THE PUBLIC JOINT-STOCK COMPANY : BLESSING OR CURSE?*

1. Context and introduction

Joint stock companies first came into being in the 18th century in Britain, and were mainly concerned with foreign trade. Initially, the organisational form was viewed with suspicion, it being supposed that it encouraged managerial inefficiency and corruption. Ricketts (1987, p 104 and pp 234-235) documents the objections of Adam Smith: "negligence and profusion therefore must always prevail, more or less, in the management of the affairs of the joint stock company", and such companies "very seldom succeed without an exclusive privilege; and frequently have not succeeded with one" (Smith (1776) vol. 2, p 233). Despite these concerns, the joint stock company was given legal recognition and the advantage of limited liability in the Joint Stock Companies Act 1856 in Britain. Since then the organisational form has spread world wide, and is the form now adopted by the vast majority of business enterprises in the market economies.

* This paper, which is intended to be exploratory rather than definitive, was given at the Tyndale Ethics meeting in July 1990. Very helpful comments were received from those at the meeting: especially David Attwood, Andy Hartropp, Paul Mills and Michael Schluter. Frederick Fourie very kindly gave me access to some of his unpublished work, and this has had a substantial impact on the content. Similar work has been undertaken at the Jubilee Centre in developing the Fair Business Principles (Schluter (1988 revised 1990)); that work considers a wider range of organisational structures than the joint-stock company which is the focus of the current paper.

The key features of the joint stock company can be simply stated. It is a separate legal entity, distinct from the people engaged in it, and with continuity, so that it does not die when the founders withdraw. The basic framework involves three sets of economic actors: the shareholders, the directors and the employees. The shareholders provide financial capital in return for a share in the profits. Their liability is limited to the capital they have subscribed, which is forfeit if the company fails. There is a distinction in practice, though not in legal treatment, between a "private company" where the shares are held by a single person or small group and cannot be transferred without the agreement of the shareholders, and a public company or PLC, where shares are offered for sale to the public at large, and can be freely traded. The largest public companies will usually take steps to have their shares listed and traded on the stock market. Smaller public companies may have to make do with less public means of trading their shares e.g. the Unlisted Securities Market in the UK, or arrangements for placing shares organised by merchant banks. The directors of the company are elected to the Company Board by the shareholders at the Annual General Meeting. Responsibility for the shareholders assets is vested in them. Their role is to protect the interests of the shareholders, to ensure that the company is operating within the law and in particular that it does not continue trading when insolvent, so that creditors interests may be protected. Traditionally, too, they have taken responsibility for the appointment of managers, for the form and level of their remuneration, and for the payment of dividends to shareholders.

The third group of actors is the employees, including the managers; this group conducts the business on a day-to-day basis, and does the work. (The internal organisation of the firm is an important and interesting issue, but one which will not be pursued in this paper). But they are not, legally at least, part of the company.

Within this framework, it is possible to describe a stylized history of the firm, in which the relationships between the different actors change over time. The enterprise begins as a private limited liability company. The entrepreneur will raise capital from his or her own sources (e.g. by mortgaging personal property), and from bank loans. The shareholders, the Board and the management will be the same people - often relatives of the entrepreneur. There is no problem about the company being run in the shareholders. Next, we suppose that the enterprise prospers and begins to grow. One possibility is that it is unable to generate sufficient funds internally for its growth; the original shareholders have no further resources to commit, and the bank is unwilling to provide long term development finance. One way out of this dilemma is to offer additional shares in the company to the public. Alternatively, there may not be a problem about finance for growth, but the initial shareholders may decide on a public offering of part of their holding. They wish to withdraw a part of their equity in the firm, either to diversify their portfolios of wealth, or to provide for consumption. Diversification is seen as a natural means to reduce the risk which arises from having virtually all ones wealth in a single asset, the value of which can vary greatly depending on the continuing success or otherwise of the firm. Provision for

consumption is perhaps a less attractive reason. Consider for example the case of Julius Drewe, who, with a partner, and a loan of #10000, opened a shop in London known as the "Home and Colonial Stores" in 1883. By 1889 the business had expanded at such a rate (in 1890 there were 106 branches nationwide) that he and his partner were able to retire from active participation with majority holdings sold to a new public limited company. Drewe then devoted his wealth to establishing himself as a gentleman, including the commissioning of Lutyens to build a Norman style castle on the edge of Dartmoor, known as Castle Drogo. Lutyens grand design was never fulfilled, but an impressive edifice was completed by the mid 1920s. Drewe only lived a few years more to enjoy what had been created for him (National Trust (1977)).

The offering of shares to the public at large opens the path to becoming a public limited company. The significance of this move is that almost invariably the shareholding becomes dispersed, and the original shareholders (or their family) cease to exercise a major influence on the company. In the U.K. at least this transition came quite late: Hannah (1983) shows that in 1914, 80% of large joint stock companies in Britain were still private rather than public. Fifty years later all but a small minority of large firms were public companies. In the U.S. the transition occurred more rapidly, so that Berle and Means (1932) could claim that in 58% of the top 200 U.S. companies in 1929, no single shareholding was greater than 5%. The implication of the transition was not only that founding or family shareholders had seen their influence diminish, but that shareholding was now so

widely dispersed that no shareholders were able to control the company. The hypothesis of Berle and Means was that these companies were now effectively controlled and run by their managers. Despite subsequent criticisms that Berle and Means had overstated their case (Stigler and Friedland) (1983)), there is little doubt that the phenomenon of "separation of ownership from control" is now a dominant characteristic of the larger public companies in both the U.S. and the U.K. (see Hay and Morris (1990), Chapter 9, for a review of the literature and current evidence).

~~A major concern of this paper is how this evolution from~~ private company to public company with widely dispersed shareholdings affects the formal structure of responsibilities and accountability. The issue has been addressed in some detail by Charkham (1989), drawing on the experience of Japan and Germany, as well as the U.K. and the U.S. In formal terms, the directors are responsible to the shareholders who elect them to the Board. But the formal structure can involve different arrangements in different countries. For example, in Germany there is a strict separation of managers and the Board: in Japan, the Board is the top management. In the U.S. there is a requirement that a majority of the Board be non-executive. In the U.K., where there is no requirement, executive directors predominate. But the key question is not the formal arrangements, but the actual channels of influence exerted by shareholders. Charkham uses the distinction between "voice" and "exit" first suggested (in a different context) by Hirschman. In the U.K. a dissatisfied shareholder will "exit" by selling the shares, since the exercise of "voice" to get the policies and/or

the management of the firm changed is thought to present insuperable obstacles. In Germany it is quite different. Many shares are held by banks or other financial institutions, as trustees or nominees: they consider themselves to be long term holders, and will therefore make their voice heard if they believe changes are necessary.

The second channel of influence is from the directors to the managers. The directors are supposed to oversee the overall business strategy and finances, to fix dividends in the light of the profits and prospects for the firm, and to determine managerial remuneration. There are bound to be some conflicts of interest here. For example, the role of oversight requires a close knowledge of the company and its affairs, so executive directors (i.e. managers) are the most suitable. But for fixing managerial remuneration, an arms-length relationship is needed. Non-executive directors should be strong enough to control the managerial contract and to dismiss a weak management team, if necessary. So the composition of the Board will be crucial to effective supervision of the management by the directors.

The public joint-stock company described above is now an international phenomenon. Despite some differences of functioning, the basic structure is the same in different economies with very different cultural backgrounds. This produces the question as to why this form has evolved rather than any other form. Does it imply that it is the most "efficient" organisation which has emerged by a process of institutional "Darwinism" under the pressure of competition in both financial markets and product markets? Has the law been purely passive,

responding to the need to give legal recognition to this structure, or has the law been instrumental in promoting its survival in competition with other structures? These academic issues have been increasingly addressed in the last 15 years, and a brief account is given in section 3 below.

One issue for debate has been disquiet over the priority given to shareholders in the formal structure of the firm. Goyder (1987) has been a particularly persuasive critic. He suggests that once the objectives of the original shareholders in setting up the firm have been achieved, then the company should be allowed to buy its own shares, so that it eventually becomes a public trust with directors responsible for ensuring that the terms of the trust are carried out. The constitution of the company should include a General Purposes clause spelling out responsibilities to consumers, employees and the community. These groups would be represented on the Board, and the performance of the company in terms of the General Purposes clause would be the subject of a "social audit" every three years. Griffiths (1982 pp 109-110) notes critiques of both limited liability and shareholder ownership of the enterprise, though he believes that there is sufficient countervailing legislation placing wider responsibilities on companies e.g. in respect of their employees, consumers and the environment.

A second issue has been emphasised by Charkham (1989). While not advocating any change in the basic structure of the public joint-stock company, he accepts that the structure is not necessarily functioning as well as it might, at least in the U.K. His concern is that the separation of ownership and control arising from dispersed shareholdings has led shareholders to

abdicate their responsibility for the company. As noted above, they exercise influence by "exit" rather than "voice". Private shareholders do this because they believe that they can have no effect. For institutional shareholders, the reasons are more complex. Their preformance is measured (against that of other institutional managers) on a 3-monthly or annual cycle. They therefore have every incentive to drop quickly any holdings in a company which is not prospering currently, even if the long term prospects are better. Any attempt to exercise "voice" to get policies changed are not considered because the results would come outside the immediate period of performance evaluation, and because it could be costly and time-consuming. Hence companies are anxious to make short term gains to satisfy shareholders, and will be unwilling to undertake long term projects. "Short-termism" is the rule by which all the players operate.

A third issue for debate concerns the role of takeovers. The traditional defence of takeovers is that they permit assets to be taken away from inefficient managerial teams to be given to better managers. The raiders are willing to pay a premium to shareholders because they have the skills to improve performance. In this way shareholder "exit" can be understood as an alternative to "voice", which will generate better use of resources in the long run. Whether the takeover mechanism does in fact generate these gains is a matter of dispute (Hay and Morris (1990) Chapter 14). A review of mergers policy in the U.K. (Department of Trade and Industry (1989) Annexe E) concluded that empirical studies of post-merger performance revealed little or no evidence of improved performances. Rather wider issues

have been raised in a report from the Industrial and Economic Affairs Committee of the Board for Social Responsibility of the Church of England (Board for Social Responsibility (1989)). The effects of takeovers on employees, customers and the local community where the company is located, are identified as proper concerns in evaluating mergers, in addition to the gains accruing to shareholders.

A final concern arises from the process of economic liberalisation in the formerly planned economies, especially in Eastern Europe. As they seek to establish market economies, a suitable ownership structure has to be provided for the former state-owned firms. Their first thought is to look to the institutions of capitalism in the West, and in particular, to the joint-stock company. Before they transplant it to their economies, it is incumbent upon us to make clear the advantages and the weaknesses of the structure. It would be a mistake to transfer a flawed organisational technology.

In the rest of the paper we hope to deal, in outline, with some of these issues. To do that effectively, we need to establish the Biblical-ethical criteria that are appropriate to the discussion, and this is undertaken in the next section. The basic methodology is to use these criteria to critique the structure of the public joint-stock company. (See Hay (1989), pp 309-313, for a justification of this approach). But to do this effectively we need to have a clear analytic understanding of the nature of the joint-stock company, how it operates and what its effects are. Section 3 attempts to summarise the findings of the rich literature on this subject. We are then ready, in section 4, to return to some of the issues outlined above.

2. Principles

The Biblical ethical principles discussed in this section are the result of an interactive process in which the nature of the issue under consideration guides the selection of appropriate principles. Consideration of the joint-stock company suggests these areas: the Biblical concept of stewardship, approaches to risk and uncertainty, and the design of organisations.

2.1 Stewardship.

Four principles which are relevant to the current discussion were derived in Hay (1989 Chapter 2). They are repeated here, without detailed justification.

(i) the resources of the creation are there to provide for human existence. This is made clear from the narratives of Genesis 1 and 2. (However there is no justification for wasting or wantonly destroying the created order, just to increase our consumption and comfort).

(ii) every person has a calling to exercise stewardship of resources and personal talents, as is made clear by the provisions for the division of the Promised Land, and by the parable of the talents in Luke 19.

(iii) our responsibility to determine the disposition of resources is linked to accountability to God himself for those resources. Thus the people of God in the Old Testament were reminded that the land belonged to God, and they were tenants. In the parable of the talents, each servant had to give an account for the use he had made of his talents, when the master returned.

(iv) Work is the means of exercising stewardship. So in his

work, a person should have access to resources, and control over them. The paradigm is the family farm in Ancient Israel. In the absence of capital markets, there was a close link between stewardship of land, work and returns. The more a family group put into the land, the greater their rewards. Prosperity came through their own diligence and thrift. This in turn gave purpose and direction to their work.

The relevance of the concept of stewardship to the evaluation of the joint-stock company is evident. The key motivation should be that of using resources carefully to provide for human existence: whether this notion of service is best stimulated by the pursuit of growth, efficiency and profit is a general issue to which we will return briefly below. But assuming for the moment that they are not inconsistent, we note that much of the analysis of the firm is concerned precisely with the conditions under which managers and employees will be effective stewards of the resources put at their disposal. The issue is whether the structure is conducive to incentives to work, and to the taking of wise decisions.

2.2 Living with risks.

As we shall see in the next section, a major explanation of the prevalence of the joint-stock company is its success as an organisational form in coping with business risk. Taking risks is very much part of the jargon of business analysis, and has been identified by some as the essential element in entrepreneurship (Knight (1921)). Traditionally, economic analysis has distinguished between "risk" and "uncertainty". Risk arises where events can be described, with some confidence, by an _ex ante_ probability distribution.

Examples are the incidence of rain or frost in a particular location, or the incidence of mechanical breakdown in a machine. Uncertainty arises where events are unexpected, for which no *a priori* probability distribution is available: innovation and technological progress are often thought to exhibit uncertainty. The distinction is important analytically because (roughly speaking), we have tools to enable us to analyse risk, but very little to go on when it comes to uncertainty.

A theological approach to the question should begin by observing that risk and uncertainty arise from the nature of the created order, and from the openness of human history. It is difficult to imagine a created order in which there was no variation in rainfall or frosts, and in which events like earthquakes did not occur. Similarly, any sensitive reading of history suggests that some events come as a surprise or shock: the assassination of President Kennedy is an example. From a human point of view, we have to accept the limitations of our finiteness: we cannot know everything, and our powers of forecasting and prediction are limited. Against this we have to set a doctrine of God's providence and foreknowledge: he has all the data at his command, he weighs the affections and desires of the heart, and his understanding of human history is perfect. We may wish to make a distinction between his providence in the realm of the created order, and his providence in history. In the latter, unless one holds to a particularly strong doctrine of predestination, he will not divert the path of a human being who is intent on wickedness, though he understands precisely what is going to happen, and what the consequences may be.

In the light of this analysis, how ought men to live their lives when faced with uncertainty and their own finitude? One Biblical theme emphasises the venture of faith. The paradigm is Abraham, setting out from Haran, trusting in God, and without any idea what his personal future might be. On a less exalted note, Jesus' injunction to the disciples in the Sermon on the Mount not to worry about food and clothing, because their Father in heaven knew about their needs, and would provide for them as he does for the birds and the flowers of the field, is an example of the Biblical calling for man to live by faith, a day at a time. On the other hand, the theme of prudence occurs widely in the Wisdom literature, especially Proverbs. The wise man fears God, and takes all sorts of sensible precautions to avoid evils and unprofitable outcomes. Echoes of the same theme may be detected in the New Testament, where the injunction to get on with our lives, both spiritual and temporal, is an antidote to those who are obsessed with the imminence of the Second Coming.

The implications of this brief analysis seem to be that we should be prudent about avoiding risks on a day to day basis, but open to take steps of faith as God calls. Prudence is particularly called for where it impinges on others for whom I have responsibility. Thus if my family needs a home, it is prudent to take steps to prevent fire and theft, and to insure against the loss that would be incurred if one of these events occurred. (Of course, this should not become a reason for ceasing to behave as a responsible steward of the insured property). I probably ought to insure my life to ensure that my family would be able to live reasonably comfortably should I die. Exactly the same justification could be given for holding some

wealth, e.g. for retirement. But a serious danger arises when the holding of wealth (or insurance) becomes so important to us that we are not prepared to step out in faith when God calls us to do so.

All this concerns individual responses to risk and the uncertainty of life. But there is also a community aspect. The impact of an event which would be disaster for an individual, e.g. a house fire, is spread to the whole group who also insure with that individual's insurance company. His damage is covered by their premiums. An analogy might be drawn with the requirement in the Old Testament Law to help a neighbour, who has fallen on hard times through no fault of his own. The analogy is however imperfect: what is missing is the personal element in aiding a neighbour, and the sense of responsibility that is enjoined. In an imperfect, and fragmented, society perhaps insurance schemes are the best we can hope for. In principle then, arrangements which spread risks, without encouraging imprudence, are to be favoured - so long as they do not entirely substitute human security for trust in God's providence.

2.3 Organisations.

In previous work, we have argued that work is a social activity in which human beings cooperate as stewards of their individual talents, and as joint stewards of resources (Hay (1989) pp 74-5). The model is the Biblical ideal of people in community. The basic examples are the family, and the <u>people</u> of God in the OT and the NT: the ideal is a community to which each member contributes according to their particular gifts. In the OT, the family is <u>the</u> basic economic unit, working the family

farm, sharing its prosperity or otherwise, and (in the absence of capital markets) providing the saving and investment for development out of their own resources. The basis for the unit is kinship within the family, widely defined. It is not obvious that this can be automatically extended to other relationships like employment, though that is the recommended route when a kinsman falls on hard times. The focus for the people of God is God himself: it is his family. If the ideal of the body of Christ is to be applied to an institution like a firm, then it requires an argument that the stewardship of resources is an exercise of responsibility before God, and so part of the worship of our whole lives. If this argument can be sustained, it has radical implications both for the objectives of firms and for their organisation. Their objectives should stress service to the community in the goods and services they produce, and stewardship of the created order in the way in which they produce. Organisationally, the focus of the firm should be on the people who contribute their skills and expertise, and thereby exercise stewardship.

3. Analysis of the joint-stock organisational form

In this section, we consider the reasons that have been advanced in the literature for the existence and advantages of joint-stock limited liability firms.

The discussion begins with the reasons for the existence of firms. The basic premiss is that team production is more productive than individual production because of division of labour and/or economies of scale in production. The question is why these cannot be achieved by contracts between the individuals rather than creating a separate institution called a firm. The basic problems with contracting were identified by Coase (1937). Sequential spot contracting is very expensive in time, as new contracts have to be negotiated in each time period. State-contingent contracting, where a contract specifies the terms depending on what state of the world occurs gives rise to difficulties: (a) bounded rationality -it is difficult to specify all contingencies in advance, or even if one could, to write a large number of appropriate contracts; (b) moral hazard - how to be sure that a particular contingency has actually arisen (a contractor blames the weather for his poor workmanship, rather than his laziness); (c) adverse selection - claims to expertise that a party to the contract in fact does not possess. In the face of these difficulties a firm has certain advantages. It internalises the gains from trade between the members of the firm, so there is no longer any need to bargain over shares in the gains. The firm develops organisational capital over time (Prescott and Visscher (1980)): it holds information about the skills and preferences of its workers, which enables it to allocate tasks more effectively. It can monitor activity to

detect shirking in situations where individual effort or output is difficult to identify (Alchian and Demsetz (1972)). Opportunistic behaviour is avoided, where transactions involve durable investments by one or both parties to a contract: once the contract is established, one party can seek to negotiate in the knowledge that the other party is tied in, with capital committed (Williamson (1980)).

The firm, then, creates a set of long term contracts between the people involved. These contracts will usually involve elements of two kinds of relationship. The first is employment, where the individual, in return for a given wage schedule, accepts the authority of the firm to direct what tasks shall be undertaken and under what conditions. The second is an agency relation. The principal-agent analysis recognises that the objectives of the principal and the agent (e.g. the manager and the employee) diverge, and that there is assymetry of information. The principal sets up an incentive contract to elicit the best possible performance from the agent (Hart and Holmstrom (1987)).

But what is the "firm" which sets up these long term contracts? Evidently it requires someone to write the contracts, to monitor performance and to identify and discipline shirkers. Assume that monitoring is effective, up to a point, in distinguishing poor performance arising from environmental difficulties, and that arising from laziness or lack of care. Then it is natural to give the monitor an incentive by becoming the residual claimant on the revenues of the firm, after wages and other costs have been paid. The more effective the

monitoring, the more efficient the operation of the firm, and hence the greater the residual claim. In a large firm, a hierarchical organisation will develop. Each level in the hierarchy sets objectives, and writes contracts for a lower level, and then monitors performance. The chief executive is then the top monitor.

The most straightforward example is where the top monitor is a sole proprietor. The supplier of capital emerges as the sole proprietor because the performance of capital does not have to be monitored: monitoring is only required to ensure that the workforce makes good use of the capital. But then the sole proprietor takes all the risk of the enterprise. Fluctuations in company income affect the residual claim after the relatively fixed wage bill and interest on loans have been paid.

The joint-stock form enables this risk to be spread. With a large number of shareholders, each with only a small proportion of their wealth in that company, held directly or indirectly via a portfolio of assets (e.g. unit trust or mutual fund, or pension fund), the risk is widely spread. Indeed the risk to a portfolio holder is only the risk arising from the covariance of returns on the share with returns on his whole portfolio. (This is the key prediction of the Capital Asset Pricing Model of Sharpe (1970) and Lintner (1965)). The existence of limited liability reduces the risk to the shareholder even further. But in a joint stock company, the chief executive is no longer the residual claimant, and will therefore have other objectives than the maximising of the residual profit (claim). He will therefore need to be given a contract, and his performance will have to be maintained. It will not be possible for individual shareholders to do this

effectively. Indeed, it will not be in the interests of any one to try, since the effort may be considerable, and all the other shareholders will have a free ride on the benefits of that effort. The natural mechanism is for shareholders to elect directors, who then fix the contract of the top executives and monitor performance on behalf of shareholders who are residual claimants. In theory, if not in practice, the Board of directors is "disciplined" by having to be re-elected by shareholders at regular intervals at the Annual General Meeting.

As noted previously, the transition from sole or family proprietorship is eased by the incentives that the initial owners have to sell shares to the public when the firm is successful. It enables them to extract wealth from the firm, and to reduce their personal risk by diversifying their portfolios of assets. It also enables assets to be transferred from family managers who are inadequate to the task to professional managers (Ekelund and Tollison (1980)).

This description of the limited liability company as a bundle of contracts between the self-seeking individuals involved is now widely accepted. However there are some arguments that it is not the whole story. Work on large unquoted companies in the U.K., the majority of them family owned, suggested that the owners were as much motivated by their commitment to the firm as an institution (which sometimes bears the family name) as by the wealth it represented (Hay and Morris (1984)). They were not interested in selling out to some other firm, and they were concerned to prevent the spreading of shareholdings. Their fear was that the inheritance taxes arising from the death of a major

shareholder would threaten their ability to remain independent. These findings are not consonant with the wealth maximising, risk avoiding objectives assumed by the contracts model.

Fourie (1989) argues that the firm should be regarded primarily as an institution to which employees "belong" and to which they contribute their work and skill. The analogy is with a social institution like a club, membership of which may involve a "contract" (e.g. promising to obey the rules, payment of a fee, agreement to participate in a particular way), but where the effective basis is a desire for social interaction and a willingness to be of service to the other members. If this analogy is appropriate, then joining a firm as an employee implies some commitment to its objectives of production and service. The management is professionally committed to the long term survival and development of the company. This view is consistent with the concept of the firm as a separate legal entity, with a life of its own. The shareholders' role is minimal. They have no involvement in the firm, and the election of directors is a charade. They are merely suppliers of capital, rather than owners in any effective sense, but differentiated from other lenders by the fact that they receive their returns in the form of dividends rather than interest payments. The concept of "ownership" attached to shareholding is an anachronism, a legacy from the previous phase in the evolution of the firm when the initial shareholders were effectively the founders and managers, of the firm, combining the roles of suppliers of capital <u>and</u> entrepreneurs.

Another critique of the contracts model of the firm is that it emphasises organisational features at the expense of an

analysis of the nature of entrepreneurship. The argument is that successful enterprises gain by taking risks, and that the incentive to the entrepreneur is the possibility of very large capital gains should a risky project succeed. The emphasis on risk spreading, both in employment contracts based on the principal-agent analysis, and in the financing of the firm via a dispersed shareholding, is entirely misplaced for the entrepreneurial firm. It can only apply to the mature firm in a relatively mature industry in terms of technology and market.

4. Evaluation

Our task in this section is to evaluate the joint-stock form in the light of the Biblical-ethical principles discussed in section 2.

We consider first limited liability and dispersed shareholding, on the traditional view that the shareholders are the owners of the firm. Ethically ownership must involve stewardship, taking responsibility for the use of resources, as well as benefitting from the returns. Yet the owners of a company can, with limited liability, duck out of all responsibility for the consequences of poor judgement or mismanagement: in liquidation or bankruptcy, debts incurred in their name are left unpaid. Not only is this state of affairs morally reprehensible, it also reduces the incentive for the owners to take an active interest in the affairs of the firm. It is not even obvious that limited liability is necessary to induce participation. A new company will almost certainly have to provide personal guarantees (secured on personal property such as a house) for borrowings, so liability is not effectively limited.

In a mature company, dispersed shareholders will almost certainly have a portfolio of assets, and so increased risks from the removal of limited liability would not be serious. The syndicates of the Lloyds insurance market are operated on this basis: the moral to be learned from their experience is that members are well advised to monitor carefully what their managers are doing. The main difficulty about removing limited liability from the joint-stock company might be the costs of pursuing all the individual shareholders should losses have to be met.

Dispersed shareholding, as we have already noted, deters the shareholders from taking an interest in and responsibility for the operations of the company. The Annual General Meeting is largely a formality, especially in respect of the electing of directors. Shareholders make their influence felt by "exit" rather than "voice". Ownership clearly does not imply stewardship in this case. There is a further aspect of this problem in that dispersed shareholding is more and more indirect shareholding. Institutions now hold a large proportion of quoted company shares in the form of pension funds, unit trusts, mutual funds and insurance companies. The individuals who are the ultimate beneficiaries of these portfolios may have no idea what assets they own indirectly. Indeed it is quite likely that they "own" a share in a company whose operations they find morally objectionable. There can be no question, with indirect shareholding, of exercising any responsible control over the assets. It might be argued that that is the role of the institution: but, as we have noted, the institution is required to maximise returns for the ultimate holders, and is more likely

to maximise value by switching within the portfolio than by trying to influence the behaviour of the companies whose shares are being held.

The irony about these ethical objections to limited liability and dispersed shareholdings is that they are greatly weakened, if not removed altogether, if we no longer insist that the shareholders are owners. If instead they are regarded as suppliers of financial capital, then they do have a responsibility to consider carefully to which firms they are going to lend - taking into account the uses to which the capital will be put as well as the returns and the risk. But their stewardship responsibility stops there. They are differentiated from bond holders only in that they receive dividends rather than a fixed interest. There is no reason why their claims should continue in perpetuity, and it would be appropriate to give the firm the right to buy back its own shares. (The consequences for takeover of removing ownership rights from shareholdings is considered further below).

The advantages of limited liability and dispersed shareholding lie in the spreading of risk. Our discussion of Biblical principles in this area makes the analogy with insurance. Dispersed shareholding enables risks to be carried more widely in the community, and given that shareholders are likely to have a portfolio of assets (either directly or indirectly) business failures or losses should not impinge too severely on any one person or group. But this advantage does not require that the shareholders be owners of the firm: exactly the same advantage would be present, if they were only suppliers of capital.

A switch from ownership to supplier of financial capital for shareholders would generate a further problem, at least within the contracts framework. The issue is that of motivating the top management. If shareholders are the owners and residual claimants, then they have an interest in providing incentives and monitoring the management via the Board of directors. Even though, as Charkham (1989) has shown, this mechanism is not particularly effective, it does in principle solve the problem of motivation. Replacing owner-shareholders with suppliers of financial capital (even with the right to residual profits) is not likely to improve matters. However many companies are _de facto_ public trusts, where the ownership rights of shareholders only come into play in the event of a takeover or a major change in the capital base. They are run by professional management, who possibly form a large majority on the Board, and they see their task as maintaining viability, and planning growth and development, while seeking to satisfy customers, lenders and the workforce, and to keep the shareholders happy. (Fourie (1989) suggests that managers should be viewed as "office-bearers" within the association the firm represents). Their performance would be monitored, and their contracts controlled, by non-executive directors whose conduct could be regulated by a code of conduct (as in the case of auditors). Non-executive directors would be members of a professional self-regulated institution, which would lay down strict entry standards including professional qualifications, and would be responsible for appointing directors to public trust companies. They would be required to report annually to all the interests in the company.

The second area of ethical concern complements the previous discussion. The principle of stewardship, and the ideals for organisations, outlined in section 2 above, suggest that those who work within the firm should have the responsibility for the use of resources, and that the major objective of the firm should be production and service rather than the maximisation of value. So the formal position previously discussed, in which the firm is run by managers appointed by directors to pursue the interests of shareholders is not morally acceptable. In practice, of course, the formal position is blurred. Serving customers well, producing without waste, caring for employees and recognising community obligations are part of the recipe for a successful firm. As previously noted, many large public companies are in practice run as public trusts. That merely strengthens the argument for a reform of the formal position. The public trust model proposed by Goyder (1987) would enable the rights and responsibilities of those who work in the company to be recognised, and the shareholders as suppliers of capital to be placed in the same position as the providers of any other input or factor of production.

The third area for discussion is the role of takeovers. The explanation for the prevalence of takeovers in the U.K. and the U.S. is that the shareholders have no effective voice in the running of companies, and will therefore "exit" by accepting a bid, if they are disenchanted with performance. The defence of this mechanism is that it enables the transfer of productive assets from poor management teams to better teams, though we noted in section 1 that the evidence for this is inconclusive at best. A Christian view is that a firm is an institution made up

of people, not physical assets - a view which is entirely consistent with empirical findings that human capital (skills) and accumulated experience are just as important as physical capital in explaining productivity levels (Davies and Caves (1987)). But people cannot be made the subject of property rights; so the sale of the firm, as in a takeover, is morally objectionable. In other words, it should not be for the shareholders to decide whether a merger is in the best interests of the business. Once again, the benefits of the public trust model are apparent. In agreeing to a merger, the non-executive directors would have to be convinced that the firm as a productive institution would be better served by merging its identity with another firm. In reaching this judgement, they would have to consider the interests of all the participants in the firm, including the workforce and the shareholders.

To sum up, we believe that there are ethical grounds for objecting to the formal structure of the joint-stock company, particularly in the role that is ascribed to the shareholders. In practice, they are unable to exercise the stewardship responsibilities that are associated in Biblical ethics with "ownership". Indeed, with limited liability they are able to shrug off any responsibility for losses incurred in their name. Their ownership of the company, and the mechanism of control via the Board of directors, is incompatible with the Biblical insistence that stewardship should involve work. The principle of stewardship, and the Biblical model of organisations, suggest that those who work within the firm should be given responsibility. As Charkham (1989) has noted, shareholders in

the U.K., at least, have signally failed to fulfil the role ascribed to them in company legislation. There are good reasons why this should have happened: in particular, it is easier to "exit" than to exercise "voice" if one is dissatisfied. _De facto_, in many companies the shareholders are no more than suppliers of financial capital, and the firm is a public trust run by professional managers. There remains however one area in which the role of shareholders is decisive: one means of "exit" is to accept a takeover bid. The moral objection to this is that a firm is primarily people, not assets, and they should not be bought and sold in this manner without their consent. Charkham, addressing the technical issues rather than the moral issues, wants shareholders to be encouraged to take their responsibilities more seriously. The alternative view, argued here, is that a public trust structure as proposed by Goyder (1987) would be more appropriate, with shareholders relegated to the position of being one group among several with interests in the company, and with powers of decision vested in the firm itself with accountability to externally appointed and professional non-executive directors.

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