

WHAT IS A CORPORATION?

Adapted from “How Corporate Law Inhibits Social Responsibility”

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If you pick up a dictionary or encyclopedia, a corporation is a “specific legal form of organization of persons and material resources, chartered by the state, for the purpose of conducting business.” The corporate design contained in hundreds of corporate laws throughout the world is nearly identical. That design creates a governing body to manage the corporation—usually a board of directors—and dictates the duties of those directors. In short, the law creates corporate purpose. That purpose is to operate in the interests of shareholders. In Maine, for example, this duty of directors is in Section 716 of the business corporation act, which reads:

the directors and officers of a corporation shall exercise their powers and discharge their duties with a view to the interests of the corporation and of the shareholders.

Although the wording of this provision differs from jurisdiction to jurisdiction, its legal effect does not. Distilled to its essence, the provision says that the people who run corporations have a legal duty to shareholders, and that duty is to make money. Failing this duty can leave directors and officers open to being sued by shareholders. Section 716 dedicates the corporation to the pursuit of its own self-interest (and equates corporate self-interest with shareholder self-interest).

No mention is made of responsibility to the public interest. Section 716 and its counterparts explain two things. First, they explain why corporations find social issues like human rights irrelevant—because they fall outside the corporation’s legal mandate. Second, these provisions explain why executives behave differently than they might as individual citizens, because the law says their only obligation in business is to make money.

This design has the unfortunate side effect of largely eliminating personal responsibility. Because corporate law generally regulates corporations but not executives, it leads executives to become inattentive to justice. They demand their subordinates “make the numbers,” and pay little attention to how they do so. Directors and officers know their jobs, salaries, bonuses, and stock options depend on delivering profits for shareholders.

Companies believe their duty to the public interest consists of complying with the law. Obeying the law is simply a cost. Since it interferes with making money, it must be minimized—using devices like lobbying, legal hairsplitting, and jurisdiction shopping. Directors and officers give little thought to the fact that these activities may damage the public interest.

Lower-level employees know their livelihoods depend upon satisfying superiors’ demands to make money. They have no incentive to offer ideas that would advance the public interest unless they increase profits. Projects that would serve the public interest—but at a financial cost to the corporation—are considered naive.

Corporate law thus casts ethical and social concerns as irrelevant, or as stumbling blocks to the corporation’s fundamental mandate. That’s the effect the law has inside the corporation. Outside the corporation the effect is more devastating. It is the law that leads corporations to actively disregard harm to all interests other than those of shareholders. When toxic chemicals are spilled, forests destroyed, employees left in poverty, or communities devastated through plant shutdowns, corporations view these as unimportant side effects outside their area of concern. But when the company’s stock price dips, that’s a disaster. The reason is that, in our legal framework, a low stock price leaves a company vulnerable to takeover or means the CEO’s job could be at risk.



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