University of Richmond
UR Scholarship Repository

Bookshelf

2018

[Chapter 1 from] Stakeholder Theory: Concepts and Strategies

R. Edward Freeman

Jeffrey S. Harrison
University of Richmond, harrison@richmond.edu

Stelios Zyglidopoulos

Follow this and additional works at: https://scholarship.richmond.edu/bookshelf

Part of the Strategic Management Policy Commons

Recommended Citation
Freeman, R. Edward, Jeffrey S. Harrison, and Stelios C. Zyglidopoulos. *Stakeholder Theory: Concepts and Strategies*. Cambridge: Cambridge University Press, 2018.

NOTE: This PDF preview of [Chapter 1 from] Stakeholder Theory: Concepts and Strategies includes only the preface and/or introduction. To purchase the full text, please click here.

This Book is brought to you for free and open access by UR Scholarship Repository. It has been accepted for inclusion in Bookshelf by an authorized administrator of UR Scholarship Repository. For more information, please contact scholarshiprepository@richmond.edu.

Cambridge Elements

Elements in Organization Theory
edited by
Nelson Phillips
Imperial College London
Royston Greenwood
University of Alberta

STAKEHOLDER THEORY

Concepts and Strategies

R. Edward Freeman
University of Virginia
Jeffrey S. Harrison
University of Richmond
Stelios Zyglidopoulos
Kedge Business School

LIBRARY
UNIVERSITY OF RICHMOND
VIRGINIA 23173

CAMBRIDGE
UNIVERSITY PRESS

1 The Origin and Foundation of Stakeholder Management

Some people were shocked to hear of a systemic problem in the venerable Wells Fargo Bank, where employees had been creating new credit accounts for their customers without their knowledge. Other people were not particularly surprised. After all, Volkswagen was caught programming its diesel engines to fool emissions testing equipment and Enron's off-book financial deals led to bankruptcy and financial disaster for thousands of employees and investors. In addition, Johns-Manville knew that producing asbestos was harming its employees, yet the company concealed this information instead of addressing the problem. So the Wells Fargo incident, though disappointing, is just one example of a larger problem in business today. At the core of these sorts of problems is an organizational value system, supported by an incentive system, that puts short-term financial profits ahead of the welfare of one or a group of stakeholders (Stout, 2012).

Stakeholders are groups and individuals that have a valid interest in the activities and outcomes of a firm and on whom the firm relies to achieve its objectives (Freeman, 1984; Freeman et al., 2007a). For most business firms, which are the focus of this Element, primary stakeholders include customers, employees, suppliers of tangible goods and services, suppliers of capital (including shareholders if the firm is a corporation or similar form), and the communities in which the firm operates. Other common stakeholders vary in importance depending on the nature of the firm and its industry. They often include government officials and regulators (in addition to those at the community level), special-interest groups, consumer advocate groups, nongovernmental organizations (NGOs), the media, unions, and competitors. These additional stakeholders are sometimes called secondary because they do not contribute as directly to the value-creating processes of the firm (Freeman et al., 2007a; Phillips, 2003). We do not mean to imply that they are not important, but rather that, from a practical perspective, much of a manager's time and attention will (and should) focus on the stakeholders who contribute most to the value the firm creates – the primary stakeholders.

1.1 Origin of the Stakeholder Perspective

The stakeholder perspective came into being as an alternative way of understanding how companies and people create value and trade with each other in a world where there is very little stability and certainty (Freeman et al., 2010). It was designed to solve three interconnected problems. First, how can we create value in a turbulent world? Second, how are we to understand the ethics of capitalism? Third, what should we be teaching in business schools?

The stakeholder perspective has often been seen as a competing perspective to the shareholder value maximization perspective that has dominated business thinking for more than half a century (Stout, 2012). This is somewhat misleading, however, as stakeholder theory acknowledges the importance of shareholders and shareholder value, although it also argues that shareholders aren't the only group that is important to running a successful business. Shareholder value maximization promotes the perspective that the primary responsibility of top managers is to maximize profits so that shareholders receive the largest returns possible. Stakeholder theory suggests that the world is far more complex and that successful business firms create value (only some of which is financial) for all key stakeholders (Freeman et al., 2010).

The shareholder perspective led to a great deal of short-term thinking in organizations, often at the expense of longer-term organizational health. An obsession with bottom-line profitability helped stimulate the sort of behavior we described in the first paragraph. However, around the same time that shareholder primacy was gaining prominence, a few others were discussing a very different management approach. The stakeholder perspective, as we understand it today, was first delineated in a comprehensive fashion in a book titled *Strategic Management: A Stakeholder Approach* (Freeman, 1984). It was written as a practical guide for managers and students of strategic management, and much of what we will share in this Element has its roots in that book.

The strategic management discipline did not immediately absorb the stakeholder approach into its mainstream, although it was the subject of much debate and development elsewhere, predominantly in the business ethics discipline. However, over the decades since the mid-1980s, the stakeholder perspective has gained significant traction in strategic management as well as in numerous other fields, including public administration, law, marketing, operations, healthcare, accounting, and finance (Freeman et al., 2010). We attribute this rise in importance to its practicality in dealing with a business world that is increasing in complexity and turbulence, and to society's increasing sensitivity to the ethical (or unethical) behavior of organizations (Freeman et al., 2007a).

1.2 Core Concepts of Stakeholder Management

Although this Element takes a practical approach, we would first like to establish a foundation of understanding upon which we will build the concepts and techniques found in later sections. We will base our approach to stakeholder management on the following seven core concepts (Freeman et al., 2007a, 2010).

Concept 1: A Managerial Focus

The stakeholder perspective is useful in that it describes what managers actually do. Business executives manage stakeholders (Freeman, 1984), and the manner in which those stakeholders are managed influences the value a business firm creates (or destroys). The real challenge is to determine best practices in managing stakeholders, and to determine the contexts in which those practices are most likely to lead to the best value-creating results. "Management" here does not mean manipulation and exploitation, but how to craft relationships in which all of a firm's key stakeholders win over time, or what might be called "win–win–win–win–win" relationships. To a great extent, that is what this Element is about. Based on our experiences as scholars and consultants who have developed and applied stakeholder theory in many types of organizations for the past several decades, we intend to share with you some of the ideas and tools we have found most useful in managing stakeholders.

Concept 2: A Moral Foundation

Stakeholder management is based on a moral foundation that includes respect for humans and their basic rights, integrity, fairness, honesty, loyalty, freedom to choose, and assumption of responsibility for the consequences of the actions a firm takes (Freeman et al., 2010; Phillips, 2003). The fact that stakeholder management is a moral approach is inherently satisfying to those managers who practice it. Their consciences tend to be less encumbered with feelings of guilt, they need not "fake" virtue around colleagues and stakeholders, they have a moral code that helps them make decisions, and they can enjoy a greater sense of self-worth. This is not to say that they do not make mistakes, but they have a set of guidelines that are somewhat universally understood and tend to be respected by those around them. They don't have to spend a great deal of energy rationalizing their decisions.