Orthodoxy in business management and business ethics is currently occupied by a deontological “Nexus-of-Contracts Theory.” It basically argues that the firm, or modern corporation, is a complex adaptive system comprised of definable subsystems, known as stakeholder groups. Its ontological status as a single system is forged out of a body of legality. Hence the modern corporation is often described as a legal fiction forged out of moral and legal agreements between various stakeholder groups. The nexus of stakeholder groups, engaged in this self-interested bargaining process include: stockholders, employees, customers, suppliers, financiers, and local communities.

The basic descriptive bases of NOC are fairly simple. The idea is that economists can scientifically analyze the “transaction costs” associated with economic activity. Traditionally, this approach usually requires protecting transactions against cheating. We human beings tend to break contracts when those contracts no longer appear to serve our short-term or long-term self-interest: especially if we believe we can get away with it. Who said, “Cheaters never prosper?” So one of the main foci of NOC is to explain, predict, and control cheating.

Opportunism or cheating is contingent upon variables present in an economic environment, especially: information, freedom, and competition. Whereas neoclassical economics assumed perfect information, perfect freedom, and perfect competition within the system, NOC accepts the reality of imperfect information, imperfect freedom, and imperfect competition. Therefore, economic activity is not entirely “natural” but requires at least some cultural “nurturing.” But in a capitalist society, this nurturing adds to the cost of doing business. In order to nurture the human capacity to maintain contracts, and control opportunism, we need both moral rules (enforced by public sentiment) and legal rules (enforced by the coercive power of government). The relative proportion of morality and legality is debated by economists, political scientists, and business ethicists.

Now in order for the Nexus-of Contracts Theory to be both descriptive and prescriptive (or normative) it must do more than explain how the various constituencies or classes of stakeholders (stockholders, consumers, managers, employees, consumers etc.) in fact bargain in the real world within various competitive environments. NOC must also prescribe moral and/or legal rules that govern how stakeholders ought to bargain, and the role that managers ought to play in this process. So NOC theory must prescribe moral and/or legal rules that ought to constrain global industries, non-governmental organizations (NGOs), and national and international governments.

Again, NOC holds that corporations are “legal fictions” that have no ontological status apart from the laws that are enforced by governmental entities. And of course, corporate laws vary between national and state governments. This implies, at least a degree of descriptive and prescriptive relativism. One of the internal debates facing the “Nexus-of-Contracts Theory” is whether there are, at least some, “hyper-norms” that form the basis for universal human morality, or whether business ethics is hopelessly mired in legality and cultural relativism. NOC suggests that markets must be nurtured in order to control the transaction costs associated with minimizing opportunism. All markets require monitoring and enforcement of rules that control opportunism as they attempt to negotiate the conflicting interests of stakeholder groups: stockholders, employees, consumers etc.

So if the descriptive dimension of the modern corporation is based on nexus of contracts theory, then what are the prescriptive parameters? In terms of corporate governance, much of the descriptive and prescriptive analysis of corporations can be summarized in terms of three basic questions:

1. Whose ends (rights or interests) are in fact served by corporate managers? (E.g.: stockholders, consumers, employees, financiers, suppliers, local communities, nations, humanity etc.) AND, whose ends (rights or interests) ought to be served by corporate managers?

2. By what means can managers in fact employ in order to efficiently realize these stated ends (rights or interests) AND, what means can managers employ within the bounds of morality?
3. What role does government in fact play in the realization of these various corporate ends AND, what role “ought” government play in this process.

Despite the idealistic ruminations of various “win-win” strategies, in the real world, what’s “good” for one or more classes of corporate stakeholders (stockholders, employees, consumers, etc) may or may not be “good” for the other stakeholders. Generally speaking, if you raise the pay of employees, either the consumers pay higher prices, or the stockholders earn less. And, what’s “good” for society may or may not be “good” for individual industries or corporations. What’s “good” for United States may or may not be “good” for the rest of the world. And what’s “good” for present stakeholders, may not be good for future stakeholders. Under the classical economic theory, this balancing act has been conducted in the context of general equilibrium theory, which holds that there is a natural point where everyone will do about as well as they can given the prevailing circumstances. So within the context of rights-based corporate governance, the concept of a “good manager,” is contingent upon how well he/she can mesh the often conflicting interests of the various classes of stakeholders. NOC scholars have identified three alternative roles for managers.

1. **Stockholder Theory**: Managers are morally and legally obligated to serve as agents of the stockholders, and advance their interests regardless of how those decisions might affect the other stakeholders.

2. **Stakeholder Theory**: Managers are morally and legally obligated to serve as agents of all stakeholder groups, and try to advance all of these interests collectively, without favoring any one group.

3. **Marxist Theory**: Managers are agents of the government that aspire to advance collective interests, often at the expense of the other stakeholder groups. This theory, therefore, views corporations as the property of the state.

### 4.1 STOCKHOLDERS AND STAKEHOLDERS

Nexus of contracts theory says that corporations are a nexus of contracts between various stakeholder groups: stockholders, employees, consumers, financiers, sub-contractors, and the local community. Business ethics, therefore, is about how to manage a corporation. Within the contractual constraints implied by the Nexus-of-Contracts framework there are two opposing theories that offer different strategies for dealing with “conflicts of interest” and “natural inequality:” stockholder theory and stakeholder theory.

Stockholder theory states that the best (most efficient) way to serve the interests of all stakeholders is to always manage the corporation to serve the interests of stockholders. Corporations are money machines that are the property of the stockholders. The CEO is regarded as an agent of the stockholders: stockholders hire the CEO to make money for stockholders. The interests of the other stakeholders are economically relevant, but are best met via the impersonal “invisi...
simply enforce contracts between rational self-interested bargainers and promote competition. This includes providing a legal framework that includes the monitoring and enforcement of impartial rules of competitive fair play.

From the standpoint of stockholder theory, the challenge is how to manage corporations in such a way that the pursuit of self-interest by stockholders benefits the other stakeholders. The traditional natural law approach suggests that Mother Nature prefers equilibrium, which tends to “floats all boats.” The stockholder theory is “naturalistic” in the sense that it is based on “reciprocal altruism,” which if left to its own devices can settle into equilibrium; whereas, utilitarianism requires a degree of other-worldly “ideal altruism.” Therefore, stockholder theory avoids the problem of how to cultivate ideal altruism (utilitarianism) into a system naturally populated with self-interested bargainers. But it also requires a bit of altruism. Not on the part of the contractors themselves, but on the part of the governmental institutions responsible for maintaining free market competition and monitoring corporations to insure contractual compliance.

“Stakeholder Theory” is management designed to serve the interests of the multiple constituencies that “have a stake in” management decisions including: stockholders, employees, consumers, suppliers, financiers, and the local community. Many stakeholder theorists are followers of the philosopher John Rawls: the most important figure in the doctrine called welfare liberalism. Stakeholder theorists argue that serving the interests of stockholders does not always maximize the interests of the other stakeholders. Managers (and/or government) must at least occasionally intervene on behalf of the “least-advantaged” stakeholders, or those that find themselves bargaining under conditions of unequal liberty. Hence, there are at least some “positive rights” associated with stakeholder theory.

The argument against Rawls’ account of the prescriptive bargaining process as the pursuit of an “overlapping consensus” conducted under a hypothetical “veil of ignorance” is that it’s not clear how bargainers in the “real world” could go about bargaining under that veil (impartiality), given that in the real world we all come to the bargaining table armed with our “natural advantages” and/or burdened with our “natural disadvantages.” We are also naturally inclined toward partiality: that is, we treat out friends and relatives better than strangers.

Again, in the real world stakeholder theory must provide an explanation as to why the “most advantaged” would bargain with the “least advantaged.” One typical Rawlsian response is that rational, self-interested bargainers would sacrifice their short-term “advantages” for long-term “security.” After all, even Donald Trump gets sick, and will eventually suffer the infirmities of old age. But when an agreement is forged between the “advantaged” and “least advantaged,” there is always the question of whether the contractors can “Trust” each other to keep their promises. For a realist, this uncertainty once again underscores the need for external monitoring of contracts by government and the use of coercive force to punish non-compliance. Of course, then the bargainers have to idealistically “Trust” the impartiality of government. So although, the Nexus-of-Contracts Theory embraces realism’s naturalistic critique of corporate altruism, it invariably raises the question: “Who is monitoring the monitors?” In the end, Nexus-of-Contracts Theory ultimately requires trustworthy international monitors, or governmental altruism.

Finally, it is important to point out that all collective moral and legal decision-making involves leaders and followers, which raises the problems related to “agency relationships,” and therefore requires “agency theory.” In its simplest terms, agency raises the question is how corporations and the nexus of stakeholders can develop strategies that induce self-interested “agents” (such as CEOs) to act in the interest of “principals” (such as stockholders). Stockholder theorists try to arrange incentives in order to align the interests of agents with stockholders. Stakeholder theorists tend to rely heavily on the coercive power of government to blend the interests of the various stakeholder groups. Of course, the main point of contention between the stockholder and stakeholder theories is how government ought to manage legality and morality in order to minimize the ill-effects of coercive, predatory, self-interested corporate behavior. I have argued that the Nexus of Contracts Theory, in both the stockholder and stakeholder traditions, require altruistic governmental institutions, although stockholder theory expects government to do less.

John Boatright argues that the descriptive claims made by stockholder and stakeholder theory are empirical matters that can be resolved based on scientific methods within the larger context of the Nexus-of-Contracts Theory. So although, stockholder theory still reins supreme in the United States, given the complexities raised by the Nexus-of-Contracts Theory, there is no guarantee that it will, in fact, maintain its status as orthodoxy, nor can there be any moral basis for arguing that it “ought” to prevail in the future or that it “ought” be adopted by other socio-political environments. Canada and most of Europe tends toward stakeholder theory.