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Fiduciary duties

Introduction

Stakeholders are persons or groups characterized by an interest in a corporation, where the corporation targets a number of different objectives depending on its functional interests (Donaldson and Preston, 1995). Accordingly, shareholders are one of the many kinds of stakeholders in a firm. Nevertheless, managers and CEOs' duties and responsibilities to shareholders—so-called fiduciary duties (Marens and Wicks, 1999)—are often given special, and even primary, consideration, placing other stakeholders in a secondary position when it comes to management and decision-making.

Fiduciary duties are liabilities to third parties that agents bear in an explicit or implicit contractual relationship with the firm's stock owners. This responsibility can be a matter of law or custom that stipulates the duties and responsibilities assumed by an agent when managing a third party (also known as beneficiaries, trustees, or shareholders). In conformity with this fiduciary relationship, the agent's duty is to achieve optimal economic benefit for beneficiaries in exchange for their economic compensation in terms of fees, profit sharing, or both.

Accordingly, fiduciary responsibilities are delimited to stock owners or trustees, leaving any other responsibility that managers could

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eventually have with other stakeholders aside. Indeed, other kinds of relationships with third parties—even commercial ones—are different in nature. Non-shareholder third parties demand a different kind of obligation because stock owners depend on the performance of managers. An equity investor, in fact, buys a residual claim; that is, the value that depends on the discretionary performance of the manager—a performance that cannot be specified in advance, making the results uncertain. Therefore, it is impossible for shareholders to demand—and for managers to promise—a specific result, and it is too costly for investors to continually bring managers' efforts under personal oversight and scrutiny (Hetherington, 1987). Management may have never promised customers, employees, or suppliers, etc., a return on investment, so the relation between managers and other third parties is based on different grounds (Goodpaster, 1991).

Considering this fiduciary relationship, management theory has provided three main conceptual frameworks for understanding the nature and importance of the manager–shareholder relationship and, derived from it, the status of non-shareowner third parties. These theories include Agency Theory (AT), Stakeholder Theory (ST), and Virtue Ethics in Business (VEB).

Managerial responsibility in agency theory

AT, originally developed by Ross when defining agency (1973), provides an economic understanding of fiduciary duties. For AT, managers (agents) act responsibly when they maximize share value for the so-called principal or owner. As a fiduciary, the agent acts in representation of the owner in the sense that he is mandated to fulfill the owner's economic expectations. This sets the agent's responsibility to shareholders in essentially economic terms; that is, fulfillment of investors' economic expectations under the principle of "the more and the sooner, the better."

However, AT sees managers as not naturally inclined to fulfill this mandate because of their own economic self-interest that motivates them to act in a way in which economic gain is achieved at the expense of the principal property; i.e., it assumes opportunistic behavior (Jensen and Meckling, 1976). AT considers this a moral risk (Eisenhardt, 1989) and, in this way, aims to improve upon and understand an adequate agent–principal arrangement that lines up the agent's individual interests with the owner's economic expectations in order to reduce moral risk. Accordingly, the principal delegates administrative decision-making to the agent—even though both have a natural tendency towards misaligned objectives—by means of an economic arrangement that is usually regulated by a contract and defined in such a way that the principal sees his/her economic value increased while the agent also satisfies his/her economic expectations (Bøhren, 1998). This is a sort of win–win situation based on economic motivation for the agent in terms of bonuses, stock options, etc. (Jehle and Reny, 2001). The better agents do in fulfilling their duty to shareholders, the more economic benefit they will reap.

This agency scheme, based on individual interest and delegation, lacks any liability on the part of managers with non-shareholder third parties, except for a minimum of legal compliance with standards and regulations (labor law, consumers rights, etc.) that impacts and mandates managers' decision-making. This is so because any other moral or voluntary concern that the agent may have with other third parties is seen as capable of reducing managers' effectiveness in maximizing share value.

In line with AT, ST is more explicit in terms of prohibited conduct with non-shareholders. In effect, this theory, especially Milton Friedman's version, very clearly explains that responsible firms make as much money as they can, within legal and ethical constraints, and society then indirectly benefits in a trickle-down scheme (Friedman, 2007). Social benefits to non-shareholder third parties and society are simply a matter of compliance or of purely philanthropic activity. Accordingly, for both AT and ST, managers' responsibility is limited to their fiduciary duty and shareholders are of chief importance.

Managerial responsibility in stakeholder theory

For its part—and as a critique of AT's lack of ethics and value judgment—ST provides a social-strategic definition of the firm (Freeman, 2010) where managers' responsibilities are broadened by integrating two kinds of responsibilities, namely those towards the organization and those towards stakeholders.

For ST, managers should first be committed to organizational development, while still always attending to third parties involved in the organization's performance, but they are not totally restricted to shareholder interest. Hence, top managers and CEOs are agents for the corporation, which is not just a shorthand way of saying that they are agents of shareholders. The corporation is meaningfully distinct; that is, ST does not direct managers to serve two masters—rather, they are meant to serve the interests of one master, namely the organization (Phillips et al., 2003). Indeed, Freeman explains that CEOs are bound by a duty of care to use reasonable judgment when defining and directing the corporation's affairs in accordance with the interests of its stakeholders, defined as employees, financiers, customers, and communities (Freeman, 1994); that is, internal and external stakeholders. In this scheme of action, managers should not prioritize shareholders' interests; their responsibilities are not to stock owners above all else, nor exclusively to any other kind of stakeholder. Investors are just as important as any other stakeholder and there is, indeed, a sort of third-party egalitarianism since managers' highest responsibility is to the organization. Thus, for ST, managers' duty is not essentially fiduciary, but rather organizational, even though corporate managers may have some fiduciary duties (Phillips et al., 2003) when shareholders are important stakeholders in the firm.

In this way, fiduciary duties to shareholders can be distinct, but never more important. Moreover, these duties are not derived from the principle of share value maximization, but rather from the principle of functionality and wellbeing that applies to every stakeholder, shareholders included. Accordingly, managers act in a responsible manner to stakeholders because they (1) are needed for the organization's development and objectives (Phillips et al., 2003) and (2) they demand moral concern in the same way that all third parties' wellbeing should be considered in every social activity. ST argues the latter from the fact that the interaction within and among organizations creates a moral obligation over and above those duties that arise simply by the condition of being human (Phillips et al., 2003). This means that stakeholders, as social actors, have intrinsic value, not merely because of their ability to further the interest of some other group (Donaldson and Preston, 1995), but because every person or group of persons must be treated as ends in themselves, not as mere means (Evan and Freeman, 1988).

In short, ST sees fiduciary duties as one among other duties that managers have with all stakeholders. As such, they must be approached based on the fact that every person in society must be considered in terms of wellbeing and, additionally, in terms of his or her relationship to managers' first duty; i.e., the organization.

Managerial responsibility in light of the common good theory of the firm

From a VE approach (Sison, and Ferrero, 2015)—according to which a firm is defined in terms of its common good (Sison and Fontrodona, 2012)—managers are responsible for the wellbeing of all members that participate in the firm and that of the firm's associated third parties. When this wellbeing is achieved, the firm materializes its common good and managers, having acted virtuously based on just leadership and decision-making in their relationships with firm members and commercial associates, are responsible for it (Pinto-Garay, 2015; Pinto-Garay et al., 2020).

For VE, justice is a virtue defined as deliberating in an intelligent and honest manner in an attempt to care for other peoples' thriving. Particularly, this means finding good reasons to respect and promote wellbeing not only for ourselves, but also for members of our family, neighborhood, and economic associates and institutions. Accordingly, managerial duties—like every moral duty—are defined as a responsibility to others or, more

precisely, a responsibility in justice, where justice is the willingness to give to others what they have the right to receive and to care for their wellbeing. This precludes arbitrary self-preference in pursuit of the good (Finnis, 2011).

However, following Aristotelian moral philosophy, justice in VE must be considered differently in commutative and distributive-contributive relationships (Pinto-Garay et al., 2021): those who integrate the firm and participate as members form part of a distributive-contributive relationship. Shareholders are thus internal stakeholders to whom managers have a fiduciary duty based on the principle of distributive-contributive justice. Other third parties, such as suppliers, regulators, competitors, or customers, come under a commercial or legal relationship with the firm and, consequently, managers are responsible to them in terms of commutative justice. Thus, fiduciary duties are naturally different from managers' duties to non-shareholder third parties, but are not different from the duties that managers have with other groups who participate in the firm as internal stakeholders; i.e., employees—even when that relationship is not defined in fiduciary terms. Thus, duties to shareholders and duties to employees are equally important, even though the remuneration schemes (profits and salaries) are different due to the nature of the economic arrangement, rather than due to the principle of justice.

Additionally, since duties to employee and shareholders are based on the same principle of justice, economic demands from shareholders have limits in distribution of benefits and do not imply any priority, because the contribution of investors and stockowners must be balanced with the common good of the firm to which employees also contribute. Accordingly, virtuous fiduciary duties to shareholders are the opposite of managing only to satisfy the economic expectations of investors, which Aristotle would define as *pleonexia*; i.e., a vicious practice in which corporations assume a duty according to which managers' first duty obliges them to maximize shareholder profit in the return for their investments (MacIntyre 2016), forcing firms to earn the most money possible and, consequently, to prioritize short-term financial achievements (Moore, 2002). Contrary to this, VEB demands that managers put their fiduciary duties in perspective with other distributive-contributive and commutative relationships, thus allowing the firm to achieve a common good. This means that employees, who fall under a distributive-contributive relationship, must be considered as important as shareholders.

Conclusion

This entry compares and contrasts three different approaches to fiduciary duties, including Agency Theory (AT), Stakeholder Theory (ST), and Virtue Ethics in Business (VEB). AT, based on the principles of individual self-interest and share value maximization, understands management as prioritizing fiduciary duties above any other responsibility or duty toward third parties. In fact, it sees any other form of obligation to non-shareholder third parties as deriving from legal and cultural restraints.

ST, on the contrary, sees shareholders as one of many stakeholders, without a per se distinct value or priority, but managers do not have more duty to them than to the firm. According to ST, managers have fiduciary duties in corporations, but they are derived from the same principles that impact managerial duty toward every stakeholder; that is, because of how they fit in with the firm's goals and the need to care for the wellbeing of any social actor. Accordingly, for ST, managers' fiduciary duties are not more important than other duties that they might have with the firm's stakeholders.

Finally, VEB understands that, for managers, shareholders are not just another stakeholder due to the principle of justice that establishes a difference in distributive-contributive and commutative relationships. Accordingly, the principle of justice applies differently to stakeholders who are in commutative relationships versus those in distributive-contributive ones. In this vein, VEB considers shareholders as part of the firm and, consequently, in a distributive-contributive relationship. Thus, managers' fiduciary duties are on the same plane as the duties that managers have towards employees. That is to say, fiduciary duties should not be seen in a purely egalitarian light, but rather based on a consideration of merit and contribution to firms' common good.

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