1 *Introduction*

In recent years an undeniable characteristic of the political discourse of developed nations has been an increased focus on the ethics of the modern business corporation. Since the mid-1990s, the public controversies surrounding the 'McLibel' trial,[1] Royal Dutch Shell's disposal of its Brent Spar platform and role in the execution of Nigerian activist Ken Saro-Wiwa,[2] and the accounting scandals of Enron and WorldCom in the United States and Ahold and Parmalat in Europe have been amongst numerous examples of growing public concern over the unethical practices of business corporations. Today, issues of bank lending in the sub-prime mortgage crisis and (following publicly funded bailouts) the level of bonuses paid to bank executives, as well as continuing environmental degradation, tax avoidance and the exploitation of cheap labour in developing countries, lead many to ask what the social role of the corporation should be and what responsibilities it has. The increasing portion of the global economy directly under the control of corporations has also caused an ethical outcry and led to calls for corporations to be held democratically to account in the same manner as national governments.[3]

[1] The colloquial term given to the court action for libel brought by McDonald's Restaurants against environmental activists Helen Steel and David Morris, in response to a pamphlet published by the activists which criticised McDonald's, inter alia, for exploiting its work force, selling unhealthy food, being cruel to animals and using unethical marketing practices. It developed into the longest-running court case in English history.

[2] Donaldson and Dunfee (1999: 1–5), in *Ties That Bind*, give a good overview of this incident and the changes it led to in Shell's approach to corporate social responsibility.

[3] Mitchell and Sikka, writing in 2005, had already pointed to the fact that some 60% of world trade was within multinational corporations and the largest hundred corporations controlled 20% of global foreign assets, to illustrate the economic power wielded by corporations and the need to limit their powers through the institutions of democracy (2005: 3). This idea also forms a central part of Bakan's (2004) argument in his book *The Corporation*.

In short, the role of the business corporation in contemporary society is a strongly contested issue, and it is perhaps impossible to have an opinion on political life today without holding a position on it. Given its prevalence as a matter of public concern and the tangible role that corporations play in the lives of almost everyone living in market-based societies, the precise way this issue is understood is a matter of more than intellectual curiosity. In democratic societies where policies largely reflect public opinion, the general interpretation of the social role of the corporation directly affects the overall organisation of society, and potentially the life prospects of all who depend on corporations for necessary goods and services. It follows that any theory which can influence the way this problem is perceived is potentially of great importance.

An example of this is the currently popular body of ideas known as 'stakeholder theory'. Stakeholder theory holds, largely as a response to the kind of ethical controversies outlined in the preceding, that the primary responsibility of a corporation is not to maximise shareholder wealth, but instead to serve the interests of a range of stakeholders that make up the society in which it operates. These stakeholders are taken to include not merely the shareholders, but employees, lenders, suppliers, the local community and even 'society' at large. Though disagreements exist over exactly which stakeholders are to be considered legitimate, the idea that a corporation's objective should encompass the interests of non-shareholding groups is held as a fundamental step in establishing an ethically responsible business outlook.

Stakeholder theory plays a valuable role in highlighting the importance of theorising about the social responsibilities of business and of generating academic debate on this issue, of which this book is a product. It also offers a compelling alternative to two sharply opposed positions, one of which sees the profit-making nature of the corporation as a commercial vehicle as disastrous for society as a whole (Bakan 2004), while the other sees the maximisation of shareholder wealth as the only legitimate objective that a corporation can pursue in a market economy (e.g., Friedman 1962, 1970). However, while stakeholder theory no doubt stimulates valuable debate on these issues, the aim of this book is to examine the conceptual coherence of the theory itself. The theory in its current form seems to assume a harmonious relationship of elements between which, in actuality, choices must be made.

My hypothesis is that a number of positions are advocated which, while of ethical value in themselves, are found upon inspection to be irreconcilable with each other.

What follows is therefore not an empirical study of the effects of corporate behaviour on stakeholders, or the effect of stakeholder theory upon the actions of corporate managers. Nor am I primarily concerned with its relationship to other theories of business or other avenues of corporate social responsibility (CSR). Though these are important areas of enquiry, my argument is aimed at the structure of the theory itself. I proceed by making an abstraction of the elements that can be considered essential to it, in order to outline the conceptual framework with which any version of stakeholder theory must be consistent. I then work through an analysis of these concepts to see whether a realisation of the theory is possible without the emergence of logical contradictions. The central question raised is whether any goals can be pursued by a corporation in a market-based economy that are not reducible to the interests of shareholders, given that an acceptance of the basic moral framework of capitalism is a premise widely shared by defenders of stakeholder theory. This book is chiefly concerned with a critical analysis of the consistency of this position. The question turns out to depend on whether the corporation is seen as a commercial entity existing for the sole purpose of market exchange, or as a political entity with sovereign rights over its stakeholders analogous to the relationship between a state and its citizens.[4] However, before summarising the stages of the argument, the importance of stakeholder theory can be gauged by placing it in the context of two popular but radically opposed discourses on the social responsibility of the corporation.

Competing perspectives on corporate responsibility

A prevailing interpretation of recent corporate scandals is that morally responsible business conduct is impossible as long as corporations remain accountable to their shareholders alone. It is argued that if

[4] This is not to suggest that any corporation involved in politics, for example, through lobbying or contracting with governments, necessarily has sovereign rights. The question is whether corporations should be understood *essentially* as political entities in relation to their stakeholders, with their responsibilities justified on this basis.

the maximisation of profits is the only legitimate objective for business, then the exercise of responsibility towards other 'stakeholders' is unobtainable. The pursuit of shareholder wealth maximisation is primarily to blame, by this reasoning, for the recent string of accounting scandals and other ethical failures. Businesses can be expected to work for the public good only when this view is abandoned and management can adopt social objectives that are not reducible to maximising shareholder wealth.

This identification of corporate scandals with shareholder wealth maximisation receives one of its best-known expressions in the book *The Corporation* (and the accompanying film) by Joel Bakan. For Bakan, the implications of the shareholder view are as follows:

> Corporations have only one duty: to promote their own and their owners' interests. They have no capacity, and their executives no authority, to act out of a genuine sense of responsibility to society, to avoid causing harm to people and the environment, or to work to advance the public good in ways that are unrelated to their own self-interest. (Bakan 2004: 109)

As a result, Bakan (2004: 2) argues, 'the corporation is a pathological institution, a dangerous possessor of the great power it wields over people and societies'. He writes that ever since the creation of the modern business corporation (with limited liability) in the middle of the nineteenth century, it has remained 'a legally designated "person" designed to valorise self-interest and invalidate moral concern. Most people would find its "personality" abhorrent, even psychopathic, in a human being, and yet curiously we accept it in society's most powerful institution' (2004: 28). The connection Bakan sees between the legally defined mandate of the corporation (to pursue shareholder value as its only objective) and its 'psychopathic' disregard for any harm it might cause in this process implies that for him the explanation for corporate scandals must be this objective to act for the shareholders alone. Therefore, in assessing the reasons for the collapse of Enron, he writes:

> Though the company is now notorious for its arrogance and ethically challenged executives, the underlying reasons for its collapse can be traced to characteristics common to all corporations: obsession with profits and share prices, greed, lack of concern for others, and a penchant for breaking legal rules. These traits are, in turn, rooted in an institutional culture, the

> corporation's, that valorises self-interest and invalidates moral concern. (Bakan 2004: 58)

The NGO Corporate Watch reaches a similar verdict in a report entitled *What's Wrong with Corporate Social Responsibility?* It argues that as a corporation is under a legal obligation to maximise profits, it is incapable of taking any wider public interest into account. Therefore, 'the wider social good can only ever be incidental to the interest of making a profit. This is a total reversal of conventional moral priorities that place the interests of society over self-interest' (Corporate Watch 2006: 11). In an argument similar to that of Bakan (2004), the report goes on to claim: 'Corporations have highly destructive impacts on society and the environment, and they are the dominant institution in our society, so if the only type of actions that they can make to mitigate their destructive impacts are the most profitable ones, then prospects for the planet do not look good' (ibid.).

Holding the shareholder view responsible for corporate scandals is a position also common to advocates of stakeholder theory. Robert Phillips (2003), in *Stakeholder Theory and Organizational Ethics*, the first book-length normative defence of stakeholder theory, writes:

> No small measure of managerial opportunism has occurred in the name of shareholder wealth maximisation. In addition to the debacles of Enron and WorldCom, one need only consider the now dethroned king of shareholder wealth, Al Dunlap . . . Dunlap grossly mismanaged at least two companies to his own significant, if temporary, financial gain; and every move he made was in the name of shareholder wealth. (Phillips 2003: 20)

Freeman et al. (2004) propound a similar view. In response to the charge that having more than one objective function (as stakeholder theory advocates) makes governance and management difficult, they declare: 'It is hard to imagine how anyone can look at the recent wave of business scandals, all of which are oriented toward ever-increasing shareholder value at the expense of other stakeholders, and argue that this philosophy is a good idea' (Freeman et al. 2004: 366). The assumption appears widely held that a causal relationship between the pursuit of shareholder wealth and morally opprobrious business conduct is a good explanation for the egregious scandals that have recently enveloped the business world.

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In tandem with this view it is often argued, though *not* by stakeholder theorists (as shall be shown later), that a meaningful remedy for the ethical failures of corporations is impossible in the context of the market institutions in which they operate. A necessary condition for alleviating the damage done to society by the corporation is assumed to be a complete reform of the market economy. Bakan (2004: 160), for example, asks, 'should all corporations become public-purpose corporations? Is that the solution to our current corporate woes?' He goes on to say that such a solution, even if desirable, is too utopian at present to be a realistic option, but writes: 'Perhaps someday we shall understand how truly to democratise economic relations, and widespread use of public-purpose corporations may be a key part of the plan' (Bakan 2004: 160–1). Likewise, Corporate Watch states that a meaningful level of social responsibility 'is not something a corporation, as corporations are currently structured, could handle. It is not within its world view. Society must create new structures to replace corporations, ones that could operate in a way that might meet [socially responsible] criteria' (2006: 24). Clearly as a solution to failures of corporate ethics this is an advocacy not merely of corporate reform, but of an upheaval of the entire economic system itself.

There is, however, a competing discourse which takes a very different view on the moral implications of acting for shareholder interests, but with an important similarity with regard to the economic context in which business operates. It is argued that the adoption by managers of any objective *other* than the maximisation of shareholder wealth is a subversion of the basic framework of a market economy and the very idea of a 'free society'. To pursue objectives which may be desirable from the perspective of 'society' or the 'public interest', but are in conflict with the interests of shareholders, would be a violation of the ethical principles that any market-based society has to recognise. This is the argument of Milton Friedman (1962, 1970), perhaps the best-known critic of CSR. The claim that a socially responsible business must not act other than to maximise shareholder wealth is clearly the opposite of the first perspective outlined. However, the assumption that a deviation from this purpose, if permitted generally, would undermine the basic framework of a market economy is common to both perspectives.

One of Friedman's central arguments is that the duty of management to pursue shareholder interests as its sole objective is founded upon ethical principles that are fundamental to a market economy, and that must be accepted by anyone for whom business plays a legitimate role in such an economy. He writes: 'In an ideal free market resting on private property, no individual can coerce any other, all cooperation is voluntary, all parties to such cooperation benefit or they need not participate' (1970). His view of business is that shareholders voluntarily entrust their private property to management, on the expectation that management will act so as to maximise the value of this property, and it is a violation of their property rights if managers pursue contrary objectives. He asserts:

> The businessmen believe they are defending free enterprise when they declaim that business is not concerned 'merely' with profit but also with promoting desirable 'social' ends. . . . In fact they are – or would be if they or anyone else took them seriously – preaching pure and unadulterated socialism. Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades. (Ibid.)

A prominent critic of stakeholder theory in recent years, Elaine Sternberg, expounds a similar view. She writes that for management to pursue social objectives with the money of shareholders would undermine two fundamental features of 'modern society': 'private property and the duties that agents owe to principals. The stakeholder doctrine undermines private property, because it denies owners the right to determine how their property will be used' (Sternberg 2004: 147).

This perspective, which defends the 'shareholder theory' of the firm, stands in marked contrast to the competing idea that this outlook is largely responsible for the ethical crises of business. Instead, it is asserted that far from being ethically culpable, the shareholder view is the *only* ethically acceptable model of the corporation, as long as the legitimacy of a market economy is assumed. However, in both cases, it is held that if one *does* assume the context of a market economy, then one cannot expect the business corporation to have any other purpose than to maximise shareholder wealth. There is of course a scale of opinions on this issue, and the brief citations offered here represent merely the opposite poles rather than the full range. However, given the key similarity between these positions, whether one takes a view favourable to one side or the other, the question of how a corporation can be socially responsible depends ultimately on the merits of rival economic and political systems. Either the basic economic and moral framework of a market economy is upheld or it is overturned. So the problem of CSR is made to depend not on what a corporation can do *within* an economic system, but on which overall political philosophy is justifiable. The striking feature of *stakeholder theory* is that it aims to show that a business can exercise social responsibility through a purpose irreducible to shareholder objectives, *without* contradicting the moral framework of a capitalist economy. Standing to reconcile the concerns of both the positions so far expounded, stakeholder theory appears to offer a compelling alternative.

Contrasting stakeholder and shareholder theories

A brief survey of the various definitions of stakeholder theory shows basic similarities across its different forms. Wijnberg (2000: 329) writes: 'In its most basic sense, stakeholder theory arises from the rejection of the idea that the corporation should single-handedly strive to maximise the benefits of a single stakeholder, the shareholders'. A similar view is expressed by Mitchell et al. (1997: 855), who write that the stakeholder approach is 'intended to broaden management's vision of its roles and responsibilities beyond the profit maximisation function to include interests and claims of non-stockholding groups'. Furthermore, in an analysis of 179 articles published on stakeholder theory between 1984 and 2007, Laplume et al. (2008: 1153) find that 'A fundamental thesis of stakeholder-based arguments is that organisations should be managed in the interests of all their constituents, not only in the interest of shareholders'. A clear similarity appears to the position of Bakan (2004) and Corporate Watch (2006), in that a business cannot be ethical if it looks only to maximise shareholder value.

In a much-cited overview of the field, Donaldson and Preston (1995: 68) write: 'Stakeholder analysts argue that *all* persons or groups with legitimate interests participating in an enterprise do so to obtain benefits and . . . there is no prima facie priority of one set of interests and benefits over another'. Here there is the added specification of *legitimate interests*. A theory of what might count as a legitimate interest is therefore crucial to the stakeholder approach. Kaler (2003: 71) expounds another position common to stakeholder theorists, writing that the crucial distinction between shareholder and stakeholder theory is 'their respective rejection and acceptance of role-specific responsibilities toward non-shareholders that are "ultimate objective fulfilling"'. These summaries suggest a clear opposition between the shareholder and stakeholder approaches, in that the latter maintains that management has a responsibility to pursue stakeholder interests as ultimate objectives of the firm.

However, Freeman (2008) and Freeman et al. (2010) claim that at the pragmatic level of managerial decision-making it is a mistake to see these two perspectives as necessarily in conflict. They argue that 'maximisation of shareholder value' is impossible without the creation of value for all primary stakeholders.[5] To illustrate this point, Freeman writes that if you want to maximise returns to shareholders:

> You've got to have great products and services that people want, that do what you say they are going to do. You need suppliers who want to make your company better, and who stand behind what they do. You need employees who show up and want to be there, be creative and productive. You need communities for whom you are at least a good citizen so they don't use the political process . . . to destroy the value you create. And, you have to make money for the financiers. (Freeman 2008: 165)

In short, the manager of any business has to recognise that the interests of a range of stakeholders in creating and trading value must be addressed for the business to succeed. An *exclusive* focus on profit maximisation to the detriment of the interests of non-shareholders is in fact a sure way to destroy value for all stakeholders, including shareholders. The implication is that stakeholder interests have to be shaped by the manager to go in the same direction over time. Freeman (ibid.) writes that there is a 'jointness to these interests' and 'the key idea about capitalism is that the entrepreneur or manager creates value by capturing the jointness of the interests'. This means that 'one must focus on how value gets created for each and every stakeholder' (Freeman et al. 2010: 9). For these reasons, Freeman (2008: 166) believes Friedman would agree with him that 'The primary responsibility of an executive is to create as much value as possible for stakeholders because that's how

[5] Freeman et al. (2010: 24) list communities, customers, employees, suppliers and financiers as 'primary stakeholders'. In their analysis a broader category of 'secondary' or 'instrumental' stakeholders who can potentially affect the achievement of an organisation's purpose include government, competitors, consumer advocate groups, special interest groups and the media (2010: 24–26).

you create as much value as possible for shareholders' (ibid.). Freeman et al. (2010: 12) add that 'Friedman's maximising shareholder value is compatible with stakeholder theory. After all, the only way to maximise value sustainably is to satisfy stakeholder interests'.

These authors argue persuasively that managers whose immediate aim is to cooperate with all stakeholders on whom the firm depends, for example, by providing good products and services for customers, and by supporting working conditions that motivate employees, will generally create more value for shareholders than managers whose *only* aim is to satisfy this latter group.[6] As Freeman (2008: 165–6) puts it, maximising profits 'is an outcome of a well-managed company' and 'stakeholder theory is an idea about what it means to be well-managed'. It might therefore be a mistake to see shareholder theory and stakeholder theory as necessarily opposed in the day-to-day management of a firm.

However, the differences between these two perspectives can be seen more clearly if one looks not at the immediate tasks necessary for running a business, but at its more fundamental, longer-term objectives. One can ask: in pursuit of what *purpose* does management require the cooperation of primary stakeholders? A business might indeed create value for its stakeholders, and find ways of satisfying their joint interests, in the pursuit of long-term aims that are not merely equivalent to the aims of all its stakeholders. Shareholder and stakeholder theorists give strongly contrasting answers to the question of whether a corporation's ultimate objective should comprise the interests of a range of stakeholders or the interests of shareholders alone.

Freeman (2008: 163) is sceptical of framing the arguments in this way. He writes, 'I tire of the debate between what really is the purpose of the firm – in other words, what are the means and what are the ends'. He cites Dewey's contention that 'means have a way of becoming ends which subsequently have a way of becoming means' (ibid.).

[6] This may sound like a common sense observation. However, a corporate scandal such as Enron in which an obsession with stock price at least partly explains an extravagant (and fraudulent) manipulation of accounting standards, and the subsequent collapse of the company (Cruver 2003; McLean and Elkind 2004) highlights the importance of the practical point that Freeman et al. are making.