from constituency statutes. As Clark and Babson (2012) observe, with constituency statutes, consideration of stakeholders is permissive, while with benefit corporation legislation, it is mandatory. They claim that this is an important difference because even if directors wish to give attention to non-shareholder stakeholders, there is uncertainty with constituency statutes as to the extent to which they might do this in many contexts, as well as a potential risk of litigation.

Moreover, this attention to the concerns of non-shareholder stakeholders must also be reported on and relative to an independent, third-party standard.⁹ Clark and Babson (2012, p. 843) write that “in many ways the third party standard is the heart of benefit corporation legislation.” This is because it is the basis for the benefit corporation’s accountability relative to the social and environmental objectives it has established for itself. Non-shareholder stakeholders may not have voting rights and they may not even have had much influence over these objectives, but their interests are at least partially addressed through this provision.

Thus, benefit corporations might be seen as a direct response to many of the challenges for CSR posed by SPN and, in this way, as a promising development. The first benefit corporation statute was introduced in 2010. As of 2014, benefit corporation legislation had been enacted in 21 states (including Delaware) and the District of Columbia, and there were 1140 registered benefit corporations.¹⁰ However, most of them are relatively small and privately

held; Patagonia is perhaps the best-known example.¹¹ It remains to be seen whether many more firms will adopt benefit corporation status, particularly larger publicly traded corporations (Google would be an interesting potential example)—and how this will be treated in the courts.

We turn now to how business schools promote shareholder primacy and SVM more specifically, and consider their potential to influence understanding in ways that might diminish the power of the SPN as an obstacle to corporate attention to CSR and sustainability.

Shareholder Primacy and Business Schools

Ghoshal’s posthumously published landmark article, “Bad Management Theories Are Destroying Good Management Practices” (2005), is a stinging critique of business school education. Reflecting on recent business scandals, Ghoshal (2005, p. 75), who was on the faculty of London Business School and INSEAD, observed: “Business schools do not need to do a great deal more to help prevent future Enrons; they need only to stop doing a lot they currently do... Our theories and ideas have done much to strengthen the management practices that we are all now so loudly condemning.” Central to his critique is the overarching role of agency theory and SVM in business school teaching. His view of the predominance of agency theory and SVM—and the harm caused—was endorsed by other prominent figures in the academy.

In an accompanying essay, Hambrick (2005, p. 106) commented that Ghoshal takes on his fellow scholars and asks if they are aware of how much harm they are causing through their research and teaching of agency theory, which has led, in Hambrick’s view, to executives being “exceedingly obsessed with shareholder value, in ways that their predecessors were not.” Similarly, Pfeffer (2005) commented that Ghoshal is right in asking what role business school academics have played in the rise of a particular form of theory that is bad for practice—and that it is even worse than Ghoshal maintains. Influential *Financial Times* columnist, John Gapper (2005) observed that Ghoshal’s ambition with this paper was no less than to change the way in which business schools do business.

⁸ Clark and Babson (2012, pp. 839–840) provide the California legislation by way of illustration, observing thus: “The directors of benefit corporations, in considering the best interests of the corporation, [S]hall consider the effects of any action or decision not to act on: (1) The stockholders of the benefit corporation; (2) The employees and workforce of the benefit corporation and the subsidiaries and suppliers of the benefit corporation; (3) The interests of customers as beneficiaries of the general or specific public benefit purposes of the benefit corporation; (4) Community and societal considerations, including those of any community in which offices or facilities of the benefit corporation or the subsidiaries or suppliers of the benefit corporation are located; and (5) The local and global environment....”

⁹ However, under current legislation, benefit corporations are not required to have their benefit report certified or audited by a third party (Clark and Babson 2012).

¹⁰ Source is the B-Lab website: <http://www.benefitcorp.net/find-a-benefit-corp> (accessed 6 October 2014).

¹¹ Patagonia is privately held. Its founders chose B-corp status to protect its commitment to a social mission, recognizing that this could not be assured as the business passed to future generations even with constituency statutes. Alterrus Systems Inc., an urban farming company, claimed in March 2013 to be the first publicly listed company to earn B-corp certification; see: http://www.csrwire.com/press_releases/35379-Alterrus-Becomes-First-Publicly-Listed-Company-To-Earn-B-Corp-Certification-Indicating-Its-Commitment-To-A-Better-Way-Of-Growing (accessed 6 October 2014).

There were some commentators on Ghoshal's essay who disagreed at the edges with his critique. Mintzberg (2005a, p. 108), for example, observed that while he agreed with everything Ghoshal wrote, he had left out the role of "sheer human greed and the need for power in driving these [bad management] behaviors." While Kanter (2005) highlighted the role of the demand side—the willingness with which knowledge consumers adopted the theories of business school knowledge producers. Walter Nord (2005, p. 92), while summarizing the commentaries, observed that he "found it a truly remarkable treat that such esteemed leaders agreed so strongly with the basic claims of a work that challenged so deeply the major tenets of the status quo in our field."

According to Jones (2010, p. 246), little has changed since: "... although I frequently hear from some colleagues at other schools that the shareholder wealth maximization (SWM) objective function for publicly held corporations is passé... I do not believe it. At many schools, my own included, SWM remains the predominant thrust of both teaching and research efforts." These remarks are echoed more recently by various business school academics interviewed in the *Financial Times* (Murray 2013). This is further confirmed by surveys of MBA students. As West (2011, p. 18) concludes: "Examination of MBA student survey data over the past decade demonstrates that students believe the primary purpose of a corporation is to maximize shareholder value and they believe this is how current corporate leaders behave when they are making decisions."

Ghoshal (2005, p. 75) writes: "Many of the worst excesses of recent management practices have their roots in a set of ideas that have emerged from business school academics over the last 30 years." In his view, as he continues, this teaching reaches well beyond MBA students and executive education participants to those who have never attended a business school "because theories have been in the air... shaping the intellectual and normative order within which all day-to-day decisions were made." He targets Jensen and Meckling's (1976) "Theory of the Firm" specifically.

Fundamental to the teaching of SVM in business schools is the principal-agent model of the corporation, where managers are viewed as agents of shareholders who are considered principals and entitled as residual claimants to financial returns from the firm. This view has its origins in Jensen and Meckling (1976), a highly influential paper that brought together theories of agency, of property rights, and of finance to develop a theory of the ownership structure of the firm, identifying the problem of agency costs in light of the separation of ownership and control. Thus, Jensen and Meckling (1976, p. 306) suggest that their theory helps explain "why an entrepreneur or manager in a firm which has a mixed financial structure (containing both debt and

outside equity claims) will choose a set of activities for the firm such that the total value of the firm is less than it would be if he were the sole owner."

Characterizing the firm as a nexus of contracts, Jensen and Meckling (1976, p. 311, emphasis in original) explicitly reject the notion of social responsibility: "the personalization of the firm implied by asking questions such as... "does the firm have a social responsibility" is seriously misleading. *The firm is not an individual*. It is a legal fiction which serves as a focus for a complex process in which the conflicting objectives of individuals (some of whom may "represent" other organizations) are brought into equilibrium within a framework of contractual relations." Seen from this perspective, CSR makes little sense because only people, not legal fictions, can have moral responsibilities (Rönnegard 2013; Vermaelen 2009).

It is a short step from this argument to the view that CSR can be an agency cost and inconsistent with an ethical obligation to maximize shareholder value, at least where an economic business case for CSR is absent (Vermaelen 2009). Accordingly, *The Economist* (2005) was critical of the "borrowed virtue" variety of CSR that raises social welfare while reducing profits, observing: "When a company gives some of its profits away in a good cause, its managers are indulging their charitable instincts not at their own expense but at the expense of the firm's owners."

However, the nexus of contracts conception of the firm and the associated agency costs perspective have been questioned as at best incomplete, if not wrong. Ghoshal (2005, p. 79) damns it as the "pretense of science." While Orts (2013, p. 86), in offering a legal theory of the firm, writes:

From a traditional legal perspective, this view is conceptually confused. Firms are either "real" or they are not. They cannot be entirely fictional (and therefore ignored as unimportant) and serve as a real-world "nexus" for a myriad of contracts. Economists writing in this vein fail to appreciate the legal nature of the firm as a "fictional" but nonetheless socially and legally "real" institutional entity and person.

Stout (2012) also explains at length how the standard principal-agent view of the firm, widely prevalent in business schools, is ill founded. First, it assumes shareholders own corporations; whereas, in fact, corporations are independent legal entities that own themselves and shareholders own shares of stock, which amount to a contract between the shareholder and the corporation providing the former with rights under certain limited circumstances. Second, it posits that shareholders are residual claimants, receiving profits left over after the company's various contractual obligations have been met; whereas, it is up to the board of directors to decide whether (if any)

profits are to be distributed as dividends to shareholders (the idea of shareholders as residual claimants has its origins in bankruptcy law and is incorrectly applied to the public corporation that is a going concern). Third, is the assumption that shareholders are principals who hire directors and executives to act as their agents, whereas, as a matter of corporate law, corporations are controlled by boards of directors, not shareholders.

Nonetheless, ill founded or not, the financial economics Theory of the Firm still today informs much teaching at business schools across the curriculum, and business purpose is widely held to be maximizing shareholder value. Heracleous and Lan (2010) suggest that MBA and executive education should change such that the legal duties of directors are better understood. We propose a broader rethink.

What Business Schools Might do Differently

Educational and professional authorities play an important institutional role in setting standards for legitimate organizational practices (Matten and Moon 2008). Campbell (2007, p. 958) points out that managers learn “mental constructs by absorbing the messages that are transmitted to them at business schools.” In this sense, business schools play an important role as normative institutions when they convey the paradigms through which managers should analyze the corporate environment. If business school students only get taught that SVM is the purpose of the firm, then this is the most likely lens through which they will see their future professional roles.

What should business schools do differently? The questioning of business school education of late has given rise to much soul-searching and various proposals for how management education might be changed. Thus, various writers have been critical of business schools for teaching business as a science, with an emphasis on scientific research, rather than as a profession and with a greater emphasis on applied knowledge and skills development (Bennis and O’Toole 2005; Ghoshal 2005; Mintzberg 2005b; Pfeffer and Fong 2002). Following in this vein, Khurana and Nohria (2008) advocate making management a true profession, which would include the teaching of a formal body of knowledge and a commitment to a code of conduct. The latter, a “Hippocratic Oath for managers,” has inspired an MBA Oath movement, to which over 300 institutions have committed as of 2013.¹² Khurana and Nohria (and the authors of the MBA Oath) are careful to frame their code such that it provides for accountability to organizational stakeholders and, while not endorsing SVM,

emphasizes that corporate purpose has much to do with value creation. They write (2008, p. 76): “By turning managers into agents of society’s interest in thriving economic enterprises, we get out of the bind of viewing them as agents of one narrowly defined master (shareholders) or many masters (stakeholders).” However, not clarified is how in practice serving “society’s interest” is different from addressing the needs and interests of multiple stakeholders. Nonetheless, broader adoption of the MBA Oath would indeed amount to a step away from SVM as traditionally conceived and taught.

Podolny (2009) also argues in favor of an MBA code of conduct as one of a number of measures business schools could take to regain trust given criticism received in light of the financial crisis.¹³ He would have schools draw up codes of conduct and monitor compliance, revoking degrees of graduates who violate the code (in practice this would likely need to be restricted to instances of successful criminal prosecution if business schools are to avoid being the target of litigation). Podolny does not specify the content of the code, but he is critical of business schools for competing by focusing on rankings and starting salaries such that participants are asking: what can I do to make the most money? Business schools, he says, give insufficient attention to values and ethics in their teaching, and MBAs are perceived as working only to serve their own selfish interests, rather than asking: “How do I want to change the world for the better?” He writes in conclusion (2009: 67): “in a world where MBAs have been directly or indirectly responsible for destroying so much value, business schools can’t point to isolated examples of leadership and scholarship as justifications for their existence. They must be able to say that they promote behavior that is consistent with society’s values.”

Business schools are not alone in deciding how much attention to give to values and ethics, with many certified by bodies such as the AACSB (Association for the Advancement of Collegiate Schools of Business). However, it seems that they cannot be relied upon to require business schools to give ethics sufficient attention. Swanson and Frederick (2003, p. 25), for example, blame weak AACSB certification requirements as a contributor to “woefully inadequate” ethics coverage in business schools and “Enron-like behavior” in business. They ask, in the title to their article: “Are business schools silent partners in corporate crime?”

Smith and Van Wassenhove (2010) suggest that it would be a mistake to say that business schools are directly to

¹² See: <http://mbaoath.org/> (accessed 10 June 2013).

¹³ A *Harvard Business Review* debate site on the role of business schools in the crisis attracted over 30,000 visitors with 67 % of respondents to its (unscientific) survey claiming that business schools were at least partly responsible for the ethical and strategic lapses of their graduates (*Harvard Business Review* 2009).

blame for the financial crisis, but they claim that business schools have played a role indirectly and criticize the teaching of SVM specifically, suggesting that adherence to and perpetuation of the SVM ideology contributed significantly to the crisis, albeit unintentionally. Ghoshal (2005) and Stout (2012) also describe SVM as an ideology, with Stout (2012, p. 3) saying that it is “just that—an ideology, not a legal requirement or a practical necessity of modern business life.” She also views it as pervasive, observing that, “by the 1990s, the idea that corporations should serve only shareholder wealth as reflected in stock price came to dominate other theories of corporate purpose. Executives, journalists, and business school professors alike embraced the need to maximize shareholder value with near-religious fervor” (2012, p. 4). She sees the SVM ideology as a root cause of the *Deepwater Horizon* disaster in the Gulf of Mexico—the reason why BP and other companies cut corners—and illustrative of how SVM can be counterproductive in regard to serving the interests of shareholders aside from not being required under the law.

Smith and Van Wassenhove (2010) explain that ideologies often appear to be serving society as a whole while advancing the interests of particular sectors. Thus, the theory of the firm holds that SVM results in societal wealth maximization, but at the same time, it serves the interests of shareholders (in theory) and the managers who are its adherents and its beneficiaries, at least when their compensation is pegged to shareholder returns. We agree where they suggest that business schools need to teach SVM with greater intellectual honesty and with attention to its many deficiencies, both theoretical and practical. Consistent with Khurana and Nohria (2008) and others (see Rubin and Dierdorff 2013), they also suggest that business schools need to do a better job of developing stakeholder theory, the most plausible contending framework to SVM. Thus, we recommend an honest teaching of the “Theory of the Firm” that would portray the plurality of views available regarding its purpose, where shareholder theory, stakeholder theory, and social contract theory are key contenders.

Contending Theories

The primary contender competing with shareholder theory is stakeholder theory, which has gained widespread acceptance among CSR and business ethics advocates. Social contract theory is another contender, which although not as widely discussed as the other theories, provides an interesting change of perspective for the purpose of the corporation. In light of their ample coverage elsewhere, if not familiarity, we do not discuss their contents in any detail, or their strengths and weaknesses. We provide only

Table 1 Theories of corporate purpose

| Corporate responsibility theory | Main idea |
|---------------------------------|--|
| Shareholder theory (SPN) | Shareholder centric: the purpose of the corporation is to act as a vehicle for furthering the interests of <i>shareholders</i> |
| Stakeholder theory | Stakeholder centric: the purpose of the corporation is to act as a vehicle for furthering the interests of <i>stakeholders</i> |
| Social contract theory | Society centric: the legitimacy of the corporation’s existence is based on its positive contributions to <i>society</i> |

a brief overview of their key characteristics relative to Shareholder Theory and our concern with SPN as a potential obstacle to CSR and sustainability (see Table 1).

Prior to the rise of the shareholder value movement, management was expected to balance the interests of multiple constituencies, or stakeholders as we would call them today. In some ways, this is a more complex view of management, one that recognizes that the task of managers is to serve multiple stakeholders—giving shareholders their due, but not to the exclusion of others with legitimate claims.

Freeman’s (1984) original articulation of stakeholder theory framed it as a response to the problem of value creation and trade in a complex and turbulent business environment. It was an account of a changing world where stakeholder groups had become an increasingly significant factor in business success. In this respect, as instrumental stakeholder theory, it is not necessarily inconsistent with the SPN. Nonetheless, Freeman’s subsequent writing on stakeholder theory also framed it as normative, wherein “each stakeholder group has a right to be treated as an end in itself, and not as means to some other end” (Donaldson and Preston 1995, p. 73). Thus, CSR that serves society’s interests but not necessarily the economic interests of shareholders is more consistent with normative stakeholder theory than instrumental stakeholder theory as it is typically conceived. Nonetheless, it has its detractors, including some within business ethics. Marcoux (2003), for example, argues that the consequentialist-like weighting and balancing of stakeholder interests eliminates the fiduciary duty owed by managers to shareholders and stakeholder theory is thus morally lacking.

In their review of the stakeholder theory literature, Laplume et al. (2008, p. 1153) assert that the fundamental thesis of stakeholder theory is that “organizations should be managed in the interest of all their constituents, not only in the interest of shareholders.” However, some stakeholder theorists go further than this. Freeman et al. (2010), in their comprehensive review of stakeholder theory,

provide an assessment of how stakeholder theory has developed over thirty years of research. In their view, a “stakeholder approach is about creating as much value as possible for stakeholders, without resorting to trade-offs” (Freeman et al. 2010, p. 28; also see Freeman et al. 2007). Thus, business is viewed as a *stakeholder value creation enterprise* (for a corporate finance perspective on this idea, see Cloninger 1997; Galai and Wiener 2008).

Social contract theory also supports a CSR prescription to satisfy the interests of a wider constituency of stakeholders beyond shareholders. First developed by Thomas Donaldson (1982, 1989) in the context of the corporation’s role in society, the basis for social contract theory is that a corporation operates in a society at the discretion of the community and on the understanding that the corporation implicitly makes some commitments to that community. Donaldson (1989, p. 47) asks us to imagine a hypothetical state of nature scenario inhabited by rational individuals “who attempt to sketch the terms of an agreement between themselves and the productive organizations upon which they are considering bestowing status as legal, fictional persons, and to which they are considering allowing access both to natural resources and the existing employment pool... The *raison d’être* for the productive organization turns out to be its contribution to society tempered by a set of reciprocal obligations existing on both sides of the organization/society divide.” While this gives rise to a variety of possible obligations of the corporation to society, one of its main moral duties, according to Donaldson, is to abstain from violating minimum standards of human rights and justice in society. This clearly connects with CSR advocacy in that corporate duties to adhere to human rights beyond legal requirements go further than a strict adherence to promoting shareholder interests and may in some circumstances be contrary to shareholder’s economic interests (see Ruggie 2013 for further discussion of this tension).

Thus, business schools could teach three distinct perspectives on the purpose of the corporation. Shareholder Theory is shareholder-centric focusing narrowly on the promotion of shareholder interests as the purpose of the firm. Stakeholder theory is corporation-centric in that it views the purpose of the firm as a coordinator and promoter of stakeholder interests. Social contract theory is society-centric as it views the legitimacy of a firm’s existence as being based on its positive contribution to society. By teaching at minimum these three perspectives (perhaps also including reference to the development of benefit corporations), business school students should obtain a broader view of corporate purpose than that provided by a single-minded focus on shareholder interests. As West (2011, p. 19) concludes: “Having broader conceptions of corporate purpose is necessary to effectively address the ways in which corporations impact life in contemporary society.”

Is the SPN Here to Stay?

We have maintained that the SPN is mute as a legal norm but alive as a social norm, primarily perpetuated through the sole voting rights of shareholders as well as the teaching of SVM dogma in business schools. We have suggested that extending legally enforceable fiduciary duties to stakeholders as well as teaching multiple theories of corporate purpose in business schools could weaken the SPN as a social norm.

Although these measures are likely to weaken the SPN, they are unlikely to remove it. As long as shareholders have sole voting rights for the board of directors, their interests are likely to remain primary as they alone wield elective power.¹⁴ However, this does not mean that SVM is here to stay. As shareholder preferences change away from a focus on shareholder value to encompass broader concerns for stakeholders, so too will the concerns of managers broaden, albeit consistent with SPN. Awareness of, and the concern for, the roles that corporations play in environmental and human rights abuses are motivating more shareholders to exert passive and active influences on corporate conduct.¹⁵ This is particularly true of institutional investors, such as investment funds and pension funds that today own the lion’s share of the stock market. An increasing number of institutional investors are choosing to use ethical criteria in their investment decisions. For example, in 2010 \$3.7 trillion worth of assets were professionally managed according to Socially Responsible Investment (SRI) criteria in the U.S., having increased by more than 380 % since 1995 (Social Investment Forum Foundation 2010). SRI investments account for 12.2 % of assets under professional management and the amount is reportedly increasing. Thus, we may see the norm of SVM diminish in importance in part because directors continue to be receptive to the interests of

¹⁴ Removing the voting rights for shareholders would remove the SPN, as it would put shareholders on an equal footing with other stakeholders who likewise lack the right to vote. Under such circumstances, all stakeholders are equal as the only avenue for any stakeholder to make enforceable demands on the board would be through the courts. However, such a system may be unfeasible due to practical difficulties and undesirable consequences. First, it may be slow and expensive to use the courts as a central system of corporate governance. Second, without any voters, it is unclear how any board would be elected. Third, it is likely that the corporate legal form would fall out of favor with investors if the act of incorporation meant that they thereby lost a measure of control over the corporation.

¹⁵ Passive influence primarily involves abstaining from investing in certain stock based on ethical criteria, while active influence involves engaging corporations to change their behavior.

shareholders who are seemingly becoming more mindful of the interests of other stakeholders.¹⁶

Conclusion

This paper has examined the SPN as a widely acknowledged impediment to CSR. In contrast to the common assertion that managers are legally constrained from addressing CSR issues if doing so is inconsistent with the interests of shareholders, we have shown that this is no longer a legal constraint, if it ever has been. However, while the SPN might be muted as a legal norm, it is very much evident as a social norm among managers and in business schools. This stems from a largely unquestioned adherence to shareholder theory in business schools and beyond and to the sole voting rights of shareholders on corporate boards. We have shown how this view of the SPN as an impediment to CSR is misguided, especially when grounded in a purported legally enforceable requirement to maximize shareholder value.

Two avenues for change in the dominance of the SPN as a social norm have been examined. We looked at the possibility of extending fiduciary duties of executives to non-shareholder stakeholders and, tackling belief systems head on, we examined the role of business schools in promoting misconceptions about shareholder primacy and the purpose of business and whether and how changes in business school teaching might promote an alternative view of managers' obligations to shareholders and other stakeholders that would also be more consistent with corporate law. Grounded in normative stakeholder theory and social contract theory, this approach would require managers to give attention to shareholder claims alongside those of other claimants. If the ideas of some stakeholder theorists gain further traction (e.g., Freeman et al. 2007), then it might even be conceived as Stakeholder Value Maximization (SVM). Thus, perhaps one day some might even proclaim: "SVM is dead, long live SVM!"

¹⁶ Some corporate leaders may not wish to wait for the evolution of mindful shareholders in order to get a clear mandate to address stakeholder concerns. To this end, it is possible for corporations to influence the composition of its shareholders. For example, as we have mentioned, in order to be able to take a long-term view of its business, Unilever has informed Hedge Funds that they are not welcome as shareholders. But there are many other strategies. Edward Rock (2012) discusses at length "recruitment" and "shaping" strategies that corporations can employ to recruit desirable shareholders and shape existing shareholders to become more desirable. Examples of recruitment strategies include the issuing of preferred stock to desirable shareholders as well as active investment relations management. Shaping strategies include the choice of corporate domicile (because different jurisdictions attract different types of shareholders), as well as providing a system of Tenured Voting whereby shares that are held longer receive greater voting power.

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