

# The Missing Dynamic: Corporations, Individuals and Contracts

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**ABSTRACT.** There are two opposing views on the nature of corporations in contemporary debates on corporate social responsibility. Opponents of corporate personhood hold that a corporation is nothing but a group of individuals coming together to achieve certain goals. On the other hand, the advocates of corporate personhood believe that corporations are persons in their own right existing over and above the individuals who comprise them. They talk of corporate decision-making structures that help translate individual decisions and actions into corporate decisions and actions. Importantly both the advocates and the opponents of corporate personhood rely on a contractual model of corporate–social interaction to explain corporate social responsibility. However, this contractual model misses crucial aspects of the relationship between corporations and societies. Economic history reveals that the relationship between corporations and societies is essentially dynamic and heterogeneous and so extremely difficult to characterise in terms of a contract. The economic and the political aspects of this relationship are so finely intertwined with each other and it is impossible to extricate the one from the other. We need to be more conscious of the actual nature of corporate–social interaction in order to deal more comprehensively with issues of corporate social responsibility.

**KEY WORDS:** corporate personhood, corporate social responsibility, contract theory, economic history, society

## Introduction

In the debates on corporate social responsibility, efforts have been made to distinguish those social responsibilities that genuinely belong to the corporation from those that do not. This distinction between real and merely apparent responsibility is always based on some sort of preliminary understanding of what a corporation is, which in turn requires an understanding of how the

corporation functions and how it interacts with society.<sup>1</sup> Thus debates on corporate social responsibility necessarily overlap with debates on corporate nature. Questions regarding the nature and the extent of corporate social responsibility cannot be divorced from questions regarding the nature of corporations. Now contemporary discussions of corporate nature have essentially centred on the notion of corporate personhood. There are traditionalists who hold that a corporation is nothing but a group of individuals who have come together to achieve some specific goals. There are advocates of corporate personhood who hold that corporations are persons in themselves and exist over and above the individuals who comprise them. They talk of structures crucial to corporations that help translate individual decisions and actions into corporate decisions and actions.

In my article, I would like to show that despite their different approaches to corporate social responsibility, the traditionalists and the advocates of corporate personhood rely upon some version of contract theory to describe how corporations interact with society. By bringing to bear some crucial insights from economic history on the corporate–society relationship, I argue that the contractual model fails to bring to light its dynamic and unpredictable nature. I further argue that we can reveal the full range and scope of corporate social responsibility only if we recognise this.

## The inseparable link between theories of corporate social responsibility and corporate nature

The traditionalists – the opponents of the notion of corporate personhood – believe that corporations are

not separate persons but only a collection of individuals. So any misdemeanour or morally repugnant act attributed to the corporation has to be, strictly speaking, attributed to an individual or a group of individuals belonging to the corporation. They argue that corporations cannot be sent to jail or fined; only individual human beings can. Traditionalists therefore recommend that “corporations” can be deterred from indulging in morally repugnant practices only by imposing heavy fines or severe punishments upon the individuals responsible for such practices. In their understanding it is ultimately only individuals such as the CEO or the board of directors who are responsible for the unlawful actions that we attribute to “corporations.”

Advocates of corporate personhood, on the other hand, believe that corporations are separate entities over and above the specific individuals who constitute them. They believe that its individual personality is revealed by its internal decision-making structure. This internal corporate decision-making (CID) structure can be understood independently of the individuals constituting the corporation. Even though the CID depends upon individuals for its implementation, it is independent of the specific intentions of those individuals and reveals the intentions of the corporation. The individuals working for the corporation may come and go. The owners might change but the CID might remain the same and if so the corporation retains its personality and its style of functioning. This style of functioning gives the corporation its individuality and grants it a personhood. The advocates of corporate personhood would admit the possibility of cases in which the blame for a morally reprehensible act may not be pinned upon any specific individual or group of individuals in the corporation. It may very well be that the corporation’s CID or the style of functioning may be responsible for the act. In that case only a serious revamp of the corporation’s CID or style of functioning would prevent such disasters. Punishment of certain individuals or imposition of heavy fines alone would not be effective in this case. Traditionalists would not be able to revamp the corporation’s internal decision-making structure or its style of functioning because they do not accept the notion of corporate personhood and subse-

quently do not recognise the independent efficacy of the corporation’s CID or its style of functioning.

The two accounts of corporate social responsibility, however, imply a common understanding of corporate–social interaction. We can give a preliminary account of this interaction as follows: On the one hand, the corporation sells a variety of goods and services that the consumers may choose to purchase for their benefit. So the corporation and society relate to each other as a seller relates to a buyer. The relationship can be viewed as a voluntary partnership of mutual benefit. On the other hand, a corporation typically employs a large number of individuals to manage its operation. The scale and the complexity of its operations are roughly proportional to the number of employees.

The corporation is thus seen in both accounts as selling its goods and services to society for a price and buying the services of its employees who are members of society for a price. The two accounts vary only to the extent that they designate the corporation differently. The traditionalists claim that the corporation is nothing more than the sum of its parts while the advocates of corporate personhood claim that the corporation is an entity over and above the sum of its parts. In this scenario it seems that the corporation is only responsible for providing goods and services of a quality that is commensurate to its price and for paying its employees wages that are commensurate to the services rendered by them. The corporation may not, for example, knowingly sell harmful products to its consumers without a prior warning of its dangers. It cannot delude its consumers regarding the potential benefits of a product. It has to see to it that its employees are fully aware of the hazards that come with the work they are doing. Thus questions of corporate social responsibility cannot be separated from questions of corporate nature and they imply an account of corporate–social interaction. Moreover, the interaction implied in these accounts is essentially of an economic nature. But our question is: Does this account reveal all the contours and complexities of corporate–social interaction? The ensuing discussion will throw some light on precisely this topic.

Before we delve into the subject of corporate–social interaction, we need to analyse the arguments of the advocates and the opponents of corporate personhood to see how their account of corporate

nature implies an account of corporate–social relationship that is essentially contractual in nature.

### **The traditionalists and their idea of corporations**

Traditionalists like Manuel Velasquez and John Danley hold that corporations do not have a separate identity over and above the individuals who constitute it. They hold that corporations do not have any real existence like human beings, trees, animals, insects or other occupants of the earth. So corporations, according to them, cannot be persons and therefore they cannot bear any responsibility unlike human beings who are the only ones who can. These writers are mainly concerned with the question of which human being or group of human beings is to be blamed in case of a corporate misdemeanour. They argue that if one accepts that a corporation can commit a crime like a human being then it will also have to be punished like a human being. The latter being impossible in the case of the corporation they argue that the corporation then can only be a useful piece of legal fiction. As Danley states:

The traditionalist recognises the corporation as a legal fiction which for better or worse may have equal protection under the law of other persons, but the traditionalist may accept those legal trappings as at best a useful way of treating the corporation for legal purposes. For the traditionalist it makes moral sense for the law to go inside the corporation. After all, morally the corporation is not responsible: only individuals are. As long as those within the corporation pay for the deed, there is no theoretical difficulty.<sup>2</sup>

The claims that these writers make have significant implications for the strategies to be employed for fixing corporate disasters and preventing further disasters. If we carefully go through what we have said before, it becomes clear that these writers hold that corporate responsibility is just a metonymy. That being the case it is possible, they believe to precisely pinpoint those individuals in the corporation who are responsible for the corporate crime and bring them to justice. Punishment of these individuals, according to them, is bound to discourage corporate misde-

meanours. Corporations cannot be fined because, according to these writers, there are no entities such as corporations that cough up the fines. On the contrary it is individuals like the shareholders or the consumers who eventually pay these fines. This is made clear from what Danley says:

The corporation cannot be kicked, whipped, imprisoned, or hanged by the neck until dead. Only individuals of the corporation can be punished. What of punishment through the pocketbook, or extracting compensation for a corporate act? Here too, the corporation is not punished, and does not pay the compensation. Usually one punishes the stockholders who in the present state have virtually no control over corporate actions. Or, if the corporation can pass on the cost of fiscal punishment or compensation, it is in the end the consumer who pays the punishment or compensation.<sup>3</sup>

We must, however, be absolutely clear that this does not in any way stop the traditionalists from treating corporations as legal entities. What is important is that we realise how they interpret this notion of a legal entity. If the residents of town Z sue corporation X for environmental damage, corporation X is not the person who will go to jail or pay the fine in case he is found guilty. Corporation X merely stands for the directors or the CEO or the shareholders or the specific employees responsible for the damage. When the judge declares that corporation X is guilty that is only a way of saying that the individuals representing corporation X are guilty. Corporation X is nothing more than a designator. It does not stand for a moral entity called corporation X. So the corporation may very well be a legal entity. But that does not amount to saying that the corporation is a moral person.

### **The advocates of corporate personhood and their idea of a corporation**

Advocates of corporate personhood such as Peter French, R. Edward Freeman, Kenneth Goodpaster and Jeffrey Nesteruk hold that corporate identity goes beyond the identity of its individuals. French uses the term “Corporation Internal Decision Structure” (CID) to express the notion of corporate identity. What is the CID structure? The CID structure is an “established way in which [the cor-

poration] makes decisions and converts them into actions.”<sup>4</sup> The CID structure is thus an organisation of the decisions and the actions of the various personnel such that they can be redescribed as corporate decisions and actions. It comprises, on the one hand, of organisational rules that define the relationship between the various personnel. For example the CEO is in a superior position to the Director of Internal Audit. On the other hand, it comprises of policy or procedure rules that tell us how actions need to be performed if they have to be considered corporate actions. For example if the decision taken by the treasurer and his team need the ratification of the vice-president for finance and administration then only with his ratification does the action become a corporate action.

So once we have a meaningful way of saying that corporations perform actions we can also say that corporations exist. Having accepted the existence of corporations as a fact, Freeman goes on to use the Kantian dictum, which forbids any individual from being used merely as a means, to espouse his stakeholder theory of the modern corporation. The modern corporation must ensure that its decisions do not lead to treating others only as a means to an end. This can be done by having those who are likely to be influenced by the actions of the corporation participate in its decisions. It might be the case, however, that they choose not to participate in these decisions but it is necessary to give them that opportunity. Every corporation has stakeholders who are groups of people either benefiting or being harmed by the corporation. The corporations may not “violate the legitimate rights of [stakeholders] to determine their own future.”<sup>5</sup> The corporations are also “responsible for the effects of their actions on other[s].”<sup>6</sup>

Peter French uses Nozick’s concept of side-constraints to prescribe a manner in which the relationship between corporations and human beings ought to be. French says that corporations are permitted to further their own ends provided they do not violate any side-constraints. Side-constraints, according to Nozick, express the inviolability of certain persons. What does it mean to say that a person is inviolable? French uses Kantian vocabulary to explain it as follows. To say that a person is inviolable is to say that he should not be treated as a means to our end without his consent. But he also

argues for another side-constraint, which he says can override the above side-constraint. Corporations and human beings can treat each other as a means without the other’s consent if it is done “for the maintenance of the basic conditions for [them] to lead a worthwhile life.”<sup>7</sup>

These writers do not stop with acts of deterrence like the punishment of the individuals found responsible and imposition of fines upon the corporation. They, in addition, also advocate reforming its CID structure to prevent further disasters.

The corporation, in this case, cannot just be reduced to the individuals who constitute it in its present state. Since the individuals comprising the corporation change over time, the advocates of corporate personhood focus on more lasting structures like the CID. The CID structure, as we have seen it defined, determines the behaviour of the individuals comprising the corporation. So reforming the CID structure would also lead to a reform in the way the latter behave. So in addition to holding individuals responsible, these writers also unearth the underlying causes for their behaviour and if it can be traced to the CID structure, then only reforming it would help to prevent further disasters.

### **The contractual model of corporate–social interaction**

Let us carefully consider the arguments of the two sides, namely, the proponents and the opponents of corporate personhood, with respect to the question of corporate social responsibility.

The opponents of corporate personhood hold that corporations simply do not exist as persons. Hence they cannot be held responsible for anything as persons would. As only individuals can be responsible towards something, corporate responsibility very cleanly reduces to the responsibility of some individual or group of individuals working for the corporation. What in the end does this responsibility amount to? Who or what are those individuals who form the corporation responsible to and how do they discharge their responsibility? The arguments of writers like Velasquez and Danley suggest that if an individual or a group of individuals has been harmed, they must be compensated and those in the corporation responsible must be punished. Thus,

the corporate members ought to act as if they had entered into some kind of contract with that individual or group and the terms of this contract forbade them from inflicting harm upon one another. This is precisely what Danley suggests in his article when compares the corporation to a complex machine that corporate members must operate with great care to ensure that no one is harmed. We can see that this argument has lent itself very easily to the language of contracts. The individual or group who had caused harm (in our case an individual corporate member or a group of corporate members) must compensate those who have been harmed. It is as if a contract had been signed between two groups of individuals – one constituting the corporation and the other constituting society into which the corporation came into being. It is society that benefits or suffers from the corporation's actions.

The proponents of corporate personhood believe that there is corporate responsibility over and above individual responsibility. But how do they understand this responsibility? French argues that the corporation must pursue its goals in such a way that it does not violate certain already defined side-constraints. Freeman, in a similar vein, argues that corporations must act in such a way that they do not infringe upon the rights of their stakeholders. Again, this argument as in the previous case, lends itself all too easily to the language of contracts. The corporation is an individual entering into a contract with other individuals. In the case of Freeman, the corporation ought to act as if it had entered into a contract with the individual members of society which forbids infringing upon their rights by treating them as a mere means to an end. French's argument is a little more complex but we could still translate it as follows. The corporation must act as if it had entered into a contract with individual members of society, which permits that the individuals be used as means only when the "basic conditions"<sup>8</sup> for a "worthwhile life"<sup>9</sup> are in jeopardy.

We can see that both sides formulate corporate responsibility by resorting to some form of social contract theory. Corporations and society interact with one another as if they had signed a contract with one with other. This contract permits certain ways of acting and forbids certain other ways. Even

though the proponents of corporate personhood understand corporate responsibility as something that differs from individual responsibility yet they see it along the same lines as individual responsibility. They see the corporation as one person among many albeit more powerful. Its relationship to the individual is understood as if the two had signed a contract when the former first came into being.

It is important to note here that both the opponents and the advocates of corporate personhood view this unwritten social contract as a static entity whose terms decide how corporations and society interact with each other. The advocates of corporate personhood do seem to recognise the complexity involved in corporate actions. But the CID structure, which they use to understand corporate action, does not capture the dynamic relationship that corporations have to society. These various formulations of the contract seem to imply that the relationship between the corporation and society is unchanging and homogeneous. Economic history, however, shows us that the relationship between corporations and societies are too dynamic and rather unpredictable to be moulded on the idea of a social contract. To this end we will be examining the history of British Joint-Stock Banking, the East-India Company and the South Sea Company.

### **The Bank of England and British joint-stock banks**

With the establishment of the Bank of England, England made its first foray into the world of formal banking.<sup>10</sup> This Bank was given its charter to make small short term loans available to the government by printing notes for circulation. It was first and foremost an economic entity. The Parliament made the bank into a central entity when it established a statute that disallowed rival banks of more than six partners. Its functions could be broadly classified into the political and the non-political. It had the political function of producing notes and the economic function of lending to merchants. In its latter function, it was like any other bank of its time and thus in competition with all other banks. But as note issuer, it was clearly distinct. This division between its political and economic function was less of a reality

when one considers how the bank had to keep the quantity of notes it printed under check to stabilise the prices on the one hand and how it could profit from excessive note-issuing on the other hand. Thus its economic interests, as it were, clearly infringed upon its political duties; for which reason it is impossible to discern whether its interests were purely economic or purely political.

Apparently it was very difficult to prevent the directors from abusing the bank's note-issuing authority to make profits for its shareholders. The bank was after all only a private entity with a special privilege. One of the ways to prevent abuse of its note-issuing authority was to issue notes only in proportion to the amount of gold the bank had in its vaults. But although these measures ought to have been successful, they were never really successful in practice; consequently, the bank had to fend off one crisis of liquidity shortage after another. In all these crises state intervention became necessary. But after the big liquidity crunch of 1825, Lord Liverpool's ministry finally decided to permit banks with more than six partners to be set up beyond a 65 mile radius of London to ease the burden of the central bank when it came to providing credit.

With the dilution of the monopoly of the Bank of England joint-stock banks began to emerge in Britain. Insofar as these banks did not have a fixed constitution, they developed with an eye on local conditions and needs. Initially these banks were voluntary associations of merchants who had the assets to pool into their formation and completely represented the interests of these merchants. Credit worthiness was decided by acquaintance. The voluntary private banks were not concerned with the overall financial or the political situation of their region, which very soon became a serious drawback of these institutions. The rapid industrial growth that characterised the early 19th century soon saw these private voluntary banks go obsolete as they found it increasingly difficult to cater to the needs of the growing industrial towns. They had now to integrate themselves better into the national economy if they hoped to survive. In order to start competing in the revenue market, they began to resemble their counterparts in London like the Bank of England.

The republican joint-stock banks thus gave place to democratic joint-stock banks. These banks were first formed in London but they eventually began

linking up with the existing provincial banks also helping to start new provincial banks. The provincial banks now acted as branches of their metropolitan counterparts while the latter acted as advisors and agents to the former. The provincial banks received information as well as rules and regulations on how to conduct their proceedings. They were also supported by their metropolitan counterparts who acted as agents and banks of deposit. The provincial banks would no longer have to keep their deposits on hand waiting for customers in the provinces to borrow but could instead deposit it in their metropolitan counterparts.

But, the democratic ideals on which these banks came into being were eroded over time. In order to survive they required that the shareholders and customers be educated enough to understand the new culture of banking and their roles as a shareholder or customer. The management of these banks did not want to have shareholders from the upper classes because they feared that these shareholders would possess the wealth and the power to influence their decisions. They therefore avoided wealthy ladies and the landed elite in the name of democracy. At the same time, they also wanted to avoid people from the lower class, but of course they could hardly defend this policy in the name of democracy. To achieve these ends the banks took the help of the state legislature in order to establish "more explicit principles of exclusion"<sup>11</sup> for deposit accounts. A distinction was thus created between working class savings bank depositors and the banks' own middle-class customers. The former were strongly encouraged to open savings accounts with public institutions like the Post Office.

From 1844 onward, the banks started changing the ways they conducted business. They started taking interest not only in domestic but also in foreign customers. The latter were mostly loan customers; subsequently, foreign loans became a major part of the banks' business. The domestic customer was mainly a depositor. The banks thus had two primary functions, namely, paying interest on domestic deposits and obtaining interest from foreign loans. In so doing, they made a profit for themselves by maintaining a difference between the borrowing and the lending interest rates.

The banks found it much easier to handle the loans they made out to foreign customers because

being foreigners they could not avail of the constitutional machinery of the state to demand lower interest rates. They had no option but to simply accept these rates. The debit side was far more democratic because the depositors being mainly British citizens could make use of the official and state machinery to demand a higher return for their savings. In addition to fending off attempts to increase the return on savings, the banks had also to ensure that the depositors did not withdraw their deposits en masse. At the inception of these joint-stock banks the shareholders were completely liable in the case of bad loans. But shareholder confidence had waned after the demise of two major banks in 1878. They had become very apprehensive of pledging all their property on an uncertain venture. The banks thereby switched from full liability to a system of limited liability of the shareholder. The banks had no problems in raising shareholder confidence under limited liability. However, in order to secure depositor confidence they had to resort to means bordering on the deceptive. But the results were there to be seen. Depositors still preferred banks as a vehicle for their savings despite this change to limited liability with deposits continuing to rise.

The joint-stock banks had by now established a firm presence in London and the provinces and were vying with the Bank of England for position in the market. Towards the end of 19th century, these banks were streamlining their operations, employing the latest technologies and improving their efficiency by leaps and bounds. Moreover, a strong work-force wedded to the ideals of professionalism meant that these banks never faced any serious labour unrest unlike in the railways. But the most significant development, which not only reshaped the banking industry but also the whole of British society was the amalgamation of banks. The late 18th and the early 19th century had seen a great number of banks under different managements sprouting out all over the provinces in England. In the late 19th and the early 20th century that movement came to a gradual standstill and banks now began merging with one another to form very powerful entities. At the same time, they were opening branches all over England – even in its most remote provinces. In 1850, there were as many as 99 joint stock banks in England. In 1913, this number

reduced to 49 till at last in 1918 there were but four major joint stock banks with innumerable branches spread across the country.

As their operations spanned the whole of Britain, these banks gained a tremendous clout in society at large. In this new incarnation they had succeeded in earning a truly national character. They were driven by a desire to play a powerful social role and they were doing this not at the behest of the state but of their own accord. By using the media to constantly broadcast their economic strength and the indispensability of their services they succeeded in winning new customers by creating a deep and favourable impression upon the common populace. This was evident in the way deposits soared towards the end of the 19th and the beginning of the 20th century. Nothing could be a clearer indication of how they were transforming the lives of the people.

These banks thus had a strong deposit base. They had London brokers who were able to use their surplus deposits fruitfully without allowing them to lie cold. They were blessed with fine interest rates from foreign securities in which the brokers invested. All they needed now was to be extremely conservative in domestic lending by continuing the policies that had been developed since the mid-1800s and become even more conservative than they had been. The banks would not want to bear any risk when it came to lending, especially by granting loans to domestic traders. The banks did not want to make unwieldy big loans to domestic traders but wanted to spread their risks as much as possible by keeping their accounts small and manageable. But this was a big change from their policies of a few decades ago when as voluntary and provincial institutions they were created to cater to these domestic traders. So they had to do this without the traders being able to recognise this drastic change so the matter would not reach the parliament. This is where these banks could use their reach and their new found status as financial pillars of Britain. They advertised their policies as being in the very interest of the trader as it encouraged him to be more financially independent and responsible. The British businessman had been raised on these ideals and it was hard to resist this rhetoric. Traders now started pooling in their resources together to form joint-stock companies. These joint-stock companies were nothing more than trading associations and they

never managed to attain the efficiency of the banks. As a result they were never able to compete with the banks. Moreover, the banks used them to their own advantage by investing in the debenture stocks raised by these associations. The banks found it advantageous to lend money to these companies because they were entitled to demand security from them which was not the case with an individual borrower. The banks were in a better position than ordinary individuals to discern good securities and thus they could keep their distance from the industry without entirely alienating the industrialists.

We had seen before how banks created a new class of middle-class consumers and left the working class to short term savings accounts at public institutions like the Post Office. But given their new philosophy of spreading risks as thin as possible and avoiding large scale loans to individual domestic traders; those very short term accounts that they had previously shunned under a different pretext were now something to be coveted. They saw these government savings bank accounts as a threat to their interests and set out to compete with the Post Office in small savings. They used their standing as “conservative pillars of the British empire”<sup>12</sup> to raise their voice against the government treasury department and warn it of the consequences of putting tax revenue behind these savings accounts. The Post Office Savings Bank had about 14,000 branches by about 1900. While the banks enjoyed steady revenue from foreign loans and joint-stock companies which offered very low risk; the post office had a deposit base consisting solely of the local working class. As long as the interest rates were high the Post Office attracted a large number of working class customers. Since the amounts deposited were relatively small and for a relatively short period of time; the high interest rates posed no problems. But the fall in interest rates had rendered what had been a profitable venture in 1860 to a loss-making proposition as the small amounts became difficult to manage with no new customers being attracted. The officials at the Post Office therefore lobbied parliament for increases in the maximum annual amount and total amount of money that could be deposited. They hoped that this would attract wealthier customers to open savings accounts and thereby lessen the burden of the expensive small savings accounts. In 1891, Parliament obliged by raising the upper limit on total

deposits from £150 to £200 and the yearly minimum deposit from £30 to £50. The Post Offices, on their part, aggressively marketed their services. In response the joint-stock banks were regularly painting the dangerous consequences of the Parliament’s pandering to the public in their publications. In addition the banks had now started opening their own savings departments. Though there is no direct evidence to suggest that the government heeded these warnings, there were some developments that suggest that the joint-stock banks did win the savings account debate. The government gave a clearer definition of banking activities by distinguishing them from other social services. Savings bank accounts would thus fall under the ambit of banking activities. Moreover, the Post Office was no longer aggressive in retaining its hold over the savings deposit market. All these developments taken together suggest that the banks had got what they wanted by wearing down the resistance posed by a public institution like the post office.

### **The East-India Company**

The East-India Company came into being in 1600 for the sole purpose of doing trade in India. India at that time was not a single political entity but an agglomeration of various princely states. The company acquired permission to conduct business in these states from their respective sovereigns. It imported spices, textiles, tea and other indigenous materials from India and exported finished British goods to India. The company thereby had a monopoly over Indian trade.

By 1766, with victory in the Battle of Plassey, the company started gaining political control over the Indian princely states. Slowly but surely it was in complete political control of all the princely states. With this development, the whole of the Indian subcontinent had acquired a single political identity for the first time in its history. It was now a vast British colony.

We are, however, not interested in the company’s direct political role in India. That is quite obvious. What we are interested in is how the combination of its economic and political power in the subcontinent was making it a major factor in the political transformation of Britain.<sup>13</sup> We are not talking of a big

company consciously deciding to play a role in British politics. The East-India Company never aspired to such a role. On the contrary, it was disbanded in 1858 after the Sepoy mutiny in India to give way to direct British control over India with Queen Victoria being declared the Empress of Hindustan. But the company was always at the centre of political debate in Britain given its singular influence on the British economy. It polarised British opinion like none other and acted as a major catalyst for political change in Britain. The history of the company brings to the fore the intricacies of corporate-social interaction which are completely ignored by the rational reconstructions of this interaction implied in the debates on corporate personhood.

The affairs of the East-India Company worked on system of patronage. Anyone willing to pay the price could purchase the shares of the company. The shareholders acted as patrons to the board of directors because they had the power to vote people onto the board. The directors were willing to exchange the votes of the shareholders for prime appointments to company positions in India. The shareholders who formed the court of proprietors were a powerful group who influenced the company's affairs in India by having their friends and relatives appointed to prime company positions in India assuring themselves of some highly lucrative deals in the Orient. The system of patronage was, however, democratic in nature. Anyone who had the financial capability could become a shareholder.

This system of patronage, as we have seen, led to severe corruption within the East-India Company. The leading parliamentarians of the time were of the view that it was better to have a relatively corrupt East-India Company manage India than have the British parliament do it. They believed that that if India came under the direct control of the British parliament, there was a danger of the British ministers selling out to the wealthy who wanted to procure lucrative trade deals in India just like the directors. There was danger that this would jeopardise the political fabric of Britain bringing back the Old Corruption putting the civil liberties of the British public in jeopardy.

The monopoly of the East-India Company was seen as an acceptable price to pay to sustain the political stability of Britain. But this monopoly was at the same a severe economic disadvantage for

Britain. The company was generating revenue for the shareholders and the company employees. But it was doing this by raising the prices of Indian imports to absurdly high levels amounting to a novel way of taxing the British public.

British merchants also found the monopoly of the East-India Company prevented them from profiting from trade with India. These merchants had to transport goods to Britain by either buying space on company ships or by using foreign ports. Both options were equally expensive and minimised profit. Moreover, British manufacturers were keen to use India as an extensive market for their finished goods. But the East-India Company with its monopoly over India trade charged a price much higher than these manufacturers would have liked for their goods. These prohibitive prices prevented the natives from purchasing cheaper and higher quality British goods. Under James Mill and his fellow free traders, there was a consistent assault on the East-India Company to change its monopolistic practices. Mill encouraged British merchants to purchase stock in the company and use their privileges to usher in wide scale changes in its commercial policies and destroy its monopoly.

We can see that the company structure was always democratic. But democracy meant something completely different to the early shareholders and the British merchants who later brought stock in the company. The former never sought to change its trading practices but rather used their financial clout to get a good dividend on their shares. The British merchants, however, bought into the company with the explicit aim of changing its monopolistic trading practices so as to benefit themselves.

Despite a radical change in its commercial policy with the destruction of its monopoly, the East-India Company continued to run on a system of patronage. However, questions were being raised in the early 1800s as to whether patronage was a truly effective way of ruling India and running Indian trade. Corruption was rife in the East-India Company because the directors were always being tempted to trade votes for favours to the shareholders. The civil servants who were appointed to India had no qualifications whatsoever and they handled the political and economic situation in India very poorly. The results of all this were some very expensive wars with the native princes and a

very inefficient utilisation of India as a market. Reformers like Malthus wanted to change this and therefore suggested that the civil servants to India be selected on merit by means of a competitive exam. Lord Wellesley and Malthus came up with a plan that the prospective candidates to India would have to undergo training before they went to India. In accordance with this plan, the India College at Haileybury was inaugurated to train civil service officers to India. However, since the board of directors still had a final say on who was to take up posts in India. It was a prerogative of the directors to pick meritorious students from Haileybury or pick friends and relatives of shareholders who were willing to vote for them. Needless to say, as long as patronage was still the system used for running company affairs, the directors more often than not chose the latter option.

If democracy meant everyone had the right to purchase shares with the company and everyone had the right to exert financial influence over the board of directors then the company proceedings were definitely democratic as everyone had an equal opportunity to become corrupt. This was evident in the way in which the shareholders influenced the decisions of the directors and the commercial policy of the company. Given the unique economic and political position of the company, it had become a microcosm of the British polity. Its style of functioning forced the public to question the very idea of democracy itself. The company therefore became a catalyst for public debate on political reform. The debate was polarised into two opposing views. There was John Stuart Mill and his fellow liberals who wanted the company to continue as the supreme administrative authority of India to ensure a truly representative democracy in England. There were radicals like Richard Cobden and John Bright who argued that the company must be abolished and the administration of India should be handed over to a single Indian minister who would appoint not British but Indian advisors to rule the country. They believed that self-rule in India was necessary to ensure democracy in Britain.

Mill's argument was that the British people would never have all the facts regarding the conditions in a distant place like India and would be incapable of voting on matters concerning India. The Indians

were simply not capable of ruling themselves because they were rationally not on the same level as the Europeans. In that case, political debates on India would simply be used by political parties to polarise the populace in Britain. A change of government in India would simply become a pretext for a change of government in Britain. All of which would be detrimental to political stability in Britain. He suggested that administration of India should be continued by the East India Company which should, however, hire its civil servants to India by means of an open competitive exam.

Cobden and Bright argued that it was possible for the Britons to become fully cognisant of the conditions in India. If they did they would be able to empathise enough with the plight of the Indian natives to realise the need for self-rule in India. Hence they suggested the disbanding of the East-India Company and the appointment of an Indian minister who would be elected by the British people to govern India. The Indian minister would then set up a governing body comprising of Indians to administer India.

What was the result of this debate? The East-India Company was disbanded and the administration of India was handed over to a new India Council comprising of civil servants who were selected on the basis of a qualifying exam. In the new bill passed in 1858, the company's shareholders were compensated by putting them on a pension scheme. Many of its directors were offered a seat in the India Council. This body would be under the supervision of a Secretary of State to India who would be appointed by every new government.

### **The South Sea Company**

The South Sea Company was the brainchild of Robert Hanley who wanted to establish an institution powerful enough to rival the Whig Bank of England.<sup>14</sup> In 1711, the South Sea Company acquired monopoly over trade in the South Seas in exchange for an offer to assume part of the national debt in the aftermath of the Anglo-Spanish war. The real prize was not the monopoly itself but the possibility opened up by the monopoly of trading exclusively with the rich Spanish colonies in South

America. This was, however, a very distant possibility and depended upon the outcome of the war. The war ended in 1713 and the treaty that followed with Spain did not grant England the privileges it expected it would get. Britain and Spain went to war in 1718 and the possibility of acquiring a monopoly over trade with Spanish South America was virtually non-existent at the time. But speculators were not really interested in the present but only in the distant future which contained a possibility, albeit slim, of acquiring such a monopoly. The directors at South Sea were only interested in triggering speculation. But to do this they needed to attract capital. In 1719, the South Sea Company offered to take up the whole public debt of the British government. To get a positive vote on this deal, they bribed members of parliament and other influential personalities with stock in the company. They got the vote they desired and used it to raise the stock price artificially. They started accepting new subscriptions to the company and spread fabricated stories regarding the imminent prospects of doing trade with Spain. The Company stock began to rise because it started attracting capital in huge amounts. Not only British, but even Dutch investors were buying stock into the company.

From January 1720 to the March 1720, the company stock rose steadily. But the success of the company attracted imitators and in the next three months, a number of bogus companies were set up with overseas or new world trade prospects. As these companies collapsed and investors lost money, the market became cautious and speculators dwindled. To encourage speculation, the directors of the South Sea convinced the government to pass the "Bubble act" which made it compulsory for joint-stock companies to receive a royal charter. The Bubble Act buoyed up investor confidence once again and the prices of South Sea Stock spiralled. By the end of June, the company stock was selling at 1000 pounds a share.

The directors by now had milked the cow of speculation dry. There was nothing more they could do as the bubble that they had engineered was now stretched to the limit. They began to offload their stock slowly and the company stock price started falling at a slow pace. At the end of September the stock price reached a low of 135 pounds. Thousands of people were rendered

bankrupt in the aftermath of the South Sea's collapse. This was mainly due to the fact that the false prospects that the company had conjured up in the minds of the public had lured them into buying stock into the company on credit. There was a huge uproar against the company and its directors. But the main players had already left the country anticipating this turn of events. Some of those who were caught had their estates confiscated.

### **The real nature of corporate–social interaction**

The examples of joint-stock banking in England, the East India Company and the South Sea Company show us how corporate–social relationships are far more dynamic, complex and unpredictable than the staid economic partnerships that are implied in the accounts of the advocates and opponents of corporate personhood. We have already seen how the advocates and the opponents of corporate personhood rationally reconstruct corporate–social interaction on the basis of social contract theory. Their rational reconstructions although justify their respective approaches to corporate social responsibility completely overlook the essentially dynamic and unpredictable nature of corporate–social interaction. The relationship between corporations and society is in most cases an intense political struggle rather than just a cosy economic partnership that is sometimes broken by a scandal only to be patched up once again with compensation from the guilty side. Corporate decision making is not merely economic but always laden with political overtones. It is impossible to isolate the economic from the political. This forces us naturally re-evaluate our current understanding of corporate social responsibility. The point we are making is evident if we consider closely the interaction between private traders and the East-India Company, on the one hand, and the joint-stock banks, on the other.

The East-India Company with its monopoly on Indian trade was exacting a stiff price from private traders. Indian imports to Britain had to be routed through company ships or through foreign ports which made them very expensive and less competitive in the British market. Similarly British exports

to India were very expensive in the Indian market making British traders very uncompetitive. The traders reacted by taking advantage of the democratic constitution of the East-India Company by purchasing shares en masse into the company under encouragement from James Mill and his fellow free trade advocates. As shareholders they were now able to transform its commercial policy from the inside and thereby destroy its monopoly. The wider ideological debate between the free traders like James Mill and the monopolists dovetailed nicely into the struggle between the traders and the East-India Company. The former was not confined to the East India Company alone but it did help the cause of the traders. The unique political situation in Britain had greatly influenced this struggle.

Private traders, however, had no such help in their struggle against the major joint-stock banks in England. When these banks first came into being, private traders were favoured clients. But as these banks grew they became increasingly undemocratic in their constitution and conservative in their lending strategies. From this new standpoint the private trader who borrowed money mainly for engaging in new and unpredictable business ventures was now the most unappealing client because of the risk involved in lending money to him. The banks, however, did not want to alienate the whole trading class. They made use of the dominant rhetoric of individualism and independence to carefully nudge the traders into finding alternative methods to obtain capital. When these traders pooled in their resources to form small joint-stock companies the same joint-stock banks were willing to lend to these companies because they could demand security which they could not from individuals like private traders. Lending to these joint stock companies was thus in line with their conservative lending strategy.

Just as the traders were able to force their commercial policy upon the East-India Company, so the joint-stock banks were able to force their commercial policy upon the individual trader. These interactions between the individual traders and corporations like the East-India Company and the joint-stock banks clearly show that corporate-social interactions are never simple voluntary economic partnerships but intense political struggles between two sides that simply cannot do without the other. Private traders did not want to destroy the East-India

Company because as shareholders they could get what they wanted. In the same way the joint-stock banks did not want to scare the entire trading class. All they wanted was to stop private traders from borrowing from them.

Let us now consider the relationship between the government, the directors who represent the corporation and the shareholders in the case of the East-India Company and the South Sea Company.

The directors of the South Sea Company connived with the British government to sacrifice the interests of the shareholders for their own gains. This was evident in the way they promised to take care of the public debt for monopoly on South Sea trade. They were then able to use the lucrative prospects of this monopoly to stir up speculative activity, raise the stock price dramatically and make a huge profit for themselves at the expense of their shareholders.

The East-India Company, however, acquired monopoly over Indian trade by taking advantage of the political situation in India. The directors of the East-India Company were conniving with their shareholders to sacrifice the interests of the State. The directors initially along with the shareholders were plundering the Indian natives with taxes. Not only that they were also "taxing" the British public with their high import and export prices on Indian and British goods. Neither the British industry nor the British citizen was able to reap the benefits of the lucrative Indian trade. Instead of taking help from the British government, the British traders took the unusual step of becoming shareholders in the East-India Company to get their grievances addressed in which they were spectacularly successful. But the subsequent destruction of the Indian cottage industry due to the incessant flooding of the Indian market with imported British goods impoverished whole sections of the Indian population. In the case of India, the East-India Company was practically the Indian State and it clearly did little to address the grievances of the Indian natives. Any attempts by the British government to introduce reforms in the workings of the company were usually unsuccessful as could be seen futile efforts of reformers like Malthus.

We can again clearly see that the interactions between government, the corporation and its shareholders are not that of simple economic part-

nership. The three parties are always jockeying for their interests and the decisions that they make in this regard have strong political overtones even if they are made for economic reasons. These interactions clearly reflect the real nature of the corporate–social interaction, which is not anything like the rational reconstructions employed by the opponents and advocates of corporate personhood.

## Conclusion

We have seen how questions of corporate nature and corporate social responsibility are inseparably linked. We have also seen how questions about corporate nature always imply questions about corporate–social interaction. These implicit accounts of corporate–social interaction that we could draw out from the corporate personhood debate are rational reconstructions that serve to justify the respective approaches to corporate social responsibility. However, these rational reconstructions simply overlook the incredibly corrugated nature of corporate–social interactions. Economic history shows us that corporate–social interactions take place in a dynamic, unpredictable and extremely complex politico–economic environment. Corporations operate within this fluid set of interactions. They are thus not static entities as portrayed by current views of corporate responsibility; rather they shape and are shaped by consumer and government forces. We need to be more conscious of the actual nature of the corporate–social interaction in order to deal more comprehensively with issues of corporate social responsibility.

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## Notes

<sup>1</sup> Milton Friedman in his article *The Social Responsibility of Business is to Increase Its Profits*. Business Ethics: Readings and Cases in Corporate Morality. Ed. W. Michael Hoffman and Robert E. Frederick. New

York: McGraw-Hill, Inc.; 1995. 137 argues in this manner. Christopher Stone (1995) in his article *Why Shouldn't Corporations Be Socially Responsible*. Ibid. 141 adopts a similar strategy.

<sup>2</sup> Danley, John R. *Corporate Moral Agency: The Case for Anthropological Bigotry*. Business Ethics: Readings and Cases in Corporate Morality. Ed. W. Michael Hoffman and Robert E. Frederick. New York: McGraw-Hill, Inc., 1995. 187

<sup>3</sup> Ibid. 187

<sup>4</sup> French, Peter; Nesturuk, Jeffrey; Risser, David T; Abbarno, John. *Corporations in the Moral Community*. Fort Worth: Harcourt Brace Jovanovich College Publishers, 1992. 17

<sup>5</sup> Evan, William M.; Freeman, Edward R. *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*. Business Ethics: Readings and Cases in Corporate Morality. Ed. W. Michael Hoffman and Robert E. Frederick. New York: McGraw-Hill, Inc.; 1995. 149

<sup>6</sup> Ibid.

<sup>7</sup> French, Peter A. *Corporate Ethics*. Fort Worth: Harcourt Brace, 1995. 77

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

<sup>10</sup> Alborn, Timothy L. *Conceiving Companies: Joint-Stock Politics in Victorian England*. London: Routledge, 1998. In his book, the author gives a penetrating analysis of the rise of modern banking in Britain. In the discussion that follows, the reader will be provided with a summary of his insights.

<sup>11</sup> Ibid. 107

<sup>12</sup> Ibid. 158

<sup>13</sup> Here I again use Timothy Alborn's historical account of the East India Company from the book cited above

<sup>14</sup> McNeil, David. "The South Sea Bubble: A Short Sketch of Events." myweb.dal.ca. Ed. David McNeil. 5 October 2005. Dalhousie University. 4 March 2006 <<http://www.myweb.dal.ca/dmcneil/bubble/sketch.html>>

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