Corporate social responsibility

CORPORATE SOCIAL RESPONSIBILITY AND CORPORATE GOVERNANCE[1]

Elaine Sternberg

Corporate social responsibility ('CSR') is often associated with hopes for improved corporate governance. As understood conventionally, however, CSR is conceptually incoherent, practically unworkable, and wholly unjustified. To be compatible with corporate governance, 'CSR' needs to be understood not as Counterproductive Stakeholder Regimentation, but as Conscientious Stakeholder Responsibility.

Keywords: Corporate social responsibility, business ethics, stakeholder doctrine, corporate governance, liberty, accountability.

Introduction

Corporate social responsibility ('CSR') is often associated with hopes for improved corporate governance . . . and vice versa. As conventionally understood, however, CSR is conceptually incoherent, practically unworkable, and wholly unjustified. More realistically standing for 'Coercive Specious Reasoning' or 'Counterproductive Stakeholder Regimentation', CSR as conventionally understood would undermine the accountability and organisational objectives that are central to corporate governance.

This article will highlight the defects and dangers of the prevalent trend in corporate social responsibility, here referred to as the 'conventional approach'. The term covers an unfortunately broad range of academic and popular doctrines. But all characteristically claim that businesses, and people in their business capacities, must pursue some objective other than long term owner value in order to be ethical or responsible. Whether expressed in the language of stakeholding, the 'triple bottom line' or 'corporate citizenship', the conventional approaches identify extraneous responsibilities that businesses allegedly owe to others . . . their 'social responsibilities'. Fulfilling such 'social responsibilities' is what constitutes conventional business ethics.

Conventional meanings of 'corporate governance', 'corporate social responsibility' and 'business ethics'

The defects of conventional corporate social responsibility and business ethics, and of popular approaches to corporate governance, start with their lack of definition. Meanings are rarely made clear, and many of the ways in which key terms are used are either vacuous or pernicious.

Even official reports on corporate governance typically fail to identify what corporate governance is. According to the OECD (1998), it concerns 'the internal means by which [a corporation] accomplishes its performance' (p. 13)[2]; so described, it might refer to plant and equipment, staff, or retained earnings. Corporate governance is also not sufficiently identified by the official UK Cadbury (1992) and Hampel (1998) Reports. Their characterisation of corporate governance as 'the system by which companies are directed and controlled' could refer to the corporation's informal power structure, accounting rules, or even international law.

Equally nebulous are definitions of social responsibility. The OECD describes it as 'the actions taken by businesses to nurture their relationships with the societies in which they

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operate.'[3] This could include almost anything – from maximising profits to giving products away to bribing local officials. And consider the characterisation proposed by The World Business Council for Sustainable Development ('WBCSD'), a coalition of 200 international companies from more than 35 countries and 20 major industrial sectors: 'Corporate social responsibility is the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life.' (WBCSD, 2002, p. 2)[4]

These unsatisfactory definitions illustrate two key characteristics of conventional notions of social responsibility. First, they are vague. The many possible interpretations of 'nurtur[ing] relationships', 'sustainable economic development', 'improve[d] quality of life' and 'society at large' make the definitions dangerously indeterminate. Lacking both clear meaning and supporting argument, conventional doctrines of 'social responsibility' typically attract support on the basis of the label alone: few people are willing publicly to oppose that which is even nominally responsible. The second – essential – characteristic of the conventional approaches, is that they hold businesses and corporations responsible for something in addition to or other than fulfilling their definitive purposes. According to the WBCSD, that added end is nothing less than improved quality of life for society at large and its components.

Fundamental confusions

Failure to differentiate 'business' and 'corporation'

Conventional CSR is even confused about the ostensible object of its attention; it characteristically fails to recognise that companies and businesses are 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[5]: that of maximising owner value over the long term by selling goods or services[6]. That definitive business objective is commonly pursued *not* through corporations, but via sole proprietorships and partnerships.

In the United Kingdom, for example, only a quarter of businesses are corporate in form[7]. Far fewer still are the sorts of corporations presupposed by most commentators: a mere 1/10 of 1% of corporations – and thus an even tinier percentage of businesses – have shares listed on the Stock Exchange.[8] Conversely, more than half of the companies listed at Companies House are not businesses.[9]

When, therefore, advocates of business ethics 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 corporate governance and of corporate responsibility.

Failure to recognise the role of purpose

Conventional approaches to CSR suffer from even more egregious confusions concerning their ethical judgements. 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.

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

According to the conventional approach, business is 'socially responsible' only if it pursues some 'socially responsible' objective: common candidates include 'corporate citizenship', 'stakeholder interests', and the 'triple bottom line'. The way for a business to be ethical, is allegedly to pursue some social welfare, environmental or religious end in addition to or in place of profits.

But though such views are very widely held, they are, nonetheless, literally absurd: they make refraining from business the condition of being responsible or ethical in business. Business is a specific activity, with a definitive end – 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 organisations neglect their definitive purposes, they fail to be businesses or corporations of the relevant sort. But such disregard is just what conventional CSR and business ethics 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: what it advocates is literally a contradiction.

CSR proponents may now protest: they don't usually advocate abandoning the business or corporate purpose. Some merely want to restrain it, by combining it with other, supposedly more worthy ends. When goals conflict, however, one must – logically and practically – take precedence.[10] For CSR advocates, it is typically 'social responsibility' that dominates, and the corporate or business purpose that gets sacrificed. Other CSR supporters also ostensibly want the business or corporate purpose to be pursued, but in ways that serve the interests of stakeholders rather than just shareholders. That qualification may strike many as both small and unobjectionable. As will be argued below, however, it is neither. Any qualification of the corporate end constitutes an alteration of it. Unless such a change receives shareholder consent, it represents a direct infringement of corporate governance . . . even if initiated by the company's own managers or board of directors.

'Corporate governance' defined

Strictly understood, corporate governance refers exclusively to '. . . . *ways of ensuring that corporate actions, agents and assets are*

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directed at achieving the corporate objectives established by the corporation's shareholders. (Sternberg, 2004, p. 28; italics in text) The purpose of corporate governance is to ensure that corporations are directed at their constitutional objectives . . . whatever those objectives may be. Assessments of corporate governance measure the regulatory effectiveness of corporate means, not the moral quality of corporate ends. Accordingly, one way to improve corporate governance might be to have corporate constitutions designate a more specific, well-defined objective[11] than 'ordinary (or general) corporate purposes'. Conventional CSR, in contrast, undermines corporate governance, insofar as it advocates overriding or qualifying the official corporate objective: shareholder consent for the goals sought by CSR is seldom sought, far less obtained.

The 'Stakeholder Doctrine' repudiated

Rather, the legitimacy of conventional CSR is typically just assumed, often on the basis of the profoundly defective Stakeholder Doctrine. As criticised here, the 'Stakeholder Doctrine' (aka 'Stakeholding', 'Stakeholder Theory' or the 'Stakeholder Model') is not about motivation or functional relationships (Sternberg, 2004, pp. 127–128) but about entitlements. It is a normative doctrine, with two essential tenets: organisations should be run for the benefit of all their stakeholders, and organisations should be accountable to all those stakeholders for doing so.[12] 'Stakeholders' typically designates everyone and everything that can affect, or be affected by, the organisation; given the interconnections made possible by modern technology and telecommunications, stakeholders are thus infinite in number.[13] Most of the criticisms would, however, apply even if 'stakeholders' referred only to some more limited subset, such as shareowners, employees, suppliers, lenders, and customers.

The Stakeholder Doctrine is incompatible with business

The Stakeholder Doctrine is typically offered as an alternative to shareholder models of business, as a way of making business more ethical or 'socially responsible'. But far from being a sensible model of either business or other substantive organisational objectives, the Stakeholder Doctrine is not even compatible with them. The Stakeholder Model automatically precludes such substantive objectives, because it requires that what organisations be run for[14], is the benefit of all their stakeholders: Stakeholder Theory makes 'providing benefits for all stakeholders' the only legitimate organisational purpose. The Stakeholder Doctrine thus precludes all objectives that seek benefits exclusively or primarily for 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 children and employment for the blind.

Once again, advocates may object: what they champion is not dispensing with business and other particular objectives, but pursuing them accountably in ways that serve the interests of all the stakeholders. But consider what is involved in pursuing the definitive Stakeholder aim. 'Providing benefits for all stakeholders' is inherently ill-defined. It provides no criteria of what constitutes a stakeholder benefit, or what weight any such benefit should have; it gives no clue as to how to rank or reconcile the normally conflicting interests of stakeholders. It therefore allows each stakeholder – including the managers – to elevate pursuit of his own interests over both the ostensible organisational objective and the interests of the other stakeholders. With each stakeholder entitled to hold the organisation accountable for pursuing some different (and probably incompatible) end, there is neither occasion nor incentive for the organisation to pursue its notional substantive goal.

The Stakeholder Doctrine undermines accountability

The more likely outcome is, instead, serious damage to the relationship of agency, a vital component of corporate governance and of modern life. 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 is, however, effectively non-existent: an organisation that is 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 such well-defined purposes are precluded by the Stakeholder Doctrine.

The Stakeholder Doctrine is, accordingly, doubly destructive of corporate governance. It undermines the substantive objectives that give corporations their distinctive identities and reasons for being, and destroys the accountability that is central to keeping corporations directed at those objectives.

The Stakeholder Doctrine is unjustified

Not surprisingly, a doctrine suffering from such fundamental conceptual and practical defects is hard to justify. CSR supporters who presuppose it usually 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 realistic. Business must take many factors into account – including, for example, the weather and burglars. That does not, however, give those factors any right to hold it to account. Nor does the fact that competitors and other groups are affected by business give them any right to control it. A few Stakeholder advocates have recognised that their Doctrine's reductive organisational end and multiple accountability require justification. But though their efforts to support it have invoked grounds as diverse[15] as economic efficiency and Kantian deontology, all have been unsuccessful.[16]

Key implications of the Stakeholder Doctrine

The Stakeholder Doctrine is nevertheless extremely popular. One reason, is that its defects are seldom acknowledged. Another, is that it attracts the promoters of worthy 'causes', who (unrealistically) believe they would be the beneficiaries if organisational (and particularly business) assets were diverted

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from their owners. Significantly, the Stakeholder Doctrine also appeals to those – notably managers and politicians – who would gain from undermining accountability, particularly all who want the power, prestige and perks of office without the concomitant responsibilities.

Conventional 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 used to rationalise almost any kind of state intervention, no matter how intrusive or restrictive. It is therefore hardly surprising that conventional CSR and Stakeholding have increasingly informed official government policy in the US, UK and the EU.[17]

Conventional CSR is counterproductive

Conventional CSR undermines business

Conventional approaches to CSR are not only intellectually suspect, but seriously uneconomic. Most obviously, insofar as conventional approaches require diverting resources from core activities to extraneous ones, they would undermine not just business success, but business itself. Considered abstractly, that outcome might even be favoured by some CSR enthusiasts.[18] But the massive economic contraction that would result in practice is unlikely to be as welcome.

Conventional CSR is irresponsible and unethical

Conventional approaches to CSR also actively undermine responsibility and ethical conduct. 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 CSR. Inciting employees to cheat, steal, and betray their employers' trust is a strange way of promoting responsibility.

Conventional CSR undermines human rights

Even more fundamentally, 'social responsibility' as conventionally advocated would undermine basic human rights. Liberty (understood as the absence of physical coercion or threats thereof initiated against persons or their property by other persons) is restricted by all enforced prescriptions and proscriptions. Compulsory regulation to implement CSR prevents 'capitalist acts between consenting adults', and deprives stakeholders of the freedom to live their lives as they think best. That such regulation may be inspired by motives or directed at objectives that are considered ethical may well make the regulation more popular; it does not reduce its coercive nature, or increase its ability to produce genuinely virtuous conduct.

Even without state intervention, conventional CSR undermines key human rights. It 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 processed by organisations, CSR requires that those assets be used in 'socially responsible' ways, for 'socially responsible' purposes. When, however, corporations are hijacked from the ends determined by their shareholders, or business assets are diverted from business uses, owners and others are denied fundamental rights. In being obliged to serve conventional CSR ends rather than those they have chosen, they are treated as slaves. And everyone's freedom is threatened: any undermining of private property undermines all individuals' ability to exercise and protect their fundamental liberties.

The essentially illiberal nature of conventional CSR is further revealed by the 'social contract' argument often invoked to support it. Unlike the social contract theories of Hobbes and Locke, the contemporary CSR version does not limit authoritarian power; it instead attributes such power to society. The CSR version alleges that in exchange for society's consenting to provide the resources that organisations need to exist, and granting them a 'licence to operate', organisations become accountable to society. This claim does, however, ignore a defining characteristic of free societies: that whatever is not expressly prohibited is allowed, and that strict limits apply as to what may be officially prohibited. All the powers needed to form and run organisations (including the ability to associate, to enter into commitments and to enforce them[19]) are possessed naturally, rather than as privileges granted by society. The willing cooperation of counterparties is indeed essential to organisational formation and operation, but consent in the sense of formal permission is largely irrelevant.

The CSR 'social contract' argument either relies on confusing accountability with functional responsiveness, or it is actually a threat: businesses must submit themselves to society's requirements, lest society prevent them from operating. That challenge looks very like extortion: agreeing not to inflict harm in exchange for compliance is not entering into a social contract, but running a protection racket. Conventional CSR and its presumed 'licence to operate' are essentially inimical to liberty.

The dangers of appeasement

Unfortunately, despite the defects of the conventional approach to CSR and business ethics, many businesses have apparently endorsed it: they have perhaps sought to deflect CSR activists' wrath by consulting them, appearing to agree with them, and even funding them in hopes of buying approval. But as has been observed[20], that's as likely as converting a crocodile to vegetarianism by feeding it your leg. Businesses that even appear to accept conventional CSR, render themselves liable to be judged by its standards. They thereby strengthen the false belief that those standards are legitimate, and fortify expectations that they should be generally applied. Pandering to CSR activists typically encourages them to escalate their unethical demands.

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Realist business ethics

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

Business ethics is about conducting *business* ethically . . . which means pursuing the business objective while satisfying two straightforward ethical constraints. The applicable constraints are just the ones that must be respected for the purpose of business – maximising long-term owner value – 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, fairness, and the absence of physical violence and coercion. Collectively, these constraints embody what may be called '*ordinary decency*'.[21]

Furthermore, since business is more likely to achieve its definitive purpose when it encourages contributions to that purpose, and not to some other, classical '*distributive justice*' is also essential. Though the term may be 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.

'Good ethics is good business'

This Realist approach helps explain the ways in which it is true that 'good ethics is good business'. Genuinely ethical conduct typically improves, rather than impairs, business performance, because being ethical in business does not involve pursuing the extraneous ends prescribed by conventional CSR. Quite the contrary: ethical business must seek to maximise owner value, subject only to respecting distributive justice and ordinary decency. Moreover, owner value (unlike current period accounting profits) automatically reflects the indirect, distant, and qualitative effects of a business's actions. It is normally enhanced when the business treats its stakeholders with ordinary decency and distributive justice.

Social responsibility as 'Conscientious Stakeholding'

Just as 'business ethics' has a genuine meaning, but one very different than that which is conventionally supposed, so 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 makes it essential for 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.

'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 not just the products that businesses produce, but also 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 people's 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.

Understood as conscientious stakeholding, social responsibility is also fully compatible with corporate governance. Unlike conventional CSR, conscientious stakeholding does not undermine either the accountability or the organisational objectives that are central to corporate governance. Conscientious managers and directors express their own views in their private capacities; they do not hijack others' property in support of questionable 'socially responsible' ends.

1. This paper draws heavily on material that was originally published and is more fully explained and justified in Sternberg (1994/2000), (1999) and (2004). Additional material was first presented in lectures delivered at the American Enterprise Institute (3 March 2006), the University of Leeds–IDEA–CETL (11 September 2008), and the University of Buckingham (13 March 2009).
2. Cf. its 2004 update, in which corporate governance is not defined at all, but broadly characterised: 'Corporate governance relates to the internal means by which corporations are operated and controlled' (OECD, 2004, p. 2).
3. Through its Investment Committee: Organisation for Economic Co-operation and Development, *Corporate Responsibility: About*. Available at www.oecd.org/document/33/0,2340,en_2649_33765_ 933025 _1_1_1_1,00.html (accessed 29 March 2009).
4. Cf. the definition showing 20 July 2009 on WBCSD's main CSR page: 'Corporate social responsibility is the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large.' Available at www.wbcsd.org/templates/TemplateWBCSD5/ layout.asp?type=p&MenuId=MTE0OQ&doOpen=1&ClickMenu=LeftMenu, taken from WBCSD (1999, p. 3).
5. And derivatively the activity of pursuing it, and those organisations (of whatever structural form) that have the business objective as their sole or

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defining purpose. Much confusion in conventional business ethics comes from assuming that the business objective is as alterable as the corporate objective.

6. 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 Sternberg (1994/2000), especially Chapter 2.
7. According to the most recent statistics available February 2009, the total number of enterprises of all sizes in the UK private sector (including public corporations and nationalised bodies) was 4,679,080 at the start of 2007, of which only 1,187,520 (25.38%) were companies. The others were partnerships (506,805) and sole proprietorships (2,984,755; 63.79%). (BERR, 2007).
8. According to the most recent statistics available February 2009 (those of December 2008), the total number of UK companies (including those with no equity) listed on the Main Market of the London Stock Exchange was only 1,174, down from 1,270 January 2007. Even the 2007 figure represents .001069 of the 1,187,520 UK companies, and .000271 of all UK businesses. (LSE, 2008).
9. According to the most recent figures available February 2009 (Companies House, 2008), as of 4 January 2009 there were 2,752,094 companies in the UK of which 9,955 were public companies. Subtracting the 1,187,520 business companies (see note 7 above) from that total leaves 1,564,574 companies (56.85%) that were not businesses.
10. 'No man can answer to two masters' . . . far less to many. See, for example, Jensen (2002).
11. For example, 'maximising long-term owner value by manufacturing and selling footwear while respecting Realist ordinary decency and distributive justice'. For an explanation of these terms, see Realist Business Ethics, below.
12. See, for example, the many works of R. Edward Freeman, including (2003, pp. 55–64). See also the much cited Donaldson and Preston (1995).
13. This definition is, nevertheless, the one adopted by, for example, the Body Shop (Suzman, 1996, p. 20) and the European Union: 'Stakeholder: an individual, community or organisation that affects, or is affected by, the operations of a company' (EU Commission, 2001, Concepts Annex, p. 28).
14. That organisations in free societies typically do benefit all their stakeholders is no evidence of their being run *for* that purpose. Quite the contrary: the benefits typically result because the organisations pursue the substantive objectives that define their reasons for being.
15. E.g., The Performance Argument, The Parallel with Government, The Residual Risk Argument, Treating Stakeholders as (Kantian) Ends, Rawlsian Fairness, The Social Contract/Licence to Operate Argument.
16. See, for example, Sternberg (2004, pp. 136–147). It is noteworthy that R. Edward Freeman, perhaps the foremost proponent of the Stakeholder approach, has progressively retreated in response to criticism; see, for example, Freeman (2004, pp. 413–415). But his defensive position suffers from the defects of Stakeholder Doctrine and from other defects as well.
17. In respect of, for example, directors' duties, takeovers and pension fund investments.
18. See, for example, Manheim (2003).
19. By, e.g., ostracising offenders.
20. By Fred Smith, President of the Competitive Enterprise Institute.
21. When initially developed, in Sternberg (1994/2000), ordinary decency included as a fourth component a presumption in favour of legality. But the increasingly cavalier attitude even of the US and UK governments has made that presumption ever less plausible.

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Dr. Elaine Sternberg is a Visiting Research Fellow of the University of Leeds School of Philosophy and its IDEA-CETL, a Senior Visiting Fellow of the University of Buckingham Beloff Centre for the Study of Liberty, and Principal of a business ethics consultancy firm (Analytical.Solutions@ethicalgovernance.com).
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