

## **The Need for Realism in Business Ethics<sup>1</sup>**

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### **1. Introduction**

Although conventional approaches to business ethics have been successful in spawning an industry, and in encouraging pernicious public policy, they suffer from fundamental confusions. Lacking realism about business or ethics, the prevalent trend in business ethics undermines both genuinely ethical conduct and individual freedom.

The prevalent trend in business ethics, referred to here as 'the conventional approach', consists of an unfortunately broad range of academic and popular doctrines. What they have in common, is the claim that businesses, and people in their business capacities, must pursue some objective other than owner value in order to be moral. Whether expressed in the language of corporate social responsibility ('CSR') or stakeholding, the 'triple bottom line' or 'corporate citizenship', conventional approaches typically identify extraneous responsibilities that businesses allegedly owe to others; fulfilling such 'social responsibilities' is what constitutes conventional business ethics. Starting with faulty assumptions, and applying defective theories, CSR as conventionally understood could well stand for 'Coercive Specious Reasoning' or 'Counterproductive Stakeholder Regimentation'.

### **2. Fundamental Confusions**

#### ***a. Failure to differentiate 'business' and 'corporation'***

The lack of understanding that is characteristic of the conventional approaches starts with the ostensible object of their attention. Conventional business ethics and corporate social responsibility both typically assume that 'business' and 'company' are the same. They are, however, categorially different. 'Company'—'corporation'—designates a particular organisational structure, which can have any objective agreed by its shareholders: it need not be, and frequently is not, business. 'Business', in contrast, designates a particular objective: maximising owner value over the long term by selling goods or services<sup>2</sup>. That definitive

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<sup>1</sup> This version of 'The Need for Realism in Business Ethics' replaces the one originally published as pp.33-48 of *Reason Papers* Vol.31 (Fall 2009); that previous version was distorted in the course of publication and should not be used.

<sup>2</sup> Sometimes abbreviated to 'maximising long-term owner value' or just 'owner value'. For a detailed derivation, justification and explanation of this characterisation of business, see

business objective is most commonly pursued *not* through corporations, but via sole proprietorships and partnerships. When, therefore, advocates of business ethics address themselves to companies, and use the language of *corporate* social responsibility, they neglect the majority of businesses that are not corporate in form. Conversely, when CSR advocates assume that companies must be businesses, they routinely misrepresent the requirements of both corporate governance and of corporate responsibility.

***b. Failure to recognise the role of purpose***

Conventional approaches to business ethics and CSR suffer from considerably more egregious confusions concerning the relation of business and ethics. They typically fail to recognise two very basic truths: that only a *business* can be an ethical business, and that what counts as an ethical business depends crucially on the purpose of business.

Artefacts and activities are most sensibly evaluated by reference to their definitive ends. The criteria of a good handkerchief are different than those of a good razor, because the purposes of handkerchiefs and razors are different. The purposes of businesses, families, churches and governments are equally dissimilar: each has a distinctive objective that both differentiates it from every other activity or organisation, and that determines the appropriate standards for assessing its conduct. The application of inappropriate, extraneous standards—of care from families, for example, or of equality from citizenship—is typically what leads conventional approaches to business ethics mistakenly to consider business as such not to be (sufficiently) ethical.

According to the conventional approach, business is ethical, or 'socially responsible', only if it pursues some 'socially responsible' objective: common candidates include 'corporate citizenship', 'stakeholder interests', and the 'triple bottom line'. But though such views are very widely held, they are, nonetheless, literally absurd. Business is a specific activity, with a definitive end, that of maximising long-term owner value. Well-ordered non-business corporations ('not-for-profits') similarly have specific objectives that define their reasons for being — housing the homeless, for example, or finding a cure for cancer. To the extent that businesses or corporations pursue something other than their definitive purposes, they fail to be organisations of the designated sort. But such deviation is just what conventional business ethics and CSR demand. It's no wonder, then, that conventional business ethics is so often dismissed as an oxymoron. It's because, as understood conventionally, it is genuinely oxymoronic: it makes refraining from business the condition of being responsible or ethical by business.

Proponents of the conventional approaches may now protest: they don't

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Elaine Sternberg, *Just Business: Business Ethics in Action* (second edition; Oxford University Press, 2000; first edition, Little, Brown & Co (U.K.) Ltd, 1994), especially Chapter 2.

usually advocate abandoning the business purpose. They merely want to restrain it, by combining it with other, supposedly more worthy ends. When goals conflict, however, one must take precedence. For CSR advocates, it is typically 'social responsibility' that dominates, and the corporate or business purpose that gets sacrificed.

### **3. The Stakeholder Doctrine Repudiated**

The business objective, and thus the possibility of ethical business, is always excluded by one of the commonest bases of conventional business ethics and CSR: the profoundly defective Stakeholder Doctrine. The term 'stakeholder' is popularly associated with three different views. Two are commonplace and have no particular moral significance; the third is largely incoherent. If taking a stakeholder approach simply means recognising that people are more likely to take an interest in a process when they are materially involved in its outcome, then stakeholding is an important notion, but one that is neither distinctive nor new. Similarly, if stakeholding simply means recognising that a wide variety of interests must ordinarily be taken into account when pursuing organisational objectives, then all that is exceptional about it is the label; the underlying truth has long informed successful practice.

It is only when force is added to those traditional observations that the 'Stakeholder Doctrine' (also known as 'Stakeholding' or the 'Stakeholder Model') emerges as something distinctive. The Stakeholder Doctrine has two essential tenets: organisations should be run for the benefit of, and should be accountable to, all their stakeholders.<sup>3</sup> This third version is not about motivation or functional relationships, but about entitlements. It is the one that is typically associated with, and invoked to justify, conventional business ethics. It is therefore only this third, entitlement, sense of stakeholding that will be considered and criticised here.

The definition of 'stakeholder' commonly associated with Stakeholding is the one introduced by R. Edward Freeman: "A stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the organization's objectives."<sup>4</sup> Here 'achievement' refers to the activity of pursuing those objectives, not just success in doing so. Officially adopted by the European Union<sup>5</sup>, this definition of stakeholder excludes all criteria of materiality,

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<sup>3</sup> See, for example, the many works of R. Edward Freeman, including his 'A Stakeholder Theory of the Modern Corporation', in Beauchamp & Bowie, eds., *Ethical Theory and Business*, 7th ed., (Englewood Cliffs, NJ: Prentice-Hall, 2004), pp.55-64.

<sup>4</sup> R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Boston: Pitman Publishing, 1984), p.46.

<sup>5</sup> *EU Green Paper Promoting a European framework for corporate social responsibility* (European Commission Directorate-General for Employment and Social Affairs, Unit EMPL/D.1, July 2001; henceforth 'EUcsr'), Concepts Annex, p.28.

immediacy and legitimacy. Given the increasing internationalisation of modern life, and the global connections made possible by improved transportation, telecommunications and computing power, those affected (at least distantly and indirectly) by any organisation include virtually everyone, everything, everywhere. Terrorists and competitors, vegetation, nameless sea creatures and generations yet unborn are amongst the many groups which are now seriously considered to be business stakeholders. Most of the criticisms would, however, apply even if 'stakeholder' referred only to some more limited subset, such as shareowners, employees, suppliers, lenders, and customers.

***a. The Stakeholder Doctrine is incompatible with business***

The Stakeholder Model is typically offered as an alternative to the shareholder model of business. But far from being a sensible model of either business or other substantive organisational objectives, Stakeholding is not even compatible with them. The Stakeholder Doctrine automatically precludes substantive objectives, because it requires that what organisations be run *for*, is the benefit of *all* their stakeholders; according to Stakeholding theory, providing benefits for all stakeholders is the only legitimate organisational purpose. The Stakeholder Doctrine thus precludes all objectives that exclusively or primarily benefit particular groups. Business as the activity of maximising long-term owner value is automatically ruled out; so are the different organisational objectives of providing education for inner-city children and employment for the blind.

Once again, advocates may protest: what they champion is not dispensing with business and other particular objectives, but pursuing them while also serving the interests of all the stakeholders. If, however, that criterion could be satisfied simply by providing widespread benefits, then the Stakeholder Model would not constitute an alternative to the shareholder model. As Adam Smith famously observed in *An Inquiry into the Nature and Causes of the Wealth of Nations*<sup>6</sup>, 'By pursuing his own interest [an individual] frequently promotes that of the society more effectually than when he really intends to promote it.' Business pursuit of owner value routinely benefits not just owners, but employees and investors, customers and communities. But benefiting other groups incidentally is not enough to satisfy the Stakeholder Doctrine. It demands instead that benefiting all stakeholders be the purpose of the organisation.

That essential Stakeholder aim of providing benefits for all stakeholders is, however, inherently ill-defined. First, it does not indicate in which of their many overlapping and often conflicting capacities individuals or groups are to be considered stakeholders: people often are employees, customers and shareholders of the same organisation. Second, the Stakeholder Doctrine provides no criteria of what constitutes a stakeholder benefit. Despite the simplifying and often presumptuous assumptions that are commonly made, even members of the same

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<sup>6</sup>1776: IV, Ch.2, para 9.

notional stakeholder constituency may have significantly different views as to what is beneficial. Some employees want higher wages, others want shorter hours; some regard more responsibility as a benefit, others consider it to be a burden. How are stakeholders' divergent perceptions of benefit to be discerned and coordinated?

Third, and most fundamentally, even if the relevant stakeholders and benefits could somehow be identified, the Stakeholder Doctrine provides no guidance as to how they are to be balanced. Given the divergent interests of the different stakeholders, that which benefits some will often harm others; higher wages for employees, for example, can mean higher prices for customers and/or lower returns for owners. The Stakeholder Doctrine gives no clue as to how to rank or reconcile the normally conflicting interests of stakeholders.

Lacking such a criterion, the Stakeholder Doctrine affords each stakeholder—including the managers—the flexibility to favour his own interests when holding the organisation accountable: each stakeholder can elevate his own interests over the interests of the other stakeholders and also over the ostensible organisational objective. With each stakeholder holding the organisation accountable for pursuing some distinct, different (and probably incompatible) end, the notional substantive goal of the organisation is unlikely to be achieved.

Moreover, how is the multiple accountability required by the Stakeholder Doctrine meant to operate? A Stakeholder business is supposed to be accountable to all of its stakeholders. This presumably means that the managers, employees and other agents of the Stakeholder business are accountable to all of the business's stakeholders instead of just to its owners. But the managers, employees and other organisational agents are themselves stakeholders of the business. The Stakeholder Doctrine would seem to render them accountable *inter alia* to themselves, without offering any explanation of how such multiple self-accountability might work.

In such circumstances, it becomes understandable that the role of management in a Stakeholding organisation is reduced from pursuing substantive objectives to (at most) balancing stakeholders' benefits. It is because, being accountable to all of the stakeholders, and having somehow to reconcile the stakeholders' conflicting interests, managements typically have neither occasion nor incentive to pursue substantive ends.

To the extent, therefore, that an organisation satisfies the essential requirements of the Stakeholder Doctrine, and is run for the benefit of and is accountable to all its stakeholders, it will not be pursuing the business objective. Considered abstractly, such undermining of business might well be favoured by defenders of the Stakeholder Doctrine, and by proponents of the conventional approaches to business ethics and corporate social responsibility<sup>7</sup>. But the massive

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<sup>7</sup> See, for example, Jarol Manheim, 'Biz-War: Origins, Structure, and Strategy of Foundation-NGO Network Warfare on Corporations in the United States', paper delivered at an AEI conference in 2003; [www.aei.org/docLib/20040402\\_20030611\\_Manheim.pdf](http://www.aei.org/docLib/20040402_20030611_Manheim.pdf).

economic contraction that would result is unlikely to be as welcome. Moreover, when business is ruled out, so is the possibility of ethical business....

***b. The Stakeholder Doctrine undermines accountability***

The possibility of ethical business is further reduced by the Stakeholder Doctrine's incompatibility with efficacious agency and accountability. In asserting that organisations should be accountable to *all* their stakeholders, the Stakeholder Doctrine denies that agents have any special duty to their principals as ordinarily understood. Accountability that is diffuse, however, is effectively nonexistent; an organisation that is notionally answerable to everyone, is actually answerable to no one. The only way that multiple accountability can function is if everyone involved accepts a clear common purpose. But well-defined purposes are incompatible with the Stakeholder Doctrine.

***c. The Stakeholder Doctrine is unjustified***

Not surprisingly, a Doctrine suffering from such fundamental conceptual and practical defects is as difficult to justify as it is to implement. Stakeholder supporters typically proceed without argument from the undeniable fact that organisations affect and are affected by certain factors, to the unjustified conclusion that organisations should be run for and accountable to them. But that is neither right nor reasonable. Business must take many factors into account, including, among others, terrorists and burglars. But businesses can hardly be run for their benefit. Nor does the fact that various groups are affected by business, give them any right to control it: consider competitors. Moreover, do Stakeholder advocates appreciate that if their creed did legitimately render Shell accountable to Greenpeace, it would equally render Greenpeace accountable to the National Rifle Association?

A few Stakeholder supporters have acknowledged that their Doctrine's reductive organisational end and multiple accountability require justification. But though their efforts to support the Doctrine have invoked grounds as diverse as economic efficiency and Kantian deontology, all have been conspicuously unsuccessful<sup>8</sup>. The lack of justification has not, however, deterred advocates of conventional business ethics from relying upon the Stakeholder Doctrine. Indeed, perhaps the most notable achievement of academic business ethics has been the extent to which the term 'stakeholder' has become embedded in ordinary language.

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<sup>8</sup> It is noteworthy that R Edward Freeman, perhaps the foremost proponent of the Stakeholder approach, has progressively retreated in response to criticism: "... attempts to more fully define, or more carefully define, a stakeholder theory are misguided.... Stakeholder is thus a genre of stories about how we could live..." ('The Politics of Stakeholder Theory: Some Future Directions', *Business Ethics Quarterly*, Vol 4, 1994, pp.413-15). The normative core (the 'Doctrine of Fair Contracts') of his own preferred 'story' of 'pragmatic liberalism' (Ibid, p.415) does, however, suffer from the defects of Stakeholder Doctrine, as well as from other defects.

***d. Key implications of the Stakeholder Doctrine***

Despite — or perhaps because of — its defects, the Stakeholder Doctrine is extremely popular. One reason, is that those defects are seldom acknowledged. Another, is that Stakeholding attracts the promoters of worthy 'causes', who (unrealistically) believe they would be the beneficiaries if organisational (and particularly business) assets were diverted from their owners to other stakeholders. Crucially, the Stakeholder Doctrine also appeals to those who would gain from undermining accountability, in particular to the managers and politicians who want the power, prestige and perks of office without the concomitant responsibilities.

Conventional business ethics, CSR, and the Stakeholder Doctrine are well suited to serving authoritarian and collectivist political ends. Their nominal association with unobjectionable doctrines lends them a superficial plausibility; their apparent generosity encourages people to accept them uncritically. And their central features—the lack of an objective standard of action, the radical undermining of accountability—mean that they can be invoked to support almost any kind of state intervention, no matter however intrusive or restrictive. It is therefore hardly surprising that conventional business ethics, CSR and Stakeholding have increasingly informed official government policy in the United States, Britain and the European Union.<sup>9</sup>

**4. Conventional Business Ethics is Counterproductive**

So conventional business ethics and CSR are politically suspect as well as intellectually defective. In addition, they are fundamentally counterproductive. Oxymoronic and uneconomic, they would actively undermine both the ethical

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<sup>9</sup> In respect of, for example, directors' duties, takeovers and pension fund investments. In the U.S., stakeholder interests had been recognised in connection with directors' duties in thirty-one states by 1999; 'From the Hustings: The Role of States with Takeover Control Laws', *Mergers & Acquisitions Journal*, 1 October 1999.

In Britain, protection of specific stakeholder interests has been enshrined in at least forty-four main U.K. statutes, in addition to statutory instruments and EU regulations (Confederation of British Industry, *Boards without tiers*, October 1996, p.23; *EUcsr*, op.cit., note 5 above, p.27). The 'stakeholder economy' was the Labour Party's initial 'defining theme' for the 1997 general election campaign (Robert Peston, 'Votes at stake over vision for economy', *Financial Times*, 11 January 1996, p.5). And disturbingly, the stakeholder doctrine was one of the 'three pillars' that underpinned the recent review of U.K. company law (Consultation Document, *Modern Company Law for a Competitive Economy*, Department of Trade and Industry Publications, 4 March 1998, especially paras. 5.1, 5.2 (i)(b)). It was designated the 'pluralist approach' in the section on the scope of company law (para 5.1.13, p.37); without any label, it was the basis for proposals for major changes in U.K. company formation procedures. Since 2000, trustees of occupation and local government pension schemes have had to disclose socially responsible investment (SRI) policies as part of the Statement of Investment Principles (SIP).

conduct they claim to support, and basic human rights.

***a. Conventional business ethics is irresponsible and unethical***

The fundamental responsibility of an organisation, or of individuals in their organisational capacities, is achieving the organisation's official purpose. Contracts of employment normally commit employees to supporting their employer's goals; corporate directors have an even stronger, fiduciary, responsibility to pursue the official corporate objective. Sacrificing that organisational purpose, or subordinating it to some other end, constitutes a violation of the core organisational responsibility. But that is what is required by conventional approaches to business ethics. Inciting employees to betray their employers' trust is a strange way of promoting responsibility.

Genuinely ethical conduct is also unlikely to ensue when the particular ends advocated in the name of conventional business ethics, and the methods used for promoting them, are themselves both immoral and irresponsible. Recall Greenpeace's attack on Shell over the disposal of the Brent Spar oil rig. In the name of environmental protection and 'social responsibility', ends enthusiastically endorsed by conventional business ethics, Greenpeace grossly misrepresented the dangers of disposing of the oil rig in the North Sea. As a result, the disposal was more harmful for the environment, substantially riskier for the disposal workers, and more wasteful than it would have been had Shell's original plan been followed.<sup>10</sup> Though counterproductive, Shell's capitulation was hailed as a notable victory for social responsibility.

***b. Conventional business ethics undermines human rights***

An even more profound defect of business ethics as conventionally advocated, is that it would undermine basic human rights. It does so necessarily, because it subverts the private property that is essential for defending and exercising fundamental individual liberties. Conventional business ethics subverts private property by denying that owners have any special right to determine how their property will be used: insofar as assets are held or utilised by organisations, conventional business ethics stipulates that those assets must be used for 'socially responsible' purposes. And to the extent that conventional CSR encourages stakeholder appropriation of those assets, it promotes what would otherwise be regarded as theft. When corporations are highjacked from the ends determined by their shareholders, or business assets are diverted from business uses, owners are denied fundamental rights. In obliging them to serve ends other than those the owners have chosen, champions of conventional business ethics would treat the owners as slaves.

The essentially illiberal nature of conventional business ethics and CSR is

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<sup>10</sup> Jon Entine, "Shell, Greenpeace, and Brent Spar: The Politics of Dialogue" in *Case Histories in Business Ethics*, eds. Chris Megone and Simon J. Robinson (London: Routledge, 2002), pp.59-95.

further revealed by the 'social contract' argument often claimed to support them. Whereas Hobbes and Locke invoked the notion of a social contract to limit authoritarian power, the CSR version attributes authoritarian power to society. It alleges that in exchange for society's consenting to provide the resources that businesses and corporations need to exist, and granting them a 'licence to operate', organisations become accountable to society. The argument thus presupposes a society that is not free: in free societies, whatever is not expressly prohibited is allowed, and strict limits apply as to what may be officially prohibited. All the powers needed to form and run organisations—the ability to associate, to enter into commitments (including market exchanges), to enforce those commitments (by, e.g., ostracising offenders), etc.—are possessed naturally. Enlisting the willing cooperation of counterparties is indeed essential to organisational formation and operation, but consent in the sense of formal permission is largely irrelevant.

Since no 'licence to operate' is necessary, the CSR 'social contract' argument either confuses consent with functional responsiveness, or it constitutes a threat: it asserts that businesses and corporations must submit themselves to society's requirements, lest society prevent them from operating.<sup>11</sup> That challenge looks very like extortion. Requiring submission as the condition for not inflicting harm is not entering into a social contract, but running a protection racket. The fact that muggers may kill you if you do not surrender your money, does not give muggers the right to appropriate your money or to control your life; it simply means that they are capable of theft and murder. Claims to justify legitimacy require demonstrations of entitlement, not displays of brute force.

The threat to human rights is exacerbated when conventional business ethics and CSR are backed by law. Enforced CSR regulation prevents 'capitalist acts between consenting adults'<sup>12</sup>; it deprives stakeholders of the freedom to live their lives as they think best. That such regulation may be inspired by an ethical motive (real or otherwise), or directed at an ethical objective, may well make it more popular; it does not reduce its coercive nature, or increase its ability to produce genuinely virtuous conduct. Coercive regulation typically makes things worse for everyone, including those it was intended to benefit... as the current economic downturn has dramatically demonstrated.<sup>13</sup>

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<sup>11</sup> Cf. the much cited 'Iron Law of Responsibility': "In the long run, those who do not use power in a manner which society considers responsible will tend to lose it."; Keith Davis and Robert L. Blomstrom, *Business and Society: Environment and Responsibility* (3rd ed.; New York: McGraw-Hill Book Co, 1975), p.50. The 'license to operate' argument goes further, in presupposing that the ordinary operations involved in conducting business are *privileges*, to be granted or withdrawn by some central authority.

<sup>12</sup> Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974), p.163.

<sup>13</sup> See Philip Booth, ed., *Verdict on the Crash: Causes and Policy Implications* (London:

All enforced prescriptions and proscriptions are inherently coercive. They restrict liberty, strictly defined as the absence of physical aggression or threats thereof initiated against persons or their property by other persons. In limiting liberty, however, all imposed regulation also reduces the realm of ethical action. It's a commonplace of ethical theory that 'ought implies can'. But it's equally true that normally 'ought presupposes cannot'. In order to be acting ethically, an agent must be able to do—or not do—the right thing, and must do it freely, deliberately and characteristically. Ethical conduct is thus precluded in respect of anything that is either effectively banned or made compulsory. Legal regulation to enforce business ethics significantly narrows the scope for genuinely ethical action.

**c. Unethical law**

The use of coercive power is especially harmful when what the law requires is itself unethical. Conventional approaches to business ethics and CSR usually assume that the requirements of law are compatible with those of ethics, though often laxer than them; the few counterexamples acknowledged—those supporting slavery or apartheid, for instance—are typically taken from jurisdictions that are temporally or geographically distant. But the United States, Britain and the European Union all have laws and regulations enacted in the interests of corporate social responsibility that actively penalise ethical business. Examples include quotas that require favouring some designated group independent of their suitability for maximising long-term owner value, and much worker/ consumer protection regulation. Many of the government policies that gave rise to the sub-prime mortgage crisis, and the government responses that have exacerbated it, were also enacted in the name of 'social responsibility', and similarly penalise ethical conduct.

Those examples may well be controversial. But the judgement that betrayal is unethical would, one hopes, be widely accepted. Nevertheless, U.S. federal law forces some businesses to choose between betraying their employees and betraying their owners; they can satisfy the law only by violating their ethical obligations. This dilemma results from the combination of the Department of Justice's post-Enron enforcement policies, strict liability for corporate criminality, and the U.S. Federal Sentencing Guidelines.<sup>14</sup> The 1991 addition of a special chapter on

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Institute of Economic Affairs, 2009), especially the Introduction, and Chapter 4 (Eamonn Butler, 'The Financial Crisis: Blame Governments Not Bankers').

<sup>14</sup> For detailed explanation and justification of this position, see the work of John Hasnas, including "Managing the Risks of Legal Compliance: Conflicting Demands of Law and Ethics" 39 *Loyola University Chicago Law Journal*, 507 (2008); "Up from Flatland: Business Ethics in the Age of Divergence," 17 *Business Ethics Quarterly*, 399 (2007) (Best Paper, 2006 Society for Business Ethics annual conference); *Trapped: When Acting Ethically Is Against the Law* (Cato Institute, 2006); "Do Nothing", *Wall Street Journal*, September 16, 2006; "Department of Coercion", *Wall Street Journal*, March 11, 2006; "Unethical Compliance and the Non Sequitur of Academic Business Ethics," 21 *Journal of*

organizational crime to the Sentencing Guidelines is often cited as having been a major stimulant of the business ethics industry, because it counted having an ethics programme as a factor that could reduce sentences for certain federal offences. Interpreted in accordance with the Department of Justice's Thompson Memorandum, however, the results are positively unethical by almost any standards.

Under strict liability for corporate criminality, a firm can be convicted of wrongdoing simply because one of its agents did something unlawful... even if the allegedly illegal act was not intended by the business, and did not benefit the business... even if the agent was acting in direct opposition to the firm's official policy. According to the Thompson Memorandum,

Corporations can attain the lowest possible culpability score by having an effective compliance program and by cooperating with the government.<sup>15</sup> To have an effective compliance program, a corporation must 'monitor and audit' the behavior of its employees to detect criminal conduct and impose 'disciplinary measures,' (typically firing) on those who engage in it.<sup>16</sup> To cooperate with the government, a corporation must report any suspected wrongdoing to the government; disclose to the government 'all pertinent information known by the organization' about such wrongdoing, whether or not protected by attorney-client privilege or other promise of confidentiality; refrain from advancing legal fees to or entering into joint defense agreements with its employees; and accept responsibility for the wrongdoing, which means being willing to plead guilty because the 'adjustment is not intended to apply to an organization that puts the government to its burden of proof at trial.'<sup>17</sup>

It's hardly surprising that the Organizational Sentencing Guidelines have been described as 'an extraordinarily effective device for undermining all of the civil

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*Private Enterprise* 87 (2006), henceforth 'Unethical Compliance'; and "Ethics and the Problem of White Collar Crime", 54 *American University Law Review* 579 (2005).

<sup>15</sup> See United States Sentencing Commission, *Guidelines Manual*, henceforth 'USSG'), Art. 8C 2.4-2.6 (1992).

<sup>16</sup> USSG, Art. 8B 2.1(b)(6).

<sup>17</sup> USSG, Art. 8C2.5(g)(1) and 8C 2.5, comments 12 and 13. Full passage quoted from Hasnas, 'Unethical Compliance', op.cit., p.10.

libertarian protections of the traditional criminal law'.<sup>18</sup> Recognising its defects, the U.S. Court of Appeals ruled on 28 August 2008<sup>19</sup> that the Thompson guidelines were unconstitutional. While this was a welcome step, especially insofar as it protected privileged information, the old rules continue to govern the Securities and Exchange Commission<sup>20</sup> and other federal agencies.<sup>21</sup>

This may seem a distant danger to those without U.S. business operations. But there are no grounds for complacency elsewhere. The British government's attempts to enforce CSR through the use of Anti-Social Behaviour Orders ('ASBOs')<sup>22</sup> are also troubling. ASBOs are civil orders, intended 'to protect the public from behaviour that causes or is likely to cause harassment, alarm or distress'; they can be issued on the basis of hearsay.<sup>23</sup> Nevertheless, breaches are a criminal offence, and can render violators liable to five years' imprisonment. So civil liberties are definitely at risk from policies adopted in the name of corporate social responsibility.

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<sup>18</sup> Ibid.

<sup>19</sup> When the Department of Justice also issued new guidelines for the second time in ten months.... Department of Justice, *Justice Department Revises Charging Guidelines for Prosecuting Corporate Fraud*, August 28, 2008; <http://www.usdoj.gov/opa/pr/2008/August/08-odag-757.html>.

<sup>20</sup> Via the Seaboard Report (*Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions*, Exchange Act Rel. No. 34-44969 (Oct. 23, 2001), available at <http://www.sec.gov/litigation/investreport/34-44969.htm>.); cited in <http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=3507>.

<sup>21</sup> E.g., the Environmental Protection Agency; CNN Money News, 'Fed ruling: Attorney talk confidential; Justice Department ruling says federal prosecutors can't strong-arm corporate suspects into waiving attorney-client privilege.' August 28, 2008: 4:51 PM EDT; available online at [http://money.cnn.com/2008/08/28/news/companies/corp\\_prosecutions/index.htm?postversion=2008082816](http://money.cnn.com/2008/08/28/news/companies/corp_prosecutions/index.htm?postversion=2008082816).

<sup>22</sup> Julia Pearlman, 'Head of Marketing company slams ASBO ruling in historic flyposting case', *Brand Republic*, 24-Mar-05, 11:00: <http://www.brandrepublic.com/news/467860/head-marketing-company-slams-asbo-ruling-historic-flyposting-case/>; 'Music company spared ASBO over fly-posting pledge', 14/06/2004; [http://www.manchestereveningnews.co.uk/news/s/121/121093\\_music\\_company\\_spared\\_asbo\\_over\\_flyposting\\_pledge.html](http://www.manchestereveningnews.co.uk/news/s/121/121093_music_company_spared_asbo_over_flyposting_pledge.html).

<sup>23</sup> *A Guide to Anti-Social Behaviour Orders*, Home Office. August 2006. Ref: 275335.

***d. The dangers of appeasement***

Unfortunately, despite the defects of the conventional approach to business ethics and CSR, it is endorsed by many businesses: they have perhaps sought to deflect the activists' wrath by consulting them, appearing to agree with them, and even funding them in hopes of buying approval. Such 'renegade capitalists' lend credence to the false belief that the conventional standards are legitimate, and fortify expectations that they should be generally applied. Some businesses even misguidedly seek CSR regulation, apparently believing that they will gain if the burden of fulfilling 'social responsibilities' is imposed by law on their actual and potential competitors. But pandering and appeasement are always dangerous tactics. Businesses that even appear to accept the activists' standards render themselves liable to be judged by them, and subjected to ever more stringent demands: pandering is more likely to stimulate than to satisfy the activists' requirements. As has been observed<sup>24</sup>, it's like trying to convert a crocodile to vegetarianism by feeding it your leg....

**5. Realist Business Ethics**

Fortunately, appeasement is unnecessary as well as counterproductive. Contrary to popular opinion, what is needed for a business to be ethical or responsible has nothing to do with the conventional, oxymoronic demands.

Business ethics is about conducting *business* ethically... which means pursuing the business objective while satisfying two straightforward ethical constraints. The operative constraints are just the ones that must be respected for the purpose of business—maximising owner value over the long term by selling goods or services—to be possible. Long-term views require confidence in a future, and confidence requires trust; consequently, the conditions of trust must be observed. Equally, owner value presupposes ownership, and therefore respect for property rights. In order not to be ultimately self-defeating, business must be conducted with honesty and fairness, and without initiating physical violence or coercion. These three conditions constitute what may be called '*Ordinary Decency*'. When the Realist approach to business ethics was initially developed (in the 1994 first edition of *Just Business: Business Ethics in Action*), Ordinary Decency also included a presumption in favour of legality. But the increasingly cavalier attitude of even the U.S. and U.K. governments has made that presumption ever less plausible.

The other essential ethical constraint on business activity is classical '*Distributive Justice*'. This notion has nothing to do with modern attempts to redistribute income on ideological grounds. Rather, it expresses the fact that business is more likely to achieve its definitive purpose when it encourages contributions to that purpose, and not to some other. Though the term may be

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<sup>24</sup> By Fred Smith of the Competitive Enterprise Institute.

unfamiliar, the underlying concept is widely recognised. It is implicit in the commonly held view that productive workers deserve more than shirkers; when properly structured, both performance-related pay and promotion on merit are expressions of Distributive Justice. What Distributive Justice requires is simply that within an organisation, contributions to the organisational objective be the basis for distributing organisational rewards.

The key to Realist business ethics is very simple: *business is ethical when it maximises long-term owner value while respecting Distributive Justice and Ordinary Decency*. If an organisation is not directed at maximising long-term owner value, it is not a business; if it does not pursue that purpose while satisfying Distributive Justice and Ordinary Decency, it is not ethical.

**a. 'Good ethics is good business'**

This Realist approach helps explain the ways in which it is (and is not) true that 'good ethics is good business'. Conventional social responsibility and business ethics require diverting assets and attention from the official organisational purpose to extraneous ends. They are therefore liable to impede, when they do not altogether prevent, achievement of the organisational purpose.<sup>25</sup> Realist business ethics, in contrast, requires business to pursue its definitive end: to be an ethical business, an organisation must seek to maximise long-term owner value, subject only to respecting Distributive Justice and Ordinary Decency. Unlike current period accounting profits, owner value automatically reflects the distant, indirect and qualitative effects of a business's actions, including the ways in which it interacts with its stakeholders. Normally, therefore, owner value is enhanced when the business acts in accordance with Ordinary Decency and Distributive Justice. Nevertheless, 'good ethics is good business' is at most a slogan. It neither constitutes an ethical justification of ethical conduct by business, nor guarantees any association between ethical conduct and business success.

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<sup>25</sup> A major academic study of CSR in 2006 confirmed that in the U.K. general industrials sector, firms with the *worst* record for community and environmental 'social responsibility' produced average returns 30% and 70% *higher* respectively than firms with the most 'responsible' scores (compared with FTSE benchmarks). See Brammer, Stephen, Brooks, Chris and Pavelin, Stephen, 'Corporate Social Performance and Stock Returns: U.K. Evidence from Disaggregate Measures', *Financial Management*, Vol. 35, No. 3, Autumn 2006, p.114; <http://ssrn.com/abstract=938725>, The study was unusual because it analysed data at the level of the firm (rather than comparing investment funds), disaggregated measures of corporate social performance ('CFP') based on EIRIS (Ethical Research Services) published data, and attempted to correct the results for factors such as company size, risk and industrial sector.

***b. Social responsibility as 'conscientious stakeholding'***

So 'business ethics' has a genuine meaning, but one very different than that which is conventionally supposed. So, too, does 'social responsibility'. Properly understood, 'social responsibility' does not refer to any organisational responsibility *to* stakeholders. It instead designates a responsibility *by* stakeholders, to act so that their values concerning society are reflected in their actions. Social responsibility is exercised when individuals express their own values in their own acts, acting separately or in concert.

What they choose has important consequences for business conduct, because the definitive business end of maximising owner value obliges businesses to heed stakeholder preferences. When each potential stakeholder—otherwise known as every member of society—acts conscientiously in his personal capacity, and strategically bestows or withholds his economic and other support on the basis of his moral values, free market forces will automatically lead businesses to reflect those values. To the extent that the term 'stakeholder' helps remind people of their individual responsibilities to act conscientiously, it can serve a valuable function.

'Ethical' investing, the 'green' consumer movement and the growth of 'vigilante consumerism' are examples of how such 'conscientious stakeholding' can influence the way business operates. 'Conscientious stakeholding' can affect the products that businesses produce, and the conduct of business in producing them, and the strategic direction and structure of businesses. 'Conscientious stakeholding' can even influence the extent to which business, as opposed to other human activities, is pursued at all. And this accords with what is normally expected of social responsibility.

But for society accurately to reflect people's values, those values need to inform individuals' daily choices, and be reflected in their purchases and practices. The true values of a society are expressed not in what people say, or in what they are eager to do with other peoples' money, but in what they actually do with their own. Achieving social goals by way of conscientious stakeholding may be slow, and the outcomes may sometimes be disappointing, but voluntary action is a necessary condition of ethical conduct... by individuals and by organisations.

**6. Conclusion**

In summary, then, organisational mission statements and political rhetoric promoting conventional business ethics may seem innocuous, but they reflect confused and dangerous doctrines. As conventionally understood, business ethics and corporate social responsibility imperil not just business profitability, but the existence of business itself. Even more fundamentally, they threaten private property, and the individual liberty that is essential for genuinely ethical conduct. Combating the conventional approaches to business ethics and corporate social responsibility requires recognising two basic facts: that only a business can be an ethical business, and that to be an ethical business, an organisation must maximise

long-term owner value while respecting Distributive Justice and Ordinary Decency. The need to proclaim these fundamental truths is particularly important now, when the economic crisis is falsely being attributed to market failure rather than government action, and business is actively under attack. Liberty and the possibility of genuinely ethical business both need, and deserve, protection from conventional business ethics.<sup>26</sup>

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<sup>26</sup> This paper draws heavily on material that was originally published and is more fully explained and justified in Elaine Sternberg, *Just Business: Business Ethics in Action* (second edition; Oxford University Press, 2000; first edition, Little, Brown & Co (U.K.) Ltd, 1994), and in Elaine Sternberg, *Corporate Governance: Accountability in the Marketplace* (second edition; Institute of Economic Affairs, 2004). Additional material was first presented in lectures delivered at the American Enterprise Institute 3 March 2006, at the University of Leeds-IDEA-CETL 11 September 2008, and at the University of Buckingham 12 March 2009.