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CORPORATIONS, PROFIT MAXIMIZATION AND THE PERSONAL SPHERE

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The efficiency argument for profit maximization says that corporations and their managers should maximize profits because this is the course of action that will lead to an 'economically efficient' or 'welfare maximizing' outcome (see e.g. Jensen 2001, 2002). In this paper, I argue that the fundamental problem with this argument is not that markets in the real world are less than perfect, but rather that the argument does not properly acknowledge the personal sphere. Morality allows each of us a sphere in which we are free to pursue our personal interests, even if these are not optimal from the social point of view. But the efficiency argument does not come to terms with this feature of social life.

Many people believe that the primary responsibility of business corporations is to maximize profits. One of the most important arguments for this view is a broadly utilitarian one that says that corporations have this responsibility because profit maximization will lead to an 'economically efficient' or 'welfare maximizing' outcome.[1] Call this the

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[1] For the purposes of this paper, I understand individual welfare to consist in the satisfaction of rational desires. A 'welfare maximizing' outcome is one in which the aggregate level of welfare in society is as high as it can be. (This assumes the possibility of interpersonal welfare comparisons.) An 'economically efficient' outcome is one in which no social

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efficiency argument for profit maximization (EAPM). This argument is politically important, particularly in the United States, and forms part of the implicit background for a great deal of popular and academic theorizing about how corporations should operate.

One common criticism of the EAPM is that it may show that corporations have a responsibility to maximize profits in an ideal market, but real markets are far from ideal, and it is not clear what implications the argument has for corporations in the real world (see Goldman 1980). This critique has merit, but insofar as it accepts the implications of the EAPM under ideal or approximately ideal conditions, it fails to get to the heart of where the argument goes wrong.

My aim in this paper is to articulate a more fundamental problem with the EAPM. The EAPM is more deeply at odds with commonsense views of the morality of market life than most people realize. The logic of the EAPM implies a requirement to maximize profits that is more wide ranging than most of us would be willing to accept. The counterintuitive implications of the EAPM are connected, I will argue, with the division in economic life between the 'personal sphere' and the 'impersonal sphere'. The EAPM does not properly take into account the importance of the personal sphere and the challenge that it poses to profit maximization.

In sections 1 and 2 of the paper, I set out the main features of the EAPM, focusing on the exceptionally clear formulation of the argument given by Michael Jensen (2001, 2002). In section 3, I explain how the EAPM is at odds with commonsense intuition. I consider a defence of the EAPM in section 4. Finally, in sections 5–7, I develop an account of where the EAPM goes wrong. I argue that the problem with the EAPM is that it does not adequately address the fact that there is a personal sphere within which we are not required to perform the action that is optimal from the social point of view.

1. THE EFFICIENCY ARGUMENT FOR PROFIT MAXIMIZATION (EAPM)

The basic idea behind the EAPM is sometimes attributed to Adam Smith, but I will focus on the formulation given by Michael Jensen.[2]

In Jensen's usage, the 'objective function' of the firm refers to the good or value that firms are normatively required to maximize (Jensen 2001: 8;

resources are 'wasted' in the sense that these resources could have been used in such a way as to achieve a higher level of aggregate welfare. I believe that my use of these terms is consistent with Jensen's use of them. I consider a more restrictive notion of a 'welfare maximizing' outcome in section 4.

[2] Jensen 2001, 2002. Adam Smith describes the invisible hand in a famous passage of *The Wealth of Nations* (Smith 2000: 485). For a helpful discussion of how to interpret Smith's remarks in this passage, see Fleischacker (2004: 138–142).

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2002: 236). The maximization of this good or value, whatever it turns out to be, defines the normative purpose of the firm, and it also specifies the duties of managers, since managers are required to manage the firm so that it fulfils its normative purpose.[3]

Jensen argues that the objective function of the firm is its own 'long term market value'.[4] People often invest in a firm by buying stocks, bonds, warrants and other financial instruments that are traded in open markets and represent financial claims on the firm. The 'long term market value' of the firm essentially consists in the total market value of these financial instruments (Jensen 2002: 236). As he says, the 'total long-run market value' of the firm is equivalent to 'the sum of the values of all financial claims on the firm – including equity, debt, preferred stock, and warrants' (Jensen 2002: 236). So on Jensen's view, the good or value that firms are normatively required to maximize is the total market value of the financial instruments through which people invest in the firm. Or more simply: firms are required to maximize the market value of the total investment that investors have made in the firm. Following Jensen, I will refer to the maximization of the long-run market value of the firm as 'value maximization'.

In ordinary usage, we tend to distinguish between 'value maximization' and 'profit maximization'. But it is important to Jensen's thinking that these two ideas are very closely related. Jensen generally uses the term 'profit' to refer to the difference between what consumers pay for the firm's outputs (revenue) and what the firm pays for inputs (costs). Firms will sometimes generate a profit, and the people who invest in a firm – whether through equity, debt preferred stock, or warrants – are essentially buying a claim on this profit. Since investors are buying a claim on the firm's profits, it follows that the long-run market value of the firm is equivalent to the long-run market value of the stream of profits that the firm will generate. As Jensen puts it: 'firm value is simply the long-term market value of th[e] stream of benefits [that the firm produces]' (2002: 239). For the purposes of defining the objective function of the firm, then, Jensen treats the long-run market value of the firm as equivalent to the long-run market value of the stream of profits that the firm will generate. This equivalence is important because, as we shall see, Jensen's normative argument for value maximization focuses more specifically on the importance of profit maximization.

[3] Jensen notes that strict maximization may be difficult or impossible under certain circumstances. For this reason, the 'objective function' of the firm should be understood, more precisely, as the good or value that a firm is normatively required to 'seek,' that is, the firm must always aim to produce more of this good or value rather than less (see Jensen 2001: 11).

[4] Thanks to Christian List for helpful suggestions on how to formulate this claim.

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Value maximization is clearly meant to define a normative requirement for both firms and their managers. The objective function of the firm is not meant to give managers friendly advice or to tell them how best to achieve some objective that they may or may not want to pursue. The objective function of the firm is authoritative. Accounts of the firm's objective function 'provide the business equivalent of the medical profession's Hippocratic Oath' (2002: 236; see also Jensen 2001: 9). At a minimum, the EAPM implies that value maximization is a normative requirement and that this requirement outweighs other requirements in most ordinary circumstances. For example, a manager choosing between different healthcare plans may have reason to adopt a costly plan that will benefit employees, but the EAPM says that he has a more pressing reason to choose the plan that will maximize the long-run market value of the firm.

Although value maximization is a normative requirement, it is not necessarily the principle that managers should use to guide and justify their decisions. For example, communicating with and motivating employees, suppliers and partners is a difficult task, one that requires paying attention to the sensitivities of the various parties. Since people are often moved by ideas of reciprocity and good personal relations, it turns out that 'if we tell all participants in an organization that its sole purpose is to maximize value, we would not get maximum value for the organization' (Jensen 2002: 245). In many cases, then, it would be most profitable for managers to adopt the strategy and language of a managerial theory such as stakeholder theory. In these cases, value maximization would require that managers think and act as stakeholder theorists recommend, since this is the course of conduct that will, in fact, lead to the highest profits. Jensen refers to this as 'enlightened value-maximization' (Jensen 2002: 245–246).

A central question to raise at this point is why value maximization? Why is the firm normatively required to maximize its long-run market value? According to Jensen:

> The short answer to the question [...] is that 200 years' worth of work in economics and finance indicate that social welfare is maximized when all firms in an economy maximize total firm value. (Jensen 2002: 239)

Jensen gives an exceptionally clear account of the connection between value maximization and social welfare. Let's assume that there are no externalities or monopolies in the economy. We can think of the firm as the locus of a process that takes existing goods and services out of the economy as factors of production and puts new goods and services back into the economy as products. When the population as a whole is willing to pay more for the firm's products than they were willing to pay for the various factors that went into the production process, the firm makes

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a profit. (Revenues exceed costs.) But if people are willing to pay more for the firm's products than they were willing to pay for the goods and services that the firm uses up, the firm also 'creates value' in the sense that it increases aggregate welfare: the firm transforms a less valued mix of goods and services in the economy into a more valued mix of goods and services.[5] In Jensen's words:

> [A] firm taking inputs out of the economy and putting its output of goods and services back into the economy increases aggregate welfare if the prices at which it sells the goods more than cover the costs it incurs in purchasing the inputs. (Jensen 2002: 240)

It follows, then, that the best policy from the point of view of maximizing aggregate welfare would be for each firm to maximize its own long-run market value (Jensen 2002: 240). As each firm seeks to maximize its market value, it seeks out all available profit-making opportunities, transforming the stock of goods and services in society from one that is less highly valued to one that is more highly valued, and thereby helps to bring about a welfare maximizing social state.[6]

2. EAPM VERSUS OTHER ARGUMENTS FOR PROFIT MAXIMIZATION

It is important to distinguish the EAPM from other arguments for profit maximization. Jensen's argument is clearly a form of welfare consequentialism: it starts with a valuable outcome, namely a social state in which aggregate welfare is maximized, and it argues that

[5] Jensen's argument assumes that an increase in the aggregate willingness to pay for the goods available in society implies an increase in the aggregate level of welfare. There are many reasons to question whether this is true. An increase in the market value of goods in society does not necessarily imply an increase in aggregate welfare (Coleman 1984; Dworkin 1985; Sen 1999). But for the sake of argument, I will assume that there is a strong correlation between aggregate willingness to pay and aggregate welfare.

[6] Strictly speaking, Jensen's efficiency argument shows that it is socially optimal for firms to maximize profits. Why then does he say that the objective function of the firm is its long-run market value? Why not leave capital markets out of the picture altogether and simply direct firms to maximize profits? Jensen seems to have two different answers to the question. Sometimes, as I note above, he says that the two formulations of the objective function are essentially equivalent (2002: 239). Other times, however, he seems to suggest that managers should focus on the long-run market value of the firm because capital markets embody the most rational and fully informed judgement in society about a company's expected future earnings (including an appropriate discount rate for future returns). (For the latter argument, see Jensen 2001: 13. See also Jensen (2002: 246), where he says that managers may have to make decisions that decrease the market value of the firm, at least in the short term, because their access to firm-specific information puts them in a better position than investors to make judgements about future profitability.) The second argument accepts that the objective function of the firm is profit, but contends that managers should look to capital markets for expert guidance about what will maximize profits.

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firms are required to pursue the policy that will lead to this outcome. Importantly, Jensen's argument does not give any special consideration to the relationship between the firm and its shareholders – or, for that matter, any of its stakeholders.

> Much of the discussion in policy circles concerning the proper corporate objective casts the issue in terms of the conflict among various constituencies or 'stakeholders' in the corporation. The question then becomes whether shareholders should be held in higher regard than other constituencies, such as employees, customers, creditors, and so on. It is both unproductive and incorrect to frame the issue in this manner. The real issue to be considered here is what firm behavior will result in the least social waste – or equivalently, what behavior will get the most out of society's limited resources . . . (Jensen 2002: 239–240)

The fact that the actual shareholders in a firm play no fundamental role in the argument distinguishes the EAPM from two other important arguments for profit maximization. One is what I will call the *delegated property rights argument*. Milton Friedman (2004) presents a version of this argument, which says that managers have a duty to maximize returns for shareholders because shareholders 'own' the firm and they delegate their authority to managers with the understanding that managers will maximize returns.[7] According to the delegated property rights argument, managers stand in an agent-principal relationship with shareholders. This is clearly different from the EAPM, since the EAPM does not say that managers must maximize profits because they owe it to shareholders to do so.

The other argument is what I will call the *'law and economics' argument for shareholder control*. Theorists in the 'law and economics' tradition, such as Easterbrook and Fischel (1991), argue that the corporate law should be designed to help the market process reach a 'wealth-maximizing' (i.e. Kaldor–Hicks efficient) outcome. One way that the law can contribute is by setting shareholder control (rather than, say, employee control) as the default arrangement for corporate decision-making. By putting shareholders in a position to direct corporate policy, the law would put control of the corporation in the hands of the actors who are most strongly motivated to use corporate assets in socially productive ways. In practice, this argument supports profit maximization because shareholders typically exercise their authority in the corporation to maximize the return on their investment. But again, the argument here is quite different from the EAPM. According to the 'law and economics' argument, if managers are required to maximize profits, they are only

[7] Many corporate law scholars reject the idea that anyone 'owns' the firm (see Stout 2002; Bainbridge 2008; cf. Hansmann 1996: ch. 1).

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required to do so because shareholders tell them to. The EAPM, by contrast, makes no fundamental reference to the shareholders in a firm.

Some readers may find this point surprising. How can shareholders play no fundamental role in the EAPM? The point should not be all that surprising. Jensen's argument appeals to a form of welfare consequentialism that implicitly informs much normative economic theorizing. This outlook starts with the idea that aggregate welfare is important and contends that laws, institutions and social rules should be structured to generate a welfare-maximizing outcome.[8] Market processes are often the best way to achieve this goal. But in some cases, market processes will not lead to the best outcome, and welfare consequentialism says that we should use nonmarket processes in these cases (assuming they will lead to better outcomes). For example, if markets will not produce pure public goods (e.g. clean air, national defence) in the amounts that would maximize aggregate welfare, then the state should use its powers of taxation to compel people to contribute to the provision of these goods. What matters fundamentally is not respect for the authority of the shareholder, but social welfare. All market processes, including the market for authority and control over the firm, are important only insofar as they help to bring about a welfare maximizing outcome.

3. AN IMPERATIVE THAT IS TOO WIDE RANGING

The EAPM says that firms should maximize their long-run market value by maximizing profits. The fundamental problem with the EAPM is that it does not constrain the imperative to maximize profits in the right way. The rationale for profit maximization offered by the EAPM extends to all firms, that is, to all economic enterprises, including corporations. Although some corporations may be subject to an imperative to maximize profits, our commonsense view of the morality of market life says that many corporations are not. Insofar as the rationale offered by the EAPM does not distinguish between corporations (which are all 'firms' in the relevant sense), it does not constrain the imperative to maximize profits in the right way. I will use three examples to illustrate.

The first example involves a corporation whose stakeholders all agree to seek profits while also seeking to advance other ends.

> **Evolving into a hybrid.** *Beta Lending* is a small bank with historic ties to the black community in West Philadelphia. One day, the CEO of the bank decides to take the company in a new direction. He writes a proposal to change the company's objectives from simply maximizing profits to seeking reasonable profits while also promoting minority home-ownership in the

[8] Among many others, Hansmann and Kraakman (2001) are also explicit that the corporate law should be written so as to maximize social welfare.

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area. He presents his proposal to the other executive officers, the board of directors, and eventually to shareholders and employees. Everyone agrees to the change, and the company revises its basic objectives. Over time, it is successful in advancing these objectives, offering better lending rates to qualified minority applicants, while also maintaining a reasonable (though not maximal) level of profit.

Just to be clear, it is possible for companies to pursue objectives such as promoting minority home ownership in ways that improve their brand image and ultimately maximize their profits in the long run. *Beta Lending* does something different. The company pursues minority home ownership as an end in itself, and this contributes in some ways to the company's long-run profits, but detracts in others. The net effect is that the company always generates a reasonable profit, but not the maximum profit possible.

Commonsense intuition says that *Beta Lending* does not violate a normative requirement when it makes a reasonable profit while also promoting minority home ownership. Corporations may sometimes be required to maximize profits, but given that all of the stakeholders participating in *Beta Lending* agree to pursue other objectives, *Beta Lending* is not subject to this requirement.

Commonsense does not take *Beta Lending* to be violating a normative requirement, but the EAPM takes a different view. The EAPM says that corporations are normatively required to maximize their long-run market value by maximizing profits. As we saw in section 2, the argument does not give any special consideration to the relationship between the corporation and its stakeholders. The logic of the argument does not effectively distinguish between corporations whose stakeholders agree to pursue other objectives besides profit maximization and those whose stakeholders do not. The central issue is minimizing 'social waste'. Any corporation that takes goods and services out of the economy as factors of production and puts goods and services back into the economy as products finds itself in a similar position: the best thing that it can do from the point of view of maximizing social welfare is to maximize its own long-run market value. As such, the EAPM implies that corporations such as *Beta Lending* are required to maximize profits, even though all of the stakeholders (including current shareholders) agree to pursue a more complex set of objectives. This puts the EAPM clearly at odds with commonsense intuition.

The second example also involves a corporation whose stakeholders agree to seek profits while also seeking to advance other ends. But the corporation comes into existence in a somewhat different way.

Establishing a hybrid. Two friends, Ben and Jerry, decide to set up an ice cream company that will seek to make a profit, but will do so while also

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> looking to pay its workers above-market wages and benefits. Ben and Jerry write these objectives into the founding documents of the corporation, and they make these goals clear on the company's website, prospectus, and other communications with potential managers, investors and employees. Everyone invests in the firm, comes to work there, or otherwise associates with the firm knowing its basic plan. The company starts to operate and is largely successful in achieving its objectives. It steadily improves sales and lowers costs. It maintains a high (though not maximal) degree of profitability, while also providing employees with above-market wages and benefits.

Commonsense moral intuition says that the ice cream company in this case does not violate a normative requirement by making a reasonable profit, while also paying workers above-market wages and benefits. Again, the EAPM takes a different view. The argument does not give any special consideration to the relationship between the corporation and its stakeholders, including its original founders. The key issue is minimizing 'social waste.' In effect, the logic of the argument does not distinguish between corporations that were established for the purpose of maximizing profits and corporations that were established for other purposes. For any corporation involved in economic exchange, the best course of action from the standpoint of maximizing aggregate welfare is to maximize its own long-run market value. So by the lights of the efficiency argument, companies such as the ice cream company in the example are required to maximize profits, even though all of the current stakeholders (including current shareholders) agree to pursue a more complex set of objectives. This again puts the EAPM at odds with commonsense intuition.

The final example presses the argument to its logical conclusion. The EAPM does not distinguish between corporations based on the intentions of their founders, so the requirement to maximize profits extends, in principle, even to corporations that were established for quite different purposes.

> **Pure nonprofit.** The *Metropolitan Museum of Art* is a corporation that takes goods and services out of the economy as factors of production and puts goods and services back into the economy as products. Among the factors of production that it takes out are electricity, construction materials and the labour of its employees. Among the goods that it puts back in is the experience of viewing great works of art. People would be willing to pay to see the *Met*'s art collection, but it does not charge for admission: the *Met* foregoes the potential revenue and allows patrons to see the collection for free.

Commonsense intuition says that the *Met* does not violate a normative requirement when it makes its product available to the public free of charge. The museum does not violate a requirement, even if it is true

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(as it undoubtedly is) that the public would be willing to pay a higher fee for admission. It may be true that some corporations are subject to a normative requirement to maximize profits, but the *Met* is not one of these corporations.

The EAPM disagrees again with commonsense intuition. The argument says that corporations are subject to a requirement to maximize their long-run market value. Some corporations are established by their founders to pursue profits and some are established to pursue other objectives entirely. But the logic of the EAPM does not take the objectives of founders into account. As long as a firm takes goods and services out of the economy as factors of production and puts goods and services back into the economy as products, the best thing that it can do from the standpoint of maximizing aggregate welfare is to maximize profits. It follows that the *Met*, and other nonprofits, such as the *The National Geographic Society*, the *University of Pennsylvania* and the *Cedars-Sinai Medical Center* are violating a normative requirement when they fail to maximize profits.

Some might argue that the EAPM actually has no implications for how the *Met* should operate. The EAPM says that the objective function of the firm is its long-run market value, but since the Met does not issue stocks, warrants or other financial instruments, there is nothing that corresponds to a 'market value' for the managers of the *Met* to maximize. But this defence is not convincing. Although the *Met* does not have a market value at the moment, this is only because no one has put the museum on the market. The *Met* could sell shares to investors, and if it also started charging patrons for admission, these shares could become very valuable. Bringing the *Met* to the market in this way would take its market value from zero to at least several hundred million dollars. If the EAPM says that firms are required to maximize their long-run market value, then this seems clearly to be the course of action that it demands.

4. AVOIDING THE OBJECTION?

The fundamental problem with the EAPM is that it does not constrain the requirement to maximize profits in the right way. Some corporations might be subject to a requirement to maximize profits, but the EAPM pulls too many corporations into the scope of the requirement. I want to consider two possible defences of the EAPM.

One possibility is to revise the EAPM so that it appeals to a more restrictive notion of a valuable outcome. Consider a revised version of the EAPM, which says that corporations are normatively required to pursue the policy that would lead to a Pareto optimal outcome, and would lead to such an outcome through a series of intermediate steps that are themselves Pareto improvements. Formulating the EAPM in terms of

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the Pareto criteria (rather than aggregate welfare maximization) would attach greater significance to the preferences of those who participate in the corporation and might thereby address the underlying problem. For example, suppose that the shareholders and CEO of *Beta Lending* want the company to pursue other objectives besides profit maximization. If this were the case, then a policy of maximizing profits would not lead to a better situation, as judged by the Pareto criteria, because any increased preference satisfaction in the aggregate would come at the expense of decreased preference satisfaction for the shareholders and CEO. At best, a policy of profit maximization would move society from one Pareto optimal outcome to another, but the process would involve an intermediate step that was not a Pareto improvement. It follows that the revised version of the EAPM would direct firms to maximize profits only when doing so would not decrease anyone's preference satisfaction. And this restrictive imperative would avoid the counterintuitive implication in the *Beta Lending* case since profit maximization in this case obviously decreases the preference satisfaction of the company's shareholders and CEO.

Although the first response to the objection seems promising, it suffers from a fundamental problem: revising the EAPM in the way that I described would undermine the whole point of the argument. The point of the EAPM is to show that there is a requirement on corporations to maximize profits. The revised version of the EAPM would restrict the imperative to maximize profits so that it would apply only if there is no one in society who prefers that the corporation should pursue some other objective. But there is almost always *someone* in society who wants the corporation to pursue some other objective: employees want the corporation to pay them higher wages; suppliers want the corporation to pay them more for supplies; and so on. So the revised version of the EAPM would effectively imply that corporations are almost never required to maximize profits.[9]

A better approach to dealing with the objection would be to emphasize that there are different ways for corporations to contribute to aggregate welfare. The defender of the EAPM could argue that some corporations, such as *ExxonMobil* or *General Electric*, contribute to aggregate welfare by maximizing profits. But other corporations, such as the *Metropolitan Museum of Art*, contribute to aggregate welfare by making

[9] It is also unclear that the revised version of the argument shows that managers are subject, in any meaningful sense, to a normative requirement. Consider that anytime a CEO wants the corporation to pursue some other objective besides profit maximization – e.g. supporting the opera – the revised argument would say that the corporation is no longer required to maximize profits since doing so would lower the CEO's level of preference satisfaction.

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great works of art available to the public. In this way, the EAPM could avoid the implication that nonprofits should aim to maximize profits by arguing that efficiency considerations tell in favour of profit maximization for *some* firms, but in favour of other objectives for other firms.

There are two things to say here. First, this line of defence also seems to undermine the point of the EAPM. The point of the argument is to show that business corporations are subject to a normative requirement to maximize profits. But if it is possible for corporations to maximize welfare in other ways besides maximizing profits, then it seems that the EAPM is radically under-described: everything turns on whether it is true that business corporations are always or almost always in a position to maximize aggregate welfare by maximizing profits. Any business corporation could, in principle, argue that it would maximize its contribution to aggregate welfare by both making a profit and advancing some other objective at the same time. For example, *GlaxoSmithKline* (GSK) could argue that it maximizes its contribution to aggregate welfare by both generating a profit and giving some of its drugs away for free in the context of urgent need (e.g. in the context of the AIDS crisis in sub-Saharan Africa).[10]

The more important point for my purposes, however, is this. Even if there are many different ways for a corporation to contribute to aggregate welfare, the EAPM is still at odds with commonsense. Suppose that the *Met* would maximize its contribution to social welfare by maximizing access to its collection. It could do this by charging admission to wealthy patrons and using the proceeds to subsidize entry for poor patrons. But suppose that everyone who contributes to the *Met* believes that art should be part of the public commons: it should be freely available to all citizens, like green spaces in public parks. Contributors believe that it is wrong to charge anyone for admission to the museum, even if this means that

[10] Jensen might argue that if a corporation is in a position to contribute to aggregate welfare in two different ways – e.g. by pursuing profits and by giving medicine away for free – it should focus on just one strategy. This is because a firm that tries to maximize in more than one dimension faces 'confusion and a lack of purpose that will handicap [it] in its competition for survival' (Jensen 2001: 11). Having a variety of ultimate objectives also: makes the rational assessment of managerial conduct impossible (Jensen 2001: 11), weakens the oversight of managers and allows managers to use the corporation for their own purposes (Jensen 2001: 14).

Jensen may be right that pursuing more than one objective has all of the costs that he lists, but these are just costs: it is an open question whether these costs are greater than the benefits that might follow from a firm adopting multiple objectives in a particular situation. For example, if there is no one else in a position to realistically provide drugs at low cost to AIDS victims in Africa except GSK, then it is hard to see how aggregate welfare would not demand that GSK try to address the problem. Whatever inefficiencies supposedly follow from having multiple objectives, could these really compare to the thousands of human lives that could be saved?

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fewer people will see the collection in the end (see Anderson 1993). The commonsense morality of market life would say, in this case, that the *Met* does not violate a normative requirement. It may provide works of art to the public free of charge, even if this does not maximize its contribution to social welfare. The reason, as I will argue further in the next section, is that it is up to us what objectives we will pursue through associations such as the *Met*. We are not always required to pursue a certain course of action simply because it would maximize aggregate welfare. Therefore, even this revised version of the EAPM fails to come to terms with an important aspect of commonsense morality.

5. UNDERSTANDING THE PROBLEM: THE PERSONAL SPHERE

As I argued in section 3, the fundamental problem with the EAPM is that it does not constrain the requirement to maximize profits in the right way: it pulls too many corporations into the scope of the requirement. How can we understand the problem with the EAPM? Where exactly does it go wrong?

An important feature of our commonsense moral outlook is the idea of a personal sphere. Commonsense morality recognizes that there is an important part of our lives in which we are not required to perform the action that maximizes aggregate welfare, that is, the action that would be optimal from the standpoint of an impartial concern for the welfare of everyone. We might put the point by saying that, on the one hand, there is an *impersonal sphere* in which we are required to perform the action or follow the policy that would be optimal from an impartial perspective. But there is also a *personal sphere* in which we are allowed to pursue any goals, plans and projects we choose, even if these are not optimal from an impartial point of view.[11]

The importance of the personal sphere becomes apparent when we consider just how demanding an impartial concern for the welfare of everyone can be. In a famous article, Peter Singer (1972) offers a vivid illustration. Right now, there are millions of people suffering with AIDS in Africa and millions more suffering from starvation and malnutrition. Any amount of time or money that we spend in pursuit of personal objectives, such as making friends, getting a college degree, or learning to play the piano, represents time and money that we could have spent satisfying the very real needs of people in Africa.[12] If we were to take seriously the idea that we are always required to do what is optimal from the perspective

[11] The critique of utilitarianism on the grounds that it does not leave room for people to have a personal life is developed by Bernard Williams (see Smart and Williams 1973).

[12] I take it that needs are among the factors that give rise to rational desires, and individual welfare consists in the satisfaction of these desires.

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of an impartial concern for the welfare of everyone, then it would be a mistake for us to spend a minute or a dollar in pursuit of our personal plans and projects. After all, any minute or dollar that we spend in this way could have been spent addressing a more urgent need in some other part of the world. Given the level of need in the world, this would leave no aspect of our lives untouched, no place where we could simply pursue our own personal goals and plans.

The impartial concern for everyone's welfare is not only demanding, but also at odds with how we understand our lives, particularly with respect to human relationships.[13] For example, I typically give special attention to my daughter's needs: I feed her when she is hungry, care for her when she needs affection, and so on. I do this even though I know that there are other children, perhaps in my own neighbourhood, who have needs that are more urgent than hers. A comprehensive requirement to do what would be optimal from the perspective of an impartial concern for the welfare of everyone would demand that I respond to my daughter's needs only when no one else has a more urgent need that I am in a position to satisfy. It would be a mistake to show partiality or special consideration for my daughter's needs, or the needs of my other family members, my friends, my colleagues, my students and so on.

The familiar problems with impartiality that I note have lead many moral theories to recognize a personal sphere in which we are not required to do what is optimal from an impartial point of view. Perhaps the most important view of the personal sphere for my purposes is articulated in liberal welfare consequentialism. Theorists in this tradition (e.g. Mill 1906) argue that individuals are permitted in a wide range of cases to pursue their own preferred objectives. The reason is that allowing individuals this freedom actually leads to a higher level of aggregate welfare than if they tried in each case to perform the course of action that they took to be optimal from the impartial perspective. For example, we typically think of individuals in the market as having the freedom to pursue their own ends. It may be true of a certain doctor that he could promote aggregate welfare by giving his services away to the needy for free, but in the market, he is understood to have the freedom to charge for his services, give them away, or ask for some partial payment – it is up to him to decide. Liberal welfare consequentialists endorse this feature of our market practice on the grounds that allowing individuals this freedom to pursue their own ends will actually lead to a higher level of aggregate welfare in the long run.

[13] To his credit, Jensen is not insensitive to this point: see his remarks about Hayek and the family (Jensen 2002: 243–245). Jensen may be right that stakeholder theory attaches the wrong sort of significance to personal relations, but this is compatible with the view that personal relations have some kind of special significance that cannot be properly understood from the perspective of an impartial concern for everyone's welfare.

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A stronger form of recognition for the personal sphere can be found in a hybrid theory that incorporates an 'agent relative prerogative'. Samuel Scheffler (1982) argues that individuals are not always required to perform the action that would be optimal from the perspective of an impartial concern for everyone's interests. This is because each of us is permitted to give proportionately greater weight to his own interests than to the interests of others. Suppose, for example, that the relevant proportion is 1000. This means that I could pursue a personal project, such as getting a college degree, as long as the benefit to others of the impartially best action (e.g. digging wells in Africa) would not have been 1000 times greater than the benefit to me of my getting a degree. The basic difference between a hybrid theory and liberal welfare consequentialism is that the scope of the permission to pursue our own projects, according to the hybrid theory, has nothing to do with how the recognition of the permission would raise or lower aggregate welfare in the long run. The permission is a basic, nonconsequentialist feature of practical reason.

The strongest form of recognition for the personal sphere can be found in deontological theories that reject the idea of an impersonal sphere altogether.[14] Kantian moral theory, for example, holds that individuals must respect the basic rights of others, such as the right to property and bodily integrity. Individuals also have various duties, such as the duty to help others when they can do so at a reasonable cost to themselves. Each person is free to pursue whatever ends he chooses, so long as he respects these basic rights and duties; there is no impersonal sphere in which a person is required to perform the action that would be best from an impartial perspective.

The three types of views present quite different interpretations of the idea of a personal sphere, and we may reasonably ask for a more concrete conception of what the boundaries of the personal sphere are and whether there is anything like an impersonal sphere. But for the purposes of understanding where the EAPM goes wrong, the precise characterization of the personal sphere is not as important as the basic recognition that some such sphere exists.

6. RESPECTING INDIVIDUAL SOVEREIGNTY IN THE PERSONAL SPHERE

We tend sometimes to think of corporations as dehumanized abstractions that society can program to pursue any ends it chooses. But it is important to keep in mind that corporations are human enterprises: they are made up of many individuals engaged in coordinated activities with other individuals. Whenever we assign tasks to the corporation, we are

[14] Among the many deontological theories that are relevant to this discussion are Rawls's contractualist theory (Rawls 1999) and Nozick's libertarian theory (Nozick 1974)

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assigning tasks to the millions of people who take part in these enterprises every day. Any normative conception of the corporation must pay special attention to the personal sphere, a sphere in which each individual has a certain kind of sovereignty over her life.

To the extent that the EAPM recognizes the corporation as a human enterprise, it seems to treat the corporation as if it were a government agency. People often think of the government as part of the impersonal sphere. We tend to think of the government as a human enterprise in which people are required to adopt laws and policies that will lead to the highest level of aggregate welfare. Since the EAPM starts with the assumption that corporations are also required to pursue the policy that would lead to the highest level of aggregate welfare, it treats the corporation as if it were an extension of the state, a kind of government agency. To be fair, this perspective has some historical basis, as the modern business corporation developed (at least in the United States) out of the special purpose entities that the US government established to build railroads in the late 19th century (Chandler 1977; Roy 1997; Micklethwait and Wooldridge 2003). But whatever the historical origins of the corporation, the view of the corporation as an extension of the state is clearly at odds with our commonsense view today.

When we consider our views about various cases, the commonsense picture of the corporation that emerges is quite different from the one presented by the EAPM. Implicit in our commonsense view is the idea that the corporation is a *private* association. People establish corporations in order to pursue their own ends, where these ends should also contribute in some broad way to the public good. For example, two chefs out of cooking school who believe in the idea of 'slow food' may set up a restaurant as a corporation in order to bring this new way of dining to the public and to make money in the process. The corporation is a way for them to pursue a shared project that also has some public benefit. Importantly, the public benefit component here does not amount to a requirement to act from an impartial point of view. The corporation is an enterprise that people undertake in the personal sphere of their lives, a sphere in which they are not required to do what would be optimal from an impartial perspective.

The commonsense view of the corporation as an enterprise that people undertake in the personal sphere is most compelling in the case of a nonprofit. Morality allows each of us to spend our time and money doing things like sharing our love of art with our friends and family, even if this is not the optimal way to spend our time and money from the perspective of an impartial concern for everyone's welfare. By the same token, we are each permitted to spend our time and money working with other individuals to share our collective love of art with the wider public. A nonprofit corporation, such as the *Metropolitan Museum of Art*, can be

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understood as the structured pursuit of a joint personal project by a group of individuals. Each person involved in the enterprise makes a choice to devote a certain amount of his time and money to the shared mission of the museum. Donors, curators and patrons contribute time and money from the personal sphere of their lives, a sphere in which they are not subject to the imperative to maximize aggregate welfare.

The view of the corporation as an enterprise that people undertake in the personal sphere also allows for corporations to combine different sorts of objectives. A hybrid corporation, such as *Beta Lending* or *Ben & Jerry's*, is also a joint effort among investors, managers, employees and others, to pursue a set of objectives. Each person involved makes a choice to devote a certain amount of his time and money to the basic mission of the enterprise, which in this case is both to make money and to advance other objectives, such as providing generous wages and benefits to employees. Since these contributions are made within the personal sphere of their lives, the corporation as a whole is not subject to any requirement to maximize aggregate welfare by maximizing profits.

Finally, the commonsense view of the corporation can extend to business corporations. A business corporation, such as *ExxonMobil* or *General Electric*, is a joint effort among investors, managers, employees and others. Each party makes a choice to devote a certain amount of his time and money to the basic mission of the enterprise, which in this case is to seek profits by providing fuel, appliances, loans and other products to the public. Since the time and money that each person devotes to these enterprises is time and money that belongs to the personal sphere of his life, it is not subject to the imperative to maximize aggregate welfare. People may choose to pursue profits through their joint efforts, and they may even choose to pursue profits because they believe that this constitutes the best way to contribute to social welfare. But the fact that they can contribute to aggregate welfare by maximizing profits does not imply a normative requirement: people may *choose* to run their joint enterprise as a profit-maximizing business, but they are not *required* to do so.

7. FURTHER OBSERVATIONS ON LIBERAL WELFARE CONSEQUENTIALISM

Many academic economists and theorists of the corporation essentially endorse the liberal welfare consequentialist perspective on the personal sphere, so I want to elaborate further on how the commonsense view of the corporation should be understood from within this outlook.

Recall that we typically think of individuals as having the freedom to pursue their own ends through their market interactions. The liberal

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welfare consequentialist endorses this feature of our market practice on the grounds that allowing market actors this freedom to pursue their own ends leads to a higher level of aggregate welfare, in the long run, than requiring them always to perform the action that they think would be optimal from an impartial perspective. The liberal welfare consequentialist's recognition of the importance of individual freedom in the market leads naturally to the commonsense view of the corporation. She might reason this way: if individual doctors have permission to pursue their own preferred ends in the market, then it stands to reason that several doctors may join together to establish a hospital that seeks partly to make a profit, partly to provide services to the needy for free, and partly to do something else entirely – e.g. support the opera. The corporation is simply a vehicle through which individuals jointly exercise their market-based freedom to spend their time and money on whatever is important to them, so long as their projects have some public benefit.

Imagine now that the liberal welfare consequentialist reads Jensen's argument. What should she think? I take it that she might agree with much of what Jensen has to say, but still reject his conclusion. Jensen may be right that the socially optimal course of action for corporations is to maximize profits. But in itself, this observation is not fundamentally different from the observation that the socially optimal course of action for a certain group of doctors is to give their services away for free. The liberal welfare consequentialist recognizes that certain courses of action and certain policies may be socially optimal, but she thinks that, taking everything into account, society actually does better when market actors are not required to pursue these courses of action or follow these policies: we achieve the highest level of aggregate welfare, in the long run, when individuals are free to pursue their own preferred objectives in market life. This belief in the optimality of freedom supports the commonsense view of the corporation. As part of their freedom to pursue their own preferred ends in market life, individuals may join together with other individuals in a corporation to advance their shared objectives, whatever these objectives happen to be. In this way, the liberal welfare consequentialist might agree with much of what Jensen has to say, but still reject the profit-maximizing view of the corporation.

Of course, the preceding considerations do not settle the issue. A requirement that corporations maximize profits essentially implies a restriction on the freedom of individual market actors: they are not free to establish corporations that pursue other objectives besides profit maximization, and they are not free to orient their activities within existing corporations towards other objectives. But it may turn out, on closer examination, that the welfare gains associated with a requirement that corporations maximize profits would be greater than the welfare

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losses associated with narrowing the scope of individual freedom in the market. If this were the case, then the liberal welfare consequentialist might have to give up the commonsense view of the corporation in favour of the profit maximizing view.

What I want to emphasize, however, is that *some such accounting of the gains and losses is necessary*. It is not enough simply to point out, as Jensen does, that the socially optimal course of action for firms is to maximize profits. The most important question, from the liberal welfare consequentialist perspective, is whether the gains generated by a requirement on corporations to maximize profits would be significant enough to outweigh the losses that would follow from narrowing the scope of individual freedom. There is a basic tension here between the idea that corporate profit maximization is socially optimal and the idea that liberty for market actors is socially optimal. I am not aware of any systematic effort in the literature to sort out where the balance of gains and losses ultimately lies.

I want to raise a final issue. Suppose that someone actually presents an argument that shows how the balance of gains and losses ultimately favours a requirement on corporations to maximize profits. Before the liberal welfare consequentialist can endorse the conclusion, she needs to consider how the argument relates to her liberal commitments. Consider that individuals are like corporations in the basic sense that they too are the locus of a process that takes goods and services out of the economy as factors of production and puts goods and services back into the economy as products. Individuals can also contribute to aggregate welfare by maximizing the value of their outputs and minimizing the value of their inputs. This means that, without further explanation, an efficiency argument in favour of a requirement on corporations to maximize profits could have similar implications for individuals more generally. The implication would be that individuals are normatively required to maximize the size of their own bank accounts because this is the policy that would lead to a welfare-maximizing outcome.[15] But this imperative would clearly conflict with the basic liberal idea that individuals are free to pursue their own preferred objectives in market life. So an added concern, from the liberal welfare consequentialist perspective, is that any efficiency argument for corporate profit maximization must explain how the balance of gains and losses works out in favour of a *corporate* requirement to maximize profits, but does not also work out in favour of a similar requirement for *individuals* more generally.

[15] Or perhaps they would be required to incorporate themselves and sell shares in their lifetime earnings. See Alan Schwarz, 'Buying Low: Minor Leaguer Takes Stock of Himself' *New York Times* (1 February 2008).

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8. CONCLUSION

My aim in this paper has been to show that the EAPM is more deeply at odds with our commonsense view of the morality of market life than most people realize.

The EAPM says that firms are normatively required to maximize their long-run market value by maximizing profits, and they are required to do this because this is the policy that will lead to the maximization of aggregate welfare. If, however, we consider individually each person who establishes a corporation or participates in it, we would reject the idea that this person is required to dig wells in Africa or to treat AIDS victims in Asia simply because this would maximize her contribution to aggregate welfare. By the same token, then, the individuals involved in a corporation would be right to argue that they are not required to orient their economic association to profit maximization simply because this would maximize their collective contribution to aggregate welfare. The corporation is a private association that they form in the personal sphere of their lives, a sphere in which they are not required to do what is optimal from an impartial point of view. They are free to orient their association to profits exclusively (a business corporation), partially (a hybrid), or not at all (a nonprofit) – it is up to them to decide.

I have not argued the point here, but I believe that the idea of a personal sphere also has implications for the 'law and economics' case for shareholder control. Theorists in this tradition argue that shareholder control should be the default arrangement in the corporate law because shareholders are the party with the strongest incentive to drive the corporation to maximize profits. Driving corporations to maximize profits is important in turn because this will ultimately push the market towards a wealth-maximizing outcome (see e.g. Easterbrook and Fischel 1991). People who participate in corporations might reasonably respond by saying that the corporation is a private association that they form in the personal sphere of their lives. Therefore it is up to them to decide whether they will help the market to reach a wealth-maximizing outcome or not. The law should not establish shareholder control as the default arrangement based on an implicit assumption that corporations are, by their very nature, just engines for the promotion of aggregate welfare.

Nothing I have said in this paper is meant to cast doubt on other possible arguments for a corporate requirement to maximize profits, such as an argument based on a libertarian conception of private property or a contractualist theory of social justice. But I believe that the commonsense notion of the corporation as a private association that people form in the personal sphere does raise problems for a variety of arguments that aim to justify normative requirements in business purely on the grounds of aggregate welfare and economic efficiency.

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