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SOME KEY QUESTIONS ABOUT STAKEHOLDER THEORY

by Robert Phillips

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When it comes to ethics in business, many accept that standards can not only be different from, but even lower than, ethics in everyday life. That should definitely not be so, argues this author. In fact, he says, a corporation's obligations to its stakeholders bind it to those stakeholders, in turn creating new and specific moral obligations.

As businesses emerge as some of the most powerful institutions in the world, business ethics have never been more important, and given very recent history, more open to question. Corporations are relative newcomers to power, and for evidence of this we can look to Europe, where the oldest, largest, most elaborate buildings are the churches and cathedrals. For thousands of years, the church and its leaders were arguably the most powerful institution, but as the liberal notions of the Enlightenment supplanted church orthodoxy, the state supplanted religion as the more powerful institution. But at the dawn of the third millennium, the newest, grandest buildings are the corporate headquarters and facilities, an architectural phenomenon that neatly illustrates the transfer of power through history.

It is not clear, however, that the business community has lived up to its obligations and responsibilities in proportion to its rapid increase in power. Witness the number of organizations and executives that are being exposed for immoral and fraudulent conduct. This is why the time is ripe for an in-depth examination of ethics in business. In this article, I will apply the principles of stakeholder theory to discuss questions that are central to the business ethics debate, specifically:

- Why should managers pay attention to stakeholders?
- Who are an organization's stakeholders and what is the basis for their legitimacy?
- What do stakeholders want?
- How should managers prioritize among stakeholders?
- Are the ethics of business different from everyday ethics? If so, how and why?

WHY PAY ATTENTION TO STAKEHOLDERS?

Any convincing justification for maximizing shareholder wealth must, at its core, be a moral argument. The most convincing case is the property rights argument popularized by Milton Friedman. Briefly, this posits that shareholders own a firm by virtue of owning equity shares, and, moreover, that they wish to maximize the value of those shares. Managers who fail to maximize shareholder wealth are violating a moral property right by spending-if not stealing-shareholders' money.

In my opinion, equating share ownership with firm ownership is unjustified because the firm is an independent entity that is not "owned" by anyone. By way of comparison, selected individuals are responsible for administering churches, universities and even nations, but there is not a compelling need to discern who "owns" these institutions. Why should business organizations be any different? And without the concept of ownership, maximizing shareholder wealth becomes less defensible as the primary, or sole, function of the firm.

If organizations are entities unto themselves, capable of bearing legal obligations, then they are also capable of bearing moral obligations. One such obligation is stakeholder fairness-that is, organizations become obligated to their contributors when they accept the benefits of mutual co-operation, although only a small portion of this obligation is codified in laws. Shareholders are significant contributors to organizations, and from this perspective they are owed a significant obligation. Typically, this obligation takes the form of dividends and/or an increase in the market value of shareholders' equity. However, there is no special (e.g., fiduciary) obligation due to shareholders that supercedes the firm's obligations to lesser (e.g., nonfiduciary) stakeholders. Company executives are responsible for administering the affairs of the organization, including the moral obligations entailed in stakeholder fairness.

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WHO ARE AN ORGANIZATION'S STAKEHOLDERS AND WHAT IS THE BASIS FOR THEIR LEGITIMACY?

The question of who is, and who is not, a stakeholder has long been a point of contention. Should stakeholder status be reserved for constituencies that have a very close relationship with the organization? Or, should stakeholder status be broadly interpreted and take into account all of the groups that can affect, and be affected by, the organization? Should activists/competitors/the natural environment/the media be classified as stakeholders? How are managers to decide?

At a minimum, stakeholders are those groups from whom the organization has voluntarily accepted benefits, and to whom the organization has therefore incurred obligations of fairness. Typically, this includes groups such as financiers, employees, customers, suppliers and local communities.

But what about the more controversial candidates for stakeholder status? For example, most organizations have not accepted benefits from their competitors or activist groups, although theories of strategic management would surely grant these constituents some consideration because they can significantly influence the organization's success. Stakeholder theory maintains that normative or legitimate stakeholders are owed an obligation by the organization and its leaders, while derivative stakeholders hold power over the organization and may exert either a beneficial or harmful influence on it.

Competitors can certainly affect an organization and should therefore be considered legitimate stakeholders, but the organization and its managers have no moral obligation to attend to their well-being. An organization may expend resources on managing media coverage for the sole purpose of advancing its own goals, and not for the sake of the media's intrinsic worth. Similarly, the natural environment is not a normative stakeholder, but an organization may choose to care for the environment because its legitimate stakeholders may care deeply about it.

WHAT DO STAKEHOLDERS WANT?

The fact that different people want different things from their relationships with organizations makes it impossible to know with certainty what stakeholders want. Stakeholder discussions often focus on allocating some measure of organizational value or outcome (e.g., who gets how much money from the firm). The question of how the organization creates this value usually gets less attention, but it is certainly not less important. Not all stakeholders want a voice in organizational decision making, but those who do desire a voice should have it.

Too often, managers sit in an office trying to divine what stakeholders want from their relationship with the organization. Someone in Human Resources has the job of finding out what employees want and then representing their wishes, while someone in Public Relations communicates the interest of the local community to managers in other departments. But stakeholder interaction and discourse should be the responsibility of managers at all levels of the organization, not simply the purview of specialized departments.

The call for stakeholder communication is nothing new. The bestseller *In Search of Excellence*, by Tom Peters and Bob Waterman, popularized "management by walking around" as early as 1988, and management approaches too numerous to list have promoted this theme. However, the significance of stakeholder communication does bear repeating in the context of this article.

Stakeholder communication is certainly good for the organization. Managers who are in constant contact with stakeholders are in a better position to assess organizational goals, to take advantage of unforeseen but mutually advantageous opportunities (e.g., cost reductions throughout the supply chain), and possibly to avert conflict before it reaches a critical stage (e.g., communication with dissatisfied employees or activists. But stakeholder communication is more than good for the organization. It is a matter of moral obligation. Individual and groups who contribute to the organization should be permitted some say in how that organization is managed.

Advocating stakeholder communication does not necessarily demand organizational democracy, stakeholder boards of directors, or any other specific institutional structure. But neither does it rule them out. How a particular company creates and reinforces stakeholder dialogue is best left to the managers and stakeholders themselves. The important point is that communication should be as frequent and as thorough as feasible.

HOW SHOULD MANAGERS PRIORITIZE AMONG STAKEHOLDERS?

Another issue that has historically plagued stakeholder theory is the question of how managers should allocate their limited time, energy and other scarce resources to stakeholders. While there is no determinate algorithm, stakeholder theory can provide some broad direction on making these decisions. Normatively legitimate stakeholders (those stakeholders to whom the organization has an obligation) take moral precedence over derivatively legitimate stakeholders. Certainly, managers need to know what the stakeholders believe to be in their best interests prior to trying to make this happen-a first priority of sorts.

Complicating the matter, however, is the fact that advancing the interests of the organization and its normative stakeholders may involve spending a lot of time and resources attending to the demands of derivative stakeholders-often with the blessing of normatively legitimate stakeholders. If some activist group or competitor threatens the viability of the organization, managers should expend as much time and effort as necessary to deal with this threat. Other stakeholders generally accept these activities as being a priority when they are understood to be in their own best interests as well as in the best interests of the organization.

This raises the important point that there are many ways of translating the concept of priority. For example, individuals may spend more waking hours at work than they spend with their family, but this does not necessarily mean that work has a higher priority than family. Time at work may make time with the family possible, and, in this case, time is a misleading indicator because the individual's priority still lies with the family. Similarly, managing for stakeholders may, *for a limited time*, involve spending a majority of time and resources contending with the issues raised by derivative stakeholders.

Of course, a person who continually claims to be working for his or her family, but instead moves from one work crisis to another, failing to spend any time with them, may be genuinely confused about their priorities. Likewise, managers who do not devote time and resources to normative stakeholders for an extended period may have reason to find that their commitment is in doubt.

There is one final way that stakeholder theory can provide some managerial guidance in prioritizing stakeholders. Many stakeholder critics-and some advocates-have interpreted the concept of "balancing" stakeholder interests as implying that all stakeholders should be treated equally. But this is not a particularly convincing interpretation of stakeholder theory. Rather, meritocracy and the equitable distribution of organizational input and resources are perfectly consistent with managing for stakeholders. Balance does not imply equality of voice or share of outputs. Voice in decision-making and share of organizational outcomes should be based on contribution to the organization. The more a stakeholder group contributes to the organization, the greater their voice and share of value created should be.

I recognize that both inputs and outcomes are typically incommensurate. There is no easy prescription for how a manager can evaluate the relative contributions of financier capital, employee effort and expertise, and customer loyalty when making allocation decisions. But prescribing equitability, rather than equality, as the criterion for distribution provides some guidance.

ARE THE ETHICS OF BUSINESS DIFFERENT FROM EVERYDAY ETHICS?

Stakeholder theory is also helpful in assessing whether business ethics is distinctive from ordinary, everyday ethics. Both commentators and managers alike have suggested that the ethics of business are less strict than the ethics that pervade day-to-day life. Albert Z. Carr's polemic of more than 30 years ago sums up this belief. In comparing the ethics of business to the ethics of poker, he writes:

> Poker's own brand of ethics is different from the ethical ideals of civilized human relationships. The game calls for distrust of the other fellow. It ignores the claim of friendship. Cunning deception and concealment of one's strength and intentions, not kindness and openheartedness, are vital in poker. No one thinks any the worse of poker on that account. And no one should think any the worse of the game of business because its standards of right and wrong differ from the prevailing traditions of morality in our society. (Albert Z. Carr, "Is Business Bluffing Ethical?" *Harvard Business Review*, January/February 1968).

A large segment of the world contends that the ethics of business *are* of a lesser grade than those of the rest of society. Some even believe that this *should* be the case. I contend the opposite.

Running an organization does not license a manager to violate the norms and standards of society, but instead introduces a brand-new set of moral considerations based on stakeholder obligations. In respect of normatively legitimate stakeholders (e.g. financiers, employees, customers), the ethics of business implies more obligations rather than less, exactly the opposite of what Carr professed. His suggestion that "bluffing" is merely part of business may be true in some limited contexts, but in my opinion these situations are not nearly as common as Carr indicates.

As business organizations gain more power, they will be under increasing pressure to recognize and act upon their obligations and responsibilities. The recent actions of some executives and firms in the business world have intensified the need for greater emphasis on ethics, but the need is nevertheless present and should be met.