ENLIGHTENED SHAREHOLDER THEORY: WHOSE INTERESTS SHOULD BE SERVED BY THE SUPPORTERS OF CORPORATE GOVERNANCE?

Eric Pichet*

Abstract

This paper questions the feasibility of corporate governance and a company's Board Members being able to serve two masters at once: shareholders; and the many different agents inhabiting the labyrinth of the stakeholder universe. Absurdist reasoning will be used to demonstrate the theoretical impossibility of a dual legitimacy. An alternative '*Enlightened shareholder theory'* will be proposed, inspired by Jensen's '*Enlightened partnership theory'* (2001). After demonstrating that a company's interest is not synonymous with the interests of its shareholders, a proposition will be made that Board Members should always highlight social interests. The paper's conclusion will identify the consequences of the new theoretical framework for the definition of corporate governance; Board Members' missions; and the composition of a Board of Directors.

Key words: Company performance, corporate governance, principles of corporate governance, shareholder value, Board Members, Board of Directors, value creation, *Enlightened partnership theory*, *Enlightened shareholder theory*.

* *BEM-Bordeaux Management School, 680 cours de la libération 33405 Talence Cedex. E-mail: eric.pichet@bem.edu - Tel.: 33.(0)6.08.57.87.71, fax : 33.(0) 5.56.84.55.00*

Introduction

There is a broad academic and professional consensus in developed societies that the finality of the corporate sphere is to create value. The heroic figure of the entrepreneur, idealised from Ricardo to Schumpeter, was further extolled throughout the 20th century, notably by Drucker and Chandler. Just as much admiration has been expressed for the construct of large companies, comprised of actors driven by the '*invisible hand'* and ultimately (and inexorably) generating widespread prosperity. We know that what distinguishes a firm from a family or government is the objective of long-term value creation that it pursues by selling goods and services and trying to maximise profits (even if incidentally but unavoidably it fulfils many other functions, like collecting taxes or contributing to the stakeholders).

At the same time, between the partisans of a shareholder approach and the supporters of a stakeholder vision, there has been much debate about the finality of corporate governance or '*the management of management'* in the justifiably famous words of Perez (2003: 23) referring to actors' efforts to optimise corporate leadership. Without going as far back as Adam Smith (1776), stakeholder arguments are tied to ideas once formulated by Berle and Means (1932). The question then becomes whether corporate governance should satisfy a company's shareholders alone or else all of its stakeholders.

The shareholder approach provides a brief but clearcut response - a company serves its owners i.e. its shareholders. This vision has given birth to various definitions of corporate governance, like the one formulated by Schleifer and Vishny (1997: 737) - '*Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment"* - or by Fama (1980: 295), for whom shareholder maximisation is the sole criterion for assessing the performance of a listed company. In this Friedman-like approach, what counts is formal legality.

The stakeholder approach – or approaches, since there are several – developed in opposition to the shareholder orientation and was born out of criticisms of the limitations of a shareholder vision considered too restrictive by some.

In a stakeholder theoretical framework, corporate governance constitutes according to Perez (2003: 3) '*the central mechanism governing the function of the modern capitalist system, via the relationships between the managers of large listed companies and all parties concerned by the operations of these companies. First and foremost this means their shareholders but also their employees, suppliers, creditors and more broadly the different categories of agents or institutions affected by their decisions'*. Corporate governance also refers for Perez (2003: 22) to the '*institutional and behavioural mechanism governing relations between the executives of a company – and more broadly, an organisation – and the parties concerned by its future, led by those who hold 'legitimate claims' to it'*. This approach emphasizes the principle of the legitimate interests of partners over the legality of shareholders' interests.

The paper's first section will analyse the difficulty – and impossibility – of finding a satisfactory definition for the stakeholder concept, thus the ontological fragility of stakeholder theories based on such a definition. It will then in the second section go on to use absurdist reasoning to demonstrate the impossibility of pure stakeholder theory while indicating the limitations of pure shareholder theory. The third section will suggest an '*Enlightened shareholder theory'* distinguishing the interests of a company from those of its shareholders. From this new theoretical vision will be derived a few consequences for the definition of corporate governance, as well as other, more practical consequences for governance protagonists such board members. The implications for the composition of a board of directors, which is the cornerstone of all governance, will also be analysed.

Stakeholders: a highly variable definition

> '*Definitions are very free…since nothing is more allowed than the right to give whatever name one chooses to an object that one has clearly chosen'*
> *PASCAL, 1657, De l'esprit géométrique.*

The stakeholder approach is rooted in the obvious existence of strong and complex interdependencies between companies and particular groups like customers, investors, suppliers or employees. These dependency relationships cannot be described in simple terms but imply, for example, a number of network and feedback effects.

In actual fact, it is the complexity of these relationships and the heterogeneity of their foundations that make the stakeholder construct so ambiguous. Hence the temptation for corporate governance specialists, like Thompson, Wartick and Smith (1991: 209), to find refuge in extremely vague formulations that define stakeholders as "*groups in relationships with an organization*". As for theorists who take more straightforward positions, they usually come up with very different characterisations, as noted by Windsor (1992).

The first appearance of the stakeholder construct seems to be an internal memorandum by Stanford Research Institute in 1963 (Donaldson, 1992: 53-54). At first, the term mixed up shareholders, employees, customers, suppliers, lenders and society in the broader sense of this term (Freeman, 1984: 32).

A Strict Definition : Voluntary Partners

Tenants of a strict definition have subordinated the effect of acting in the capacity of a stakeholder to the existence of voluntary relationships with a firm, insofar as the legitimacy of stakeholders is based on the willingness to take risks rooted in contracts, exchange and law (Agle, Mitchell & Wood, 1997: 862).

This latter notion is central to most definitions, notably the one preferred by Clarkson (1994: 5), '*Voluntary stakeholders bear some form of risk as a result of having invested some form of capital, human or financial, something of value, in a firm. Involuntary stakeholders are placed at risk as a result of a firm's activist. But without the element of risk, there is no stake'*.

However, there are other criteria in addition to the assumption of risk. For instance, Savage, Nix Whitehead and Blair (1991) state that two attributes that are indispensable for identifying stakeholders: a legitimate claim; and the ability to influence a firm – to which Agle et al. (1997: 863) responded that influence over a firm and legitimacy must be necessary attributes in any models used to identify stakeholders.

Definitions That can Be Extended ad infinitum

Whereas partisans of a strict definition of stakeholders (Ring, 1994) view volunteering as a necessary precondition, for Starik (1998: 90), it suffices that there is a potential relationship: '*Those who are or might be influenced by, or are or potentially are influencers of, some organization"*. This goes beyond the definition of Freeman (1984: 31) for whom stakeholders are '*groups without whose support the organization would cease to exist*.'

Clarkson (1994: 5) has even used the expression of involuntary stakeholders to describe those who are subjected, against their own will, to risks generated by the firm. Similarly, Alkhafaji (1989: 36) defines stakeholders as '*groups to whom the corporation is responsible*". These expressions constitute a clear displacement of definitional criteria compared to the narrower stakeholder conception, since they all infer a direct and deliberate relationship with a firm's interests, be it in regards to the firm's survival or the impact of its actions (Bowie, 1988; Freeman & Reed: 1983). The existence of latent stakeholders is now acknowledged. This is a considerable (and almost infinite) expansion of the term's potential connotations.

The more radical supporters of the stakeholder approach have no qualms about asserting the '*legitimate claims*' that (almost) everyone has on companies. This makes it particularly difficult to come up with a precise definition or structured typology for stakeholders. The benchmark text for the stakeholder approach is the study undertaken by Freeman (1984: 46) describing partners (stakeholders) as '*Any group or individual who can affect or is affected by the achievement of the organization's objectives*'. This new definition, which would have a bright future, was a radical change since it broadened the scope of stakeholders from those whose situation is stake when the firm acts to those who have a stake in the firm. Basically, it transformed everyone into a stakeholder, and as Sternberg (1997: 4) maliciously noted, it included '*Everyone, everything, everywhere'*: *Terrorists and Competitors, Vegetation and nameless sea creatures and generations yet un born*. Unquestionably, this goes a little bit far.

At the end of this brief literature review, it is clear that whereas the shareholder conception of Corporate governance is relatively monolithic and generally sees shareholders as a homogeneous class (Which is not the case, as demonstrated in many studies on the divergent interests of small, large, long-term and other shareholders, one example being questions about shareholders' equal rights when some are awarded a double vote to ensure their loyalty), the stakeholder approach is much more nebulous. A distinction can be made between primary and secondary partners, those with proprietary interests and/or an equity stake (actors who have voluntary chosen to be involved) and those with an interest in less tangible assets, like contractors, resource suppliers, risks takers or anyone who influences an organisation.

An Uncertain Typology

The full array of a company's stakeholders can be depicted by concentric circles representing everyone gravitating in its close or distant orbit, from key shareholders to customers, employees, suppliers, local communities, national or international society as a whole (i.e. a cooperative bank open to members worldwide thus theoretically to the planet's 6.5 billion inhabitants), future generations and, slightly more utopically, biodiversity.

The different categories of stakeholders could also be classified into three main groups, in addition to shareholders. In a utilitarian vision, direct stakeholders' corporate decisions affect the well-being of - in decreasing order - employees whose jobs are at risks, followed by the company's business partners (i.e. suppliers, retailers, bankers and other creditors). Then come the indirect stakeholders, led by local communities, environmentalists and beneficiaries of socially responsible investments. Lastly come the more distant stakeholders, like future generations or biodiversity.

Table 1. Typology of stakeholders

Types of stakeholders	Examples
Shareholders	Shareholders
Direct stakeholders	Employees Suppliers, customers, bankers, other creditors
Indirect stakeholders	Local communities, society
Distant stakeholders	Future generations, Biodiversity

There is no use denying the superficial and fragile nature of these inevitably schematic attempts at rationalization. Occasional shifts in the borders of stakeholder categories further complicate analysis, as if there were any need. Customers, for example, are often lumped in with a category of services (like management consulting) that are rendered by the co-producers of services sold by providers. Nor is any

stakeholder subgroup monolithic. For example, the different banks with a direct or indirect interest in companies - like a firm's advisory bank, the bank that lends it funds or the bank that manages its lead shareholders' private wealth – do not all have the same interests. Indeed, these can even be antagonistic, as when a bank advices a party seeking to acquire a company through a hostile takeover.

This is why stakeholder identification has become an almost insurmountable obstacle for corporate governance researchers, and why efforts at synthesizing these various elements have encountered so many contradictions. Not only are there a multitude of stakeholders (almost too many to be counted), but also each category pursues divergent and even antagonistic interests. The main weakness of the stakeholder approach to corporate governance is the difficulty of building solid governance on such fragile foundations.

Overcoming the aporia of a stakeholder approach and the constraints of pure shareholder theory

> *'You don't need to understand something to moralise about it.'*
> *Gilles DELEUZE, 21 December 1980 Cours sur Spinoza.*

The popularity of the stakeholder approach is easy to understand since every citizen is a stakeholder (using the broad definition of this term) in one or several firms. Of course, politicians have been aware of this popularity, since Citizens vote, even if companies do not. The whole trend has been reinforced by the wave of corporate social responsibility and sustainable development, phenomena confused all too easily in people's minds. A significant paradox is that firms are generally deprived of the rights usually associated with the kind of stake they have in governments and policies, i.e. they are affected by governmental decisions but cannot vote. All they can do is hope that the general climate is as business friendly as possible, since the harmonious development of the economy is naturally in the interest of a country and its government, which is accountable to citizens for things like purchasing power and jobs. Like taxpayers, firms also pay taxes without receiving any direct recompense.

The absurdist approach reveals a few prohibitive obstacles to stakeholder theory's further development. Imagine that it is possible to construct a corporate governance theory based on stakeholder interests (This intimates of course that the problems in defining such stakeholders have been resolved once and for all, which has been shown is anything but true), once the aforementioned obstacles have been overcome (via contortions, it is true, that can be very hard to accept). At this stage, two objections would arise, with both being equally apt to destroy corporate governance theory.

The impossible Arbitration of Different Stakeholder Interests

The tragic consequences of certain dramatic situations that have accentuated social upheavals and brought about emergency legislation exemplify this conundrum. There is no doubt that stakeholders face residual risk, as witnessed by the terrible events at Bhopal in India (A toxic cloud following a 3 December 1984 explosion at the Union carbide chemicals plant in Bhopal (India) caused the death of ca. 10,000 persons and injured a further 200,000. India first claimed $2.6 billion from the firm before settling in 1989 for $470 million to facilitate inwards investment from American sources).

The legal environment must define rules for protecting stakeholders, and it is naturally up to lawmakers to assume their responsibilities. As Friedman (1962: 15) wrote, 'The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the ''rules of the game' and as an umpire to interpret and enforce the rules decided on.' The real question is whether firms should go further than they have been asked to and add the protection of stakeholder interests to the mission they fulfill.

But what are 'stakeholder interests'? This notion promises to be just as hard to define as the stakeholder concept itself. Asides from an ironic comment by Jensen (2001: 9) about the interests of terrorists and blackmailers, which groups' interests should firms take into consideration? Insurmountable problems arise very quickly at this level. For instance, which employees should be viewed as stakeholders - permanent staff members, people on short-term contracts, temps, interns, potential recruits and/or pensioners? How far can this go? What about when people belong to several stakeholder categories at once, i.e. they can be both customers and employees, raising questions about the breakdown between these two roles. Even more complicated is figuring out who is supposed to speak on future generations' behalf.

The difficulties in defining the interests of a category of stakeholders are compounded *ad infinitum* when extended to the interests of multiple sub-groups. Much in the same way that stakeholders are not a homogeneous category, neither are subgroups of stakeholders. Take employees, for example: some want to earn more; others want to work less. Moreover, different stakeholders can have

conflicting interests, for instance, with higher wages for employees implying higher prices for customers. Even within a given group, wage hikes for some might mean that fewer new recruits will be hired and even that current employees will have to be fired. The question is important since – as shown by the example of Bophal's tragedy – the interests of indirect stakeholders are sometimes distinct from those of direct stakeholders, not to mention shareholders.

The big question, then, is which criteria should determine the necessary arbitrages between different categories making conflicting demands? How can priorities be ascertained when each interest group claims that it is the most legitimate and seeks to maximise its advantages by capturing entrepreneurial rents? The only possible answer is that in the stakeholder conception of corporate governance, the advantages gained by some parties are matched by the disadvantages besetting others. In turn, this raises questions about how this might happen.

Stakeholder Theories Lead to an Excessive Reinforcement of Executive Power, Wrongs Shareholders and Undermines Corporate Performance

The stakeholder approach tends to make corporate governance meaningless when based on the defence of the firm. This is due to the fact that the spirit of this paradigm – balancing benefits for all partners – excludes any objective that might benefit one group of stakeholders in particular. Instead of just maximising shareholder value in the long run, customers must also receive greater value, employees further advantages, the homeless better housing and all poverty eliminated (Sternberg, 1998: 16). Paying attention to stakeholders does not mean being accountable to them - being accountable to everyone means being accountable to no one.

Far from constituting a good method of governance, stakeholder theories are counter to the aims of corporate governance and undermine its disciplinary mission by increasing executives' power excessively. Indeed, the argument that all stakeholders' interests must receive consideration means that executives and employees – stakeholders themselves – must incorporate their own interests as well. This can generate a serious conflict of interests, as witnessed in overly generous stock options schemes or the exorbitant advantages that executives and their own stakeholders sometimes accrue: a poignant example of the excesses of a stakeholder orientation is the way Enron's executives used to pay enormous sums to charities that had little to do with the company's activity.

This temptation will be all the stronger if loyalty towards the company itself is no longer required from executives all employees - as is the case in the shareholder vision - but starts to blur due to a lack of clearly identified beneficiaries. Board members and executives would then be left without clearly defined objectives and could present themselves - behind the cover of an ostensible desire to protect stakeholders' interests - as defenders of stakeholders versus shareholders, trying thereby to create or expand room to manoeuvre for themselves. Ultimately, stakeholder theory could lead to a dictatorship of executives (as surely as Marxist theory seeking a dictatorship of the proletariat led to the *nomenklatura*). In short, corporate governance's stakeholder approach tends to destroy the very basis of corporate governance.

Lastly, the stakeholder approach undermines ownership rights, the basis of stock corporations. It denies a firm's owners the right to dispose freely of their goods, by adding to current law a number of stipulations for which no one was asking, much in the same way as it largely neglects the obligations that board members (agents) have towards shareholders. To a certain extent, this stakeholder model seems like a belated avatar of Marxist thinking seeking to undermine the very principles of capitalism. This is in line with the analysis of Milton Friedman, in a still topical essay (1962: 134) '*Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine. If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is?*'. He felt that a company is '*instrument between the hands of its shareholders'* so that '*in a free economy, there is one and only one social responsibility of business–to use it resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.*'

The Limitations of Purely Shareholder-Based Legitimacy

If stakeholder theories are not credible, what missions should board members fulfill? Their role are circumscribed by the mandates that shareholders delegate to them (Note that these people are the representatives of all of the firm's shareholders, and

that it is up to them to verify that the company's decisions do not benefit some shareholders to the detriment of others.), thus it is to shareholders that they are supposed to be accountable. But being appointed by shareholders does not necessarily mean being accountable to them alone or even to them as a priority. An analogy with official auditors springs to mind. They are appointed by a company to an oversight function where they control and validate its accounts. The same applies to Hedge Funds whose board members are named for their accounting or sectoral competencies but who must then defend the sole interests of the fund, which in this instance happen to be strictly aligned, at least in the short term, with the interests of shareholders. What would happen if the interests of the company and its owners were no longer aligned, and if shareholders started to act contrary to a company's interests. This hypothesis is not only theoretical: a 2006 example was when the Acas pension fund suicidally requested such high returns from Synodys that it ended up asphyxiating the company. Board members would likely suffer from a conflict of interests, or worse, from a Cornelian conflict of loyalties.

What is the first duty of a board member, and towards whom does s/he owe this duty? In certain instances, the answer appears obvious, like when a large shareholder tries to appropriate an organisational rent to everyone else's detriment. But what if one shareholder suddenly goes crazy or is overtaken by Machiavellian desires, sabotaging a firm to defend the interests of a rival company? Should corporate governance protect the company against the shareholder who decreed this action or else – to perpetuate the theoretical fiction - protect the shareholder against him/herself? All of which explains why board members must ensure that no conflicts of interest exist between their different mandates.

Outside of these extreme cases, a frequent point of discord between shareholders and guarantors of a company's interests resides in the timeframe used to assess performance. People holding shares in a listed company tend to focus on short-term financial results, whereas a well governed company seeking long-term success and truly sustainable development will aim to satisfy customers, increase employee responsability and empowerment and create stable, trust-based supplier relations, all with a view towards generating value for the firm in the long run.

The general interest of a firm is not always equal to the sum of shareholders' (sometimes incoherent) personal interests. This means that the social interest of a company is distinct from the interest of its shareholders, even if in practice - *grosso modo*, it could be said – such interests are very often identical. A firm is not a toy for shareholders to play with.

Enlightened shareholder theory and its practical implications for corporate governance

'*The hard thing for a honest man is not to do his duty but to know it*.'
Louis de Bonald, 1796,
Considérations sur la Révolution française.

As key figures in corporate governance, board members have amongst other duties what might be called a duty of loyalty (Remember the excellent definition of Littré, for whom "*loyalty means obeying the laws of honour and integrity"* towards shareholders. The shareholder conception of corporate governance is not so simple where a company's superior interest is at stake. Its stakeholder aspect also offers a few lessons about the best ways of improving a firm's performance.

Enlightened Shareholder Theory

Stakeholder theories may be a dead end, but it is clear that when a company adopts a radical strategy geared solely towards the defence of its shareholders' interests, by so doing it is likely to wrong many stakeholders. In turn, this can be damaging to the firm. Thus, it is the firm's clearcut interest – and this alone - that forces firms to think about their stakeholders (It is useful to re-read Jensen (2001: 16) on this point. '*We cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency. We cannot create value without good relations with customers, employees, financial backers, suppliers, regulators and communities*'.

In the shareholder perspective, the goal of corporate governance is to focus on the company, thus on stakeholders only to the extent that this is required by law and by concerns for the firm's reputation, credibility and image. Therefore, the question is at what point this concern for certain stakeholders is a good thing for a firm's image – and inversely, when does it become detrimental to shareholders and advantageous not to the firm but to other stakeholders, notably senior executives.

The stakeholder vision of corporate governance is not systematically incompatible with shareholder interests. Analysis of the different stakeholder doctrines can even be useful to the construction of a shareholder-based theory integrating certain interesting element derived from stakeholder theories.

There are at least two merits to this stakeholder construct. The first is a common sense observation that people will be much more involved in a process if they consider that they have a financial or other stake in it (The most important issues may not even be financial, see for instance Freud and Maslow). This is an issue of motivation for both employees and executives. The second merit of the stakeholder concept is to recall the complexity of the world, to understand that the relationships of an organisation as sophisticated as a company are more than mere head-to-head confrontations with its shareholders. In effect, a firm that totally ignores its customers or critics is in danger. It is obvious that for a firm, protecting its image is a win-win situation. As several studies have demonstrated (For example, Freedman & Patten, 2004, or Cormier, Magnan & and Morard, 1993), maximising shareholder wealth does not contradict the satisfaction of other partners.

The *Enlightened shareholder theory* being proposed here is based on the work that Jensen did (2001). This study criticises stakeholder theories because they offer no criteria for choosing – and measuring the choice - of different stakeholders. It considers that firms cannot maximise value if they ignore stakeholders' interests : '*In order to maximize value, corporate managers must not only satisfy, but enlist the support of, all corporate stakeholders – customers, employees, managers, suppliers, local communities*' (2001: 16). Lastly, it offers an '*Enlightened value maximization*' or '*Enlightened stakeholder theory*' that uses most of the structure of stakeholder theory but accepts the maximisation of the firm's long-term value as the criterion for choosing between different stakeholders : '*Enlightened value maximization is identical to what I call Enlightened stakeholder theory ...(It) uses much of the structure of stakeholder theory but accepts maximization of the long run value of the firm as the criterion for making the requisite tradeoffs among its stakeholders. Enlightened value maximization, while focusing attention on meeting the demands of all important corporate constituencies, specifies long-term value maximization as the firm's objective*' (Jensen, 2001: 9).

The approach on offer here is the opposite of Jensen's much loved '*Enlightened stakeholder theory*', which is based on stakeholders and therefore fragile for the aforementioned reasons. Critical readers will have correctly discovered similarities between our approach to Jensen's *Enlightened stakeholder theory* and the attitude adopted by Marx, who decided to reverse the order of priorities found in Hegelian theory (which he considered upside down) to get it to work…

This is replaced with an '*Enlightened shareholder theory'* based on shareholder reasoning but integrating useful elements from stakeholder theories as well as more recent contributions from cognitive theory. A good image would be to say that *Enlightened shareholder theory* has been doubly enlightened by stakeholder theory and by cognitive and behavioural theory. It is not possible within the framework of the present paper to go more deeply into the contributions of cognitive theories. For summary of the latest thinking, it is useful to read Charreaux (2004).

Starting with a basic disciplinary vision that is strongly geared towards shareholders, the new goal is to integrate cognitive contributions: Firms exist because they are more efficient than the market at coordinating collective learning processes (Foss, 1996). This should help to achieve a synthesis: something that Winter (1993) or Foss (1996) consider improbable due to the questionable compatibility of disciplinary and cognitive theories: For further details on these still unproductive attempts at a synthesis, see: Winter (1993), Foss (1996), Foss and Foss (2000), but that Charreaux (2004), inter alia, strongly welcomes.

The long-Term Interest of the Firm as the Ultimate Goal of Corporate Governance.

Even if shareholders' short-term interest can differ from a firm's interest, in the long run it seems obvious that the two will converge. It is the notion of legal trust that best defines actors' responsibilities. In France, a 24 July 1966 law on commercial companies stresses an institutional approach where the firm bears a social interest distinct from shareholders' interests. This framework offers great legal security, but it is too restrictive and runs contrary to the imperatives of competitiveness.

Thus, according to the Viénot I report (Medef-Afep French Code), the idea behind governance is to discover in '*the sole interest of the company concerned – viewed as the superior interest of a legal entity – the existence of an autonomous economic agent, pursuing its own goals, ones distinct from the goals of shareholders, employees, creditors, suppliers and customers but corresponding to their joint general interest. The purpose is to ensure the prosperity and continuity of the company (*Medef-Afep, 1995: 8). Note that the first French code, published in 1995, expressed a marginal position in good practice guidelines, one that stressed shareholder interests or did not distinguish between them and social interests. It is specifically this objective that a board of directors – obliged under French Commercial Law to ensure the social interests

of the company – is supposed to promote by ensuring that it does not remain a moot point and/or pure legal fiction.

These pious statements of intent must not hide the concrete and very real difficulties contained in the notion of a company's social interests, which can be difficult to circumscribe. Questions pertaining to measurements and standards of corporate performance are a topic of heated debate. *Grosso modo* and where listed companies are concerned, the preferred benchmark has been long-term share performance (capital gains and dividends).

A few Practical Implications of Enlightened Shareholder Theory

'*Nothing is more practical than a good theory*.' *Kurt LEWIN*

Enlightened shareholder theory leads to a new definition for corporate governance. The classical definition of the Cadbury Code – corporate governance involves '*the implementation of a system by means of which companies are directed and controlled'* – can now be replaced with the idea of a '*system comprised of all of the internal mechanisms enabling shareholders to be informed of the proper functioning of their company, controlling it through their AGMs and by the powers they delegate to the Board of Directors, while ensuring corporate strategy in compliance with existing laws in the long-term interest of the firm*.'

In this new theoretical framework, the first obligation of board members becomes clear - at all times and places, they must defend the firm's long-term social interests. This notion clarifies the duties of board members but also gives them a great deal of room to manœuvres. Even with a well-defined objective, corporate governance offer board members margin for interpretation and a central role not only in this disciplinary sphere but also and above all in the field of strategy.

Another practical consequence concerns the composition of the board of directors, which must be chosen very carefully. Not only must the board be competent in accountancy and company law and have perfect knowledge of a firm's organisation, operations and sector, it also has to be able to assess the risks of a firm's activity, for itself and for its stakeholders. What is new is the knowledge that a board needs about corporate culture. The new theory - and the definition of corporate governance that derives from it - has practical consequences, including the need for board members to be aware of cultural or behavioural biases (Practices like board of directors meetings outside of the presence of executives, can for example reduce biases like submission to authority). This theory affects the prescriptions that determine a board's composition, since to defend a firm's long-term interests, the board will require different kinds of expertises and must be capable of integrating and understanding a company's culture.

Conclusion

At the end of this paper, the main problem of governance and its finality appear clearly to relate to the legitimacy of actors and more particularly to the role of board members, who are the key actors in governance matters. For whom do board members work? To whom should they be accountable? Above all, who are the ultimate beneficiaries of their governance? It has been shown that stakeholders are not the main targets at this level. Shareholders do benefit at times, but not always. In reality, it is the long-term interest of the firm that must be the aim of corporate governance and the constant concern of board members. This is the finality of the *Enlightened shareholder theory* whose foundations the present paper has attempted to outline.

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