Managing for Stakeholders[1]

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INTRODUCTION

The purpose of this essay is to outline an emerging view of business that we shall call "managing for stakeholders".[2] This view has emerged over the past 30 years from a group of scholars in a diverse set of disciplines, from finance to philosophy.[3] The basic idea is that businesses, and the executives who manage them, actually do and should create value for customers, suppliers, employees, communities, and financiers (or shareholders). And, that we need to pay careful attention to how these relationships are managed and how value gets created for these stakeholders. We contrast this idea with the dominant model of business activity, namely, that businesses are to be managed solely for the benefit of shareholders. Any other benefits (or harms) that are created are incidental.[4]

Simple ideas create complex questions, and we proceed as follows. In the next section we examine why the dominant story or model of business that is deeply embedded in our culture is no longer workable. It is resistant to change, not consistent with the law, and for the most part, simply ignores matters of ethics. Each of these flaws is fatal in the business world of the twenty-first century.

We then proceed to define the basic ideas of "managing for stakeholders" and why it solves some of the problems of the dominant model. In particular we pay attention to how using "stakeholder" as a basic unit of analysis makes it more difficult to ignore matters of ethics. We argue that the primary responsibility of the executive is to create as much value for stakeholders as possible, and that no stakeholder interest is viable in isolation of the other stakeholders. We sketch three primary arguments from ethical theory for adopting "managing for stakeholders." We conclude by outlining a fourth "pragmatist argument" that suggests we see managing for stakeholders as a new narrative about business that lets us improve the way we currently create value for each other. Capitalism is on this view a system of social cooperation and collaboration, rather than primarily a system of competition.

THE DOMINANT STORY: MANAGERIAL CAPITALISM WITH SHAREHOLDERS AT THE CENTER

The modern business corporation has emerged during the twentieth century as one of the most important innovations in human history. Yet the changes that we are now experiencing call for its reinvention. Before we suggest what this revision, "managing for stakeholders" or "stakeholder capitalism," is, first we need to understand how the dominant story came to be told.

Somewhere in the past, organizations were quite simple and "doing business" consisted of buying raw materials from suppliers, converting it to products, and selling it to customers. For the most part owner-entrepreneurs founded such simple businesses and worked at the business along with members of their families. The development of new production processes, such as the assembly line, meant that jobs could be specialized and more work could be accomplished. New technologies and sources of power became readily available. These and other social and political forces combined to require larger amounts of capital, well beyond the scope of most individual owner-manager-employees. Additionally, "workers" or non–family members began to dominate the firm and were the rule rather than the exception.

Ownership of the business became more dispersed as capital was raised from banks, stockholders, and other institutions. Indeed, the management of the firm became separated from the ownership of the firm. And, in order to be successful, the top managers of the business had to simultaneously satisfy the owners, the employees and their unions, suppliers, and customers. This system of organization of businesses along the lines set forth here was known as managerial capitalism or laissez faire capitalism, or more recently, shareholder capitalism.[5]

As businesses grew, managers developed a means of control via the divisionalized firm. Led by Alfred Sloan at General Motors, the divisionalized firm with a central headquarters staff was widely adapted.[6] The dominant model for managerial authority was the military and civil service bureaucracy. By creating rational structures and processes, the orderly progress of business growth could be well-managed.

Thus, managerialism, hierarchy, stability, and predictability all evolved together, in the United States and Europe, to form the most powerful economic system in the history of humanity. The rise of bureaucracy and managerialism was so strong that the economist Joseph Schumpeter predicted that it would wipe out the creative force of capitalism, stifling innovation in its drive for predictability and stability.

During the last 50 years this "Managerial Model" has put "shareholders" at the center of the firm as the most important group for managers to worry about. This mindset has dealt with the increasing complexity of the business world by focusing more intensely on "shareholders" and "creating value for shareholders." It has become common wisdom to "increase shareholder value," and many companies have instituted complex incentive compensation plans aimed at aligning the interests of executives with the interests of shareholders. These incentive plans are often tied to the price of a company's stock, which is affected by many factors not the least of which is the expectations of Wall Street analysts about earnings per share each quarter. Meeting Wall Street targets and forming a stable and predictable base of quarter over quarter increases in earnings per share has become the standard for measuring company performance. Indeed, all of the recent scandals at Enron, WorldCom, Tyco, and others are in part due to executives trying to increase shareholder value, sometimes in opposition to accounting rules and law. Unfortunately, the world has changed so that the stability and predictability required by the shareholder approach can no longer be assured.

The Dominant Model Is Resistant to Change

The Managerial View of business with shareholders at the center is inherently resistant to change. It puts shareholders' interests over and above the interests of customers, suppliers, employees, and others, as if these interests must conflict with each other. It understands a business as an essentially hierarchical organization fastened together with authority to act in the shareholders' interests. Executives often speak in the language of hierarchy as "working for shareholders," "shareholders are the boss," and "you have to do what the shareholders want." On this interpretation, change should occur only when the shareholders are unhappy, and as long as executives can produce a series of incrementally better financial results there is no problem. According to this view the only change that counts is change oriented toward shareholder value. If customers are unhappy, if accounting rules have been compromised, if product quality is bad, if environmental disaster looms, even if competitive forces threaten, the only interesting questions are whether and how these forces for change affect shareholder value, measured by the price of the stock every day. Unfortunately in today's world there is just too much uncertainty and complexity to rely on such a single criterion. Business in the twenty-first century is global and multifaceted, and shareholder value may not capture that dynamism. Or, if it does, as the theory suggests it must eventually, it will be too late for executives to do anything about it. The dominant story may work for how things turn out in the long run on Wall Street, but managers have to act with an eye to Main Street as well, to anticipate change to try and take advantage of the dynamism of business.[7]

THE DOMINANT MODEL IS NOT CONSISTENT WITH THE LAW

In actual fact the clarity of putting shareholders' interests first, above that of customers, suppliers, employees, and communities, flies in the face of the reality the law. The law has evolved to put constraints on the kinds of trade-offs that can be made. In fact the law of corporations gives a less clear answer to the question of in whose interest and for whose benefit the corporation should be governed. The law has evolved over the years to give *de facto* standing to the claims of groups other than stockholders. It has, in effect, required that the claims of customers, suppliers, local communities, and employees be taken into consideration.

For instance, the doctrine of "privity of contract," as articulated in *Winterbottom v. Wright* in 1842, has been eroded by recent developments in product liability law. *Greenman v. Yuba Power* gives the manufacturer strict liability for damage caused by its products, even though the seller has exercised all possible care in the preparation and sale of the product and the consumer has not bought the product from nor entered into any contractual arrangement with the manufacturer. *Caveat emptor* has been replaced, in large part, with *caveat venditor.* The Consumer Product Safety Commission has the power to enact product recalls, essentially leading to an increase in the number of voluntary product recalls by companies seeking to mitigate legal damage awards. Some industries are required to provide information to customers about a product's ingredients, whether or not the customers want and are willing to pay for this information. Thus, companies must take the interests of customers into account, by law.

A similar story can be told about the evolution of the law forcing management to take the interests of employees into account. The National Labor Relations Act gave employees the right to unionize and to bargain in good faith. It set up the National Labor Relations Board to enforce these rights with management. The Equal Pay Act of 1963 and Title VII of the Civil Rights Act of 1964 constrain management from discrimination in hiring practices; these have been followed with the Age Discrimination in Employment Act of 1967, and recent extensions affecting people with disabilities. The emergence of a body of administrative case law arising from labor–management disputes and the historic settling of discrimination claims with large employers have caused the emergence of a body of management practice that is consistent with the legal guarantee of the rights of employees.

The law has also evolved to try and protect the interests of local communities. The Clean Water Act of 1977 and the Clean Air Act of 1990, and various amendments to these classic pieces of legislation, have constrained management from "spoiling the commons." In a historic case, *Marsh v. Alabama,* the Supreme Court ruled that a company-owned town was subject to the provisions of the U.S. Constitution, thereby guaranteeing the rights of local citizens and negating the "property rights" of the firm. Current issues center around protecting local businesses, forcing companies to pay the health care costs of their employees, increases in minimum wages, environmental standards, and the effects of business development on the lives of local community members. These issues fill the local political landscapes, and executives and their companies must take account of them.

Some may argue that the constraints of the law, at least in the U.S., have become increasingly irrelevant in a world where business is global in nature. However, globalization simply makes this argument stronger. The laws that are relevant to business have evolved differently around the world, but they have evolved nonetheless to take into account the interests of groups other than just shareholders. Each state in India has a different set of regulations that affect how a company can do business. In China the law has evolved to give business some property rights but it is far from exclusive. And, in most of the European Union, laws around "civil society" and the role of "employees" are much more complex than even U.S. law.

"Laissez-faire capitalism" is simply a myth. The idea that business is about "maximizing value for stockholders regardless of the consequences to others" is one that has outlived its usefulness. The dominant model simply does not describe how business operates. Another way to see this is that if executives always have to qualify "maximize shareholder value" with exceptions of law, or even good practice, then the dominant story isn't very useful anymore. There are just too many exceptions. The dominant story could be saved by arguing that it describes a normative view about how business should operate, despite how actual businesses have evolved.[8] So, we need to look more closely at some of the conceptual and normative problems that the dominant model raises.

The Dominant Model Is Not Consistent with Basic Ethics

Previously we have argued that most theories of business rely on separating "business" decisions from "ethical" decisions.[9] This is seen most clearly in the popular joke about "business ethics as an oxymoron." More formally we might suggest that we define:

The Separation Fallacy

> It is useful to believe that sentences like "x is a business decision" have no ethical content or any implicit ethical point of view. And, it is useful to believe that sentences like "x is an ethical decision, the best thing to do all things considered" have no content or implicit view about value creation and trade (business).

This fallacy underlies much of the dominant story about business, as well as in other areas in society. There are two implications of rejecting the Separation Fallacy. The first is that almost any business decision has some ethical content. To see that this is true one need only ask whether the following questions make sense for virtually any business decision:

The Open Question Argument

1. If this decision is made for whom is value created and destroyed?
2. Who is harmed and/or benefited by this decision?
3. Whose rights are enabled and whose values are realized by this decision (and whose are not)?
4. What kind of person will I (we) become if we make this decision?

Since these questions are always open for most business decisions, it is reasonable to give up the Separation Fallacy, which would have us believe that these questions aren't relevant for making business decisions, or that they could never be answered. We need a theory about business that builds in answers to the "Open Question Argument" above. One such answer would be "Only value to shareholders counts," but such an answer would have to be enmeshed in the language of ethics as well as business. Milton Friedman, unlike most of his expositors, may actually give such a morally rich answer. He claims that the responsibility of the executive is to make profits subject to law and ethical custom. Depending on how "law and ethical custom" is interpreted, the key difference with the stakeholder approach may well be that we disagree about how the world works. In order to create value we believe that it is better to focus on integrating business and ethics within a complex set of stakeholder relationships rather than treating ethics as a side constraint on making profits. In short we need a theory that has as its basis what we might call:

The Integration Thesis

> Most business decisions, or sentences about business have some ethical content, or implicit ethical view. Most ethical decisions, or sentences about ethics have some business content or implicit view about business.[10]

One of the most pressing challenges facing business scholars is to tell compelling narratives that have the Integration Thesis at its heart. This is essentially the task that a group of scholars, "business ethicists" and "stakeholder theorists," have begun over the last 30 years. We need to go back to the very basics of ethics. Ethics is about the rules, principles, consequences, matters of character, etc., that we use to live together. These ideas give us a set of open questions that we are constantly searching for better ways to answer in reasonable complete ways.[11] One might define "ethics" as a conversation about how we can reason together and solve our differences, recognize where our interests are joined and need development, so that we can all flourish without resorting to coercion and violence. Some may disagree with such a definition, and we do not intend to privilege definitions, but such a pragmatist approach to ethics entails that we reason and talk together to try and create a better world for all of us.

If our critiques of the dominant model are correct then we need to start over by reconceptualizing the very language that we use to understand how business operates. We want to suggest that something like the following principle is implicit in most reasonably comprehensive views about ethics.

The Responsibility Principle[12]

> Most people, most of the time, want to, actually do, and should accept responsibility for the effects of their actions on others.

Clearly the Responsibility Principle is incompatible with the Separation Fallacy. If business is separated from ethics, there is no question of moral responsibility for business decisions. More clearly still, without something like the Responsibility Principle it is difficult to see how ethics gets off the ground. "Responsibility" may well be a difficult and multifaceted idea. There are surely many different ways to understand it. But, if we are not willing to accept the responsibility for our own actions (as limited as that may be due to complicated issues of causality and the like), then ethics, understood as how we reason together so we can all flourish, is likely an exercise in bad faith.

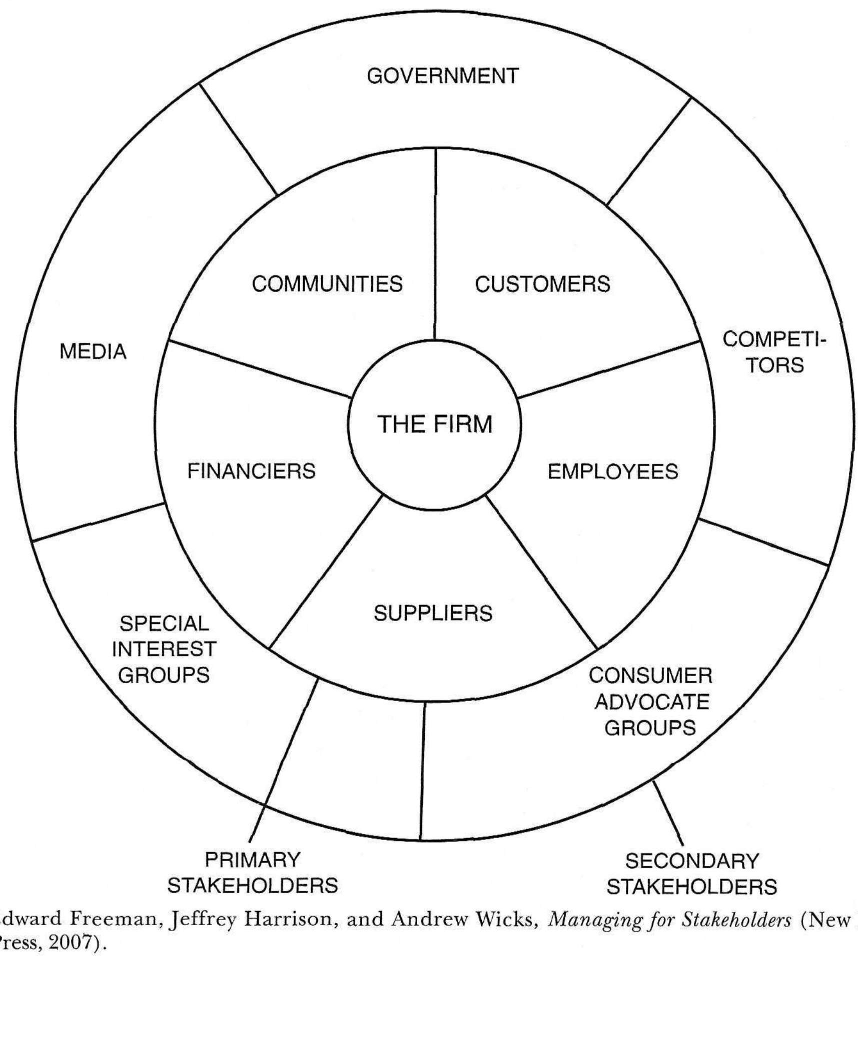
If we want to give up the separation fallacy and adopt the integration thesis, if the open question argument makes sense, and if something like the responsibility thesis is necessary, then we need a new model for business. And, this new story must be able to explain how value creation at once deals with economics and ethics, and how it takes account of all of the effects of business action on others. Such a model exists, and has been developing over the last 30 years by management researchers and ethics scholars, and there are many businesses who have adopted this "stakeholder framework" for their businesses.

MANAGING FOR STAKEHOLDERS

The basic idea of "managing for stakeholders" is quite simple. Business can be understood as a set of relationships among groups which have a stake in the activities that make up the business. Business is about how customers, suppliers, employees, financiers (stockholders, bondholders, banks, etc.), communities, and managers interact and create value. To understand a business is to know how these relationships work. And, the executive's or entrepreneur's job is to manage and shape these relationships, hence the title, "managing for stakeholders."

Figure 1 depicts the idea of "managing for stakeholders" in a variation of the classic "wheel and spoke" diagram.[13] However, it is important to note that the stakeholder idea is perfectly general. Corporations are not the

FIGURE 1



Source: R. Edward Freeman, Jeffrey Harrison, and Andrew Wicks, *Managing for Stakeholders* (New Haven: Yale University Press, 2007).

center of the universe, and there are many possible pictures. One might put customers in the center to signal that a company puts customers as the key priority. Another might put employees in the center and link them to customers and shareholders. We prefer the generic diagram because it suggests, pictorially, that "managing for stakeholders" is a theory about management and business; hence, managers and companies are in the center. But, there is no larger metaphysical claim here.

Stakeholders and Stakes

Owners or financiers (a better term) clearly have a financial stake in the business in the form of stocks, bonds, and so on, and they expect some kind of financial return from them. Of course, the stakes of financiers will differ by type of owner, preferences for money, moral preferences, and so on, as well as by type of firm. The shareholders of Google may well want returns as well as be supportive of Google's articulated purpose of "Do No Evil." To the extent that it makes sense to talk about the financiers "owning the firm," they have a concomitant responsibility for the uses of their property.

Employees have their jobs and usually their livelihood at stake; they often have specialized skills for which there is usually no perfectly elastic market. In return for their labor, they expect security, wages, benefits, and meaningful work. Often, employees are expected to participate in the decision making of the organization, and if the employees are management or senior executives, we see them as shouldering a great deal of responsibility for the conduct of the organization as a whole. And, employees are sometimes financiers as well, since many companies have stock ownership plans, and loyal employees who believe in the future of their companies often voluntarily invest. One way to think about the employee relationship is in terms of contracts.

Customers and suppliers exchange resources for the products and services of the firm and in return receive the benefits of the products and services. As with financiers and employees, the customer and supplier relationships are enmeshed in ethics. Companies make promises to customers via their advertising, and when products or services don't deliver on these promises, then management has a responsibility to rectify the situation. It is also important to have suppliers who are committed to making a company better. If suppliers find a better, faster, and cheaper way of making critical parts or services, then both supplier and company can win. Of course, some suppliers simply compete on price, but even so, there is a moral element of fairness and transparency to the supplier relationship.

Finally, the local community grants the firm the right to build facilities, and in turn, it benefits from the tax base and economic and social contributions of the firm. Companies have a real impact on communities, and being located in a welcoming community helps a company create value for its other stakeholders. In return for the provision of local services, companies are expected to be good citizens, as is any individual person. It should not expose the community to unreasonable hazards in the form of pollution, toxic waste, etc. It should keep whatever commitments it makes to the community, and operate in a transparent manner as far as possible. Of course, companies don't have perfect knowledge, but when management discovers some danger or runs afoul of new competition, it is expected to inform and work with local communities to mitigate any negative effects, as far as possible.

While any business must consist of financiers, customers, suppliers, employees, and communities, it is possible to think about other stakeholders as well. We can define "stakeholder" in a number of ways. First of all, we could define the term fairly narrowly to capture the idea that any business, large or small, is about creating value for "those groups without whose support, the business would cease to be viable." The inner circle of Figure 1 depicts this view. Almost every business is concerned at some level with relationships among financiers, customers, suppliers, employees, and communities. We might call these groups "primary" or "definitional." However, it should be noted that as a business starts up, sometimes one particular stakeholder is more important than another. In a new business start-up, sometimes there are no suppliers, and paying lots of attention to one or two key customers, as well as to the venture capitalist (financier), is the right approach.

There is also a somewhat broader definition that captures the idea that if a group or individual can affect a business, then the executives must take that group into consideration in thinking about how to create value. Or, a stakeholder is any group or individual that can affect or be affected by the realization of an organization's purpose. At a minimum some groups affect primary stakeholders and we might see these as stakeholders in the outer ring of Figure 1 and call them "secondary" or "instrumental."

There are other definitions that have emerged during the last 30 years, some based on risks and rewards, some based on mutuality of interests. And, the debate over finding the one "true definition" of "stakeholder" is not likely to end. We prefer a more pragmatic approach of being clear of the purpose of using any of the proposed definitions. Business is a fascinating field of study. There are very few principles and definitions that apply to all businesses all over the world. Furthermore, there are many different ways to run a successful business, or if you like, many different flavors of "managing for stakeholders." We see limited usefulness in trying to define one model of business, either based on the shareholder or stakeholder view, that works for all businesses everywhere. We see much value to be gained in examining how the stakes work in the value creation process, and the role of the executive.

THE RESPONSIBILITY OF THE EXECUTIVE IN MANAGING FOR STAKEHOLDERS

Executives play a special role in the activity of the business enterprise. On the one hand, they have a stake like every other employee in terms of an actual or implied employment contract. And, that stake is linked to the stakes of financiers, customers, suppliers, communities, and other employees. In addition, executives are expected to look after the health of the overall enterprise, to keep the varied stakes moving in roughly the same direction, and to keep them in balance.[14]

No stakeholder stands alone in the process of value creation. The stakes of each stakeholder group are multifaceted, and inherently connected to each other. How could a bondholder recognize any returns without management's paying attention to the stakes of customers or employees? How could customers get the products and services they need without employees and suppliers? How could employees have a decent place to live without communities? Many thinkers see the dominant problem of "managing for stakeholders" as how to solve the priority problem, or "which stakeholders are more important," or "how do we make trade-offs among stakeholders." We see this as a secondary issue.

First and foremost, we need to see stakeholder interests as joint, as inherently tied together. Seeing stakeholder interests as "joint" rather than "opposed" is difficult. It is not always easy to find a way to accommodate all stakeholder interests. It is easier to trade off one versus another. Why not delay spending on new products for customers in order to keep earnings a bit higher? Why not cut employee medical benefits in order to invest in a new inventory control system?

Managing for stakeholders suggests that executives try to reframe the questions. How can we invest in new products and create higher earnings? How can we be sure our employees are healthy and happy and are able to work creatively so that we can capture the benefits of new information technology such as inventory control systems? In a recent book reflecting on his experience as CEO of Medtronic, Bill George summarized the managing for stakeholders mindset:[15]

> Serving all your stakeholders is the best way to produce long term results and create a growing, prosperous company . . . Let me be very clear about this: there is no conflict between serving all your stakeholders and providing excellent returns for shareholders. In the long term it is impossible to have one without the other. However, serving all these stakeholder groups requires discipline, vision, and committed leadership.

The primary responsibility of the executive is to create as much value as possible for stakeholders.[16] Where stakeholder interests conflict, the executive must find a way to rethink the problems so that these interests can go together, so that even more value can be created for each. If trade-offs have to be made, as often happens in the real world, then the executive must figure out how to make the trade-offs, and immediately begin improving the trade-offs for all sides. **Managing for stakeholders is about creating as much value as possible for stakeholders, without resorting to trade-offs.**

We believe that this task is more easily accomplished when a business has a sense of purpose. Furthermore, there are few limits on the kinds of purpose that can drive a business. Wal-Mart may stand for "everyday low price." Merck can stand for "alleviating human suffering." The point is that if an entrepreneur or an executive can find a purpose that speaks to the hearts and minds of key stakeholders, it is more likely that there will be sustained success.

Purpose is complex and inspirational. The Grameen Bank wants to eliminate poverty. Fannie Mae wants to make housing affordable to every income level in society. Tastings (a local restaurant) wants to bring the taste of really good food and wine to lots of people in the community. And, all of these organizations have to generate profits, or else they cannot pursue their purposes. Capitalism works because we can pursue our purpose with others. When we coalesce around a big idea, or a joint purpose evolves from our day-to-day activities with each other, then great things can happen.

To create value for stakeholders, executives must understand that business is fully situated in the realm of humanity. Businesses are human institutions populated by real live complex human beings. Stakeholders have names and faces and children. They are not mere placeholders for social roles. As such, matters of ethics are routine when one takes a managing for stakeholders approach. Of course this should go without saying, but a part of the dominant story about business is that business people are only in it for their own narrowly defined self-interest. One main assumption of the managerial view with shareholders at the center is that shareholders only care about returns, and therefore their agents, managers, should only care about returns. However, this does not fit either our experiences or our aspirations. In the words of one CEO, "The only assets I manage go up and down the elevators everyday."

Most human beings are complicated. Most of us do what we do because we are self-interested and interested in others. Business works in part because of our urge to create things with others and for others. Working on a team, or creating a new product or delivery mechanism that makes customer's lives better or happier or more pleasurable, all can be contributing factors to why we go to work each day. And, this is not to deny the economic incentive of getting a pay check. The assumption of narrow self-interest is extremely limiting, and can be self-reinforcing—people can begin to act in a narrow self-interested way if they believe that is what is expected of them, as some of the scandals such as Enron, have shown. We need to be open to a more complex psychology—one any parent finds familiar as they have shepherded the growth and development of their children.

SOME ARGUMENTS FOR MANAGING FOR STAKEHOLDERS

Once you say stakeholders are persons then the ideas of ethics are automatically applicable. However you interpret the idea of "stakeholders," you must pay attention to the effects of your actions on others. And, something like the Responsibility Principle suggests that this is a cornerstone of any adequate ethical theory. There are at least three main arguments for adopting a managing for stakeholders approach. Philosophers will see these as connected to the three main approaches to ethical theory that have developed historically. We shall briefly set forth sketches of these arguments, and then suggest that there is a more powerful fourth argument.[17]

The Argument from Consequences

A number of theorists have argued that the main reason that the dominant model of managing for shareholders is a good idea is that it leads to the best consequences for all. Typically these arguments invoke Adam Smith's idea of the invisible hand, whereby each business actor pursues her own self-interest and the greatest good of all actually emerges. The problem with this argument is that we now know with modern general equilibrium economics that the argument only works under very specialized conditions that seldom describe the real world. And further, we know that if the economic conditions get very close to those needed to produce the greatest good, there is no guarantee that the greatest good will actually result.

Managing for stakeholders may actually produce better consequences for all stakeholders because it recognizes that stakeholder interests are joint. If one stakeholder pursues its interests at the expense of all the others, then the others will either withdraw their support, or look to create another network of stakeholder value creation. This is not to say that there are not times when one stakeholder will benefit at the expense of others, but if this happens continuously over time, then in a relatively free society, stakeholders will either (1) exit to form a new stakeholder network that satisfies their needs; (2) use the political process to constrain the offending stakeholder; or (3) invent some other form of activity to satisfy their particular needs.[18]

Alternatively, if we think about stakeholders engaged in a series of bargains among themselves, then we would expect that as individual stakeholders recognized their joint interests, and made good decisions based on these interests, better consequences would result than if they each narrowly pursued their individual self-interests.[19]

Now it may be objected that such an approach ignores "social consequences" or "consequences to society" and, hence, that we need a concept of "corporate social responsibility" to mitigate these effects. This objection is a vestigial limb of the dominant model. Since the only effects, on that view, were economic effects, then we need to think about "social consequences" or "corporate social responsibility." However, if stakeholder relationships are understood to be fully embedded in morality, then there is no need for an idea like corporate social responsibility. We can replace it with "corporate stakeholder responsibility," which is a dominant feature of managing for stakeholders.

The Argument from Rights

The dominant story gives property rights in the corporation exclusively to shareholders, and the natural question arises about the rights of other stakeholders who are affected. One way to understand managing for stakeholders is that it takes this question of rights seriously. If you believe that rights make sense, and further that if one person has a right to X then all persons have a right to X, it is just much easier to think about these issues using a stakeholder approach. For instance, while shareholders may well have property rights, these rights are not absolute, and should not be seen as such. Shareholders may not use their property to abridge the rights of others. For instance, shareholders and their agents, managers, may not use corporate property to violate the right to life of others. One way to understand managing for stakeholders is that it assumes that stakeholders have some rights. Now, it is notoriously difficult to parse the idea of "rights." But, if executives take managing for stakeholders seriously, they will automatically think about what is owed to customers, suppliers, employees, financiers, and communities, in virtue of their stake, and in virtue of their basic humanity.

The Argument from Character

One of the strongest arguments for managing for stakeholders is that it asks executives and entrepreneurs to consider the question of what kind of company they want to create and build. The answer to this question will be in large part an issue of character. Aspiration matters. The business virtues of efficiency, fairness, respect, integrity, keeping commitments, and others are all critical in being successful at creating value for stakeholders. These virtues are simply absent when we think only about the dominant model and its sole reliance on a narrow economic logic.

If we frame the central question of management as "how do we create value for shareholders," then the only virtue that emerges is one of loyalty to the interests of shareholders. However if we frame the central question more broadly as "how do we create and sustain the creation of value for stakeholders" or "how do we get stakeholder interests all going in the same direction," then it is easy to see how many of the other virtues are relevant. Taking a stakeholder approach helps people decide how companies can contribute to their well-being and the kinds of lives they want to lead. By making ethics explicit and building it into the basic way we think about business, we avoid a situation of bad faith and self-deception.

The Pragmatist's Argument

The previous three arguments point out important reasons for adopting a new story about business. Pragmatists want to know how we can live better, how we can create both ourselves and our communities in ways where values such as freedom and solidarity are present in our everyday lives to the maximal extent. While it is sometimes useful to think about consequences, rights, and character in isolation, in reality our lives are richer if we can have a conversation about how to live together better. There is a long tradition of pragmatist ethics dating to philosophers such as William James and John Dewey. More recently philosopher Richard Rorty has expressed the pragmatist ideal:[20]

> pragmatists . . . hope instead that human beings will come to enjoy more money, more free time,

and greater social equality, and also that they will develop more empathy, more ability to put themselves in the shoes of others. We hope that human beings will behave more decently toward one another as their standard of living improves.

By building into the very conceptual framework we use to think about business a concern with freedom, equality, consequences, decency, shared purpose, and paying attention to all of the effects of how we create value for each other, we can make business a human institution, and perhaps remake it in a way that sustains us.

For the pragmatist, business (and capitalism) has evolved as a social practice, an important one that we use to create value and trade with each other. On this view, first and foremost, business is about collaboration. Of course, in a free society, stakeholders are free to form competing networks. But the fuel for capitalism is our desire to create something of value, and to create it for ourselves and others. The spirit of capitalism is the spirit of individual achievement together with the spirit of accomplishing great tasks in collaboration with others. Managing for stakeholders makes this plain so that we can get about the business of creating better selves and better communities.

NOTES

1. The ideas in this paper have had a long development time. The ideas here have been reworked from: R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Boston: Pitman, 1984); R. Edward Freeman, "A Stakeholder Theory of the Modern Corporation," in T. Beauchamp and N. Bowie (eds.) *Ethical Theory and Business* (Englewood Cliffs: Prentice Hall, 7th edition, 2005), also in earlier editions coauthored with William Evan; Andrew Wicks, R. Edward Freeman, Patricia Werhane, Kirsten Martin, *Business Ethics: A Managerial Approach* (Englewood Cliffs: Prentice Hall, forthcoming in 2008); and R. Edward Freeman, Jeffrey Harrison, and Andrew Wicks, *Managing for Stakeholders* (New Haven: Yale University Press, 2007). I am grateful to editors and coauthors for permission to rework these ideas here.
2. It has been called a variety of things: "stakeholder management," "stakeholder capitalism," "a stakeholder theory of the modern corporation," and so on. Our reasons for choosing "managing for stakeholders" will become clearer as we proceed. Many others have worked on these ideas, and should not be held accountable for the rather idiosyncratic view outlined here.
3. For a stylized history of the idea see R. Edward Freeman, "The Development of Stakeholder Theory: An Idiosyncratic Approach" in K. Smith and M. Hitt (eds.), *Great Minds in Management* (Oxford: Oxford University Press, 2005).
4. One doesn't manage "for" these benefits (and harms).
5. The difference between managerial and shareholder capitalism is large. However, the existence of agency theory lets us treat the two identically for our purposes here. Both agree on the view that the modern firm is characterized by the separation of decision making and residual risk bearing. The resulting agency problem is the subject of a vast literature.
6. Alfred Chandler's brilliant book *Strategy and Structure* (Boston: MIT Press, 1970) chronicles the rise of the divisionalized corporation. For a not-so-flattering account of General Motors during the same time period see Peter Drucker's classic work *The Concept of the Corporation* (New York: Transaction Publishers, reprint ed., 1993).
7. Executives can take little comfort in the nostrum that in the long run things work out and the most efficient companies survive. Some market theorists suggest that finance theory acts like "universal acid" cutting through every possible management decision, whether or not, actual managers are aware of it. Perhaps the real difference between the dominant model and the "managing for stakeholders" model proposed here is that they are simply "about" different things. The dominant model is about the strict and narrow economic logic of markets, and the "managing for stakeholders" model is about how human beings create value for each other.
8. Often the flavor of the response of finance theorists sounds like this. The world would be better off if, despite all of the imperfections, executives tried to maximize shareholder value. It is difficult to see how any rational being could accept such a view in the face of the

recent scandals, where it could be argued that the worst offenders were the most ideologically pure, and the result was the actual destruction of shareholder value (see *Breaking the Short Term Cycle*, Charlottesville, VA: Business Roundtable Institute for Corporate Ethics/CFA Center for Financial Market Integrity, 2006). Perhaps we have a version of Aristotle's idea that happiness is not a result of trying to be happy, or Mill's idea that it does not maximize utility to try and maximize utility. Collins and Porras have suggested that even if executives want to maximize shareholder value, they should focus on purpose instead, that trying to maximize shareholder value does not lead to maximum value, see J. Collins and J. Porras, *Built To Last* (New York: Harper Collins, 2002).

9. See R. Edward Freeman, "The Politics of Stakeholder Theory: Some Future Directions," *Business Ethics Quarterly* 4:409–22.

10. The second part of the integration thesis is left for another occasion. Philosophers who read this essay may note the radical departure from standard accounts of political philosophy. Suppose we began the inquiry into political philosophy with the question, How is value creation and trade sustainable over time? and suppose that the traditional beginning question, How is the state justified? was a subsidiary one. We might discover or create some very different answers from the standard accounts of most political theory. See R. Edward Freeman and Robert Phillips, "Stakeholder Theory: A Libertarian Defense," *Business Ethics Quarterly* 12, no. 3 (2002): 331ff.

11. Here we roughly follow the logic of John Rawls in *Political Liberalism* (New York: Columbia University Press, 1995).

12. There are many statements of this principle. Our argument is that whatever the particular conception of responsibility there is some underlying concept that is captured like our willingness or our need to justify our lives to others. Note the answer that the dominant view of business must give to questions about responsibility. "Executives are responsible only for the effects of their actions on shareholders, or only insofar as their actions create or destroy shareholder value."

13. The spirit of this diagram is from R. Phillips, *Stakeholder Theory and Organizational Ethics* (San Francisco: Berret-Koehler Publishers, 2003).

14. In earlier versions of this essay in this volume we suggested that the notion of a fiduciary duty to stockholders be extended to "fiduciary duty to stakeholders." We believe that such a move cannot be defended without doing damage to the notion of "fiduciary." The idea of having a special duty to either one or a few stakeholders is not helpful.

15. Bill George, *Authentic Leadership* (San Francisco: Jossey Bass, 2004).

16. This is at least as clear as the directive given by the dominant model: create as much value as possible for shareholders.

17. Some philosophers have argued that the stakeholder approach is in need of a "normative justification." To the extent that this phrase has any meaning, we take it as a call to connect the logic of managing for stakeholders with more traditional ethical theory. As pragmatists we eschew the "descriptive vs. normative vs. instrumental" distinction that so many business thinkers (and stakeholder theorists) have adopted. Managing for stakeholders is inherently a narrative or story that is at once *descriptive* of how some businesses do act; *aspirational* and *normative* about how they could and should act; *instrumental* in terms of what means lead to what ends; and *managerial* in that it must be coherent on all of these dimensions and actually guide executive action.

18. See S. Venkataraman, "Stakeholder Value Equilibration and the Entrepreneurial Process," *Ethics and Entrepreneurship*, The Ruffin Series, 3 (2002): 45–57; S. R. Velamuri, "Entrepreneurship, Altruism, and the Good Society," *Ethics and Entrepreneurship*, The Ruffin Series 3 (2002): 125–43; and, T. Harting, S. Harmeling, and S. Venkataraman, "Innovative Stakeholder Relations: When "Ethics Pays" (and When it Doesn't)" *Business Ethics Quarterly* 16 (2006): 43–68.

19. Sometimes there are trade-offs and situations that economists would call "prisoner's dilemma" but these are not the paradigmatic cases, or if they are, we seem to solve them routinely, as Russell Hardin has suggested in *Morality Within the Limits of Reason* (Chicago: University of Chicago Press, 1998).

20. E. Mendieta (ed.), *Take Care of Freedom and Truth Will Take Care of Itself: Interviews with Richard Rorty* (Stanford: Stanford University Press, 2006), 68.