From the time of Adam Smith, through the age of industrialization, the Great Depression, and the recent half-century of globalization and prosperity, the purpose and role of the business enterprise, and particularly of the large corporation, has been the focus of debate. Some governments have attempted to tame the corporation through regulation. Others have taken major spheres of economic activity into the public sector, often with unsatisfactory results and subsequent privatization. Whatever the terms of debate, the fundamental questions remain the same: What is the corporation, and to whom and for what are it and its managers responsible?

The persistence of these questions is a tribute to the success of the corporation, which, for more than two centuries, has evolved into a highly adaptable and successful form of human enterprise. As a result, its structures and processes have been emulated throughout the private sector all over the world, and in public and nonprofit institutions as well. The global scope of the private sector—and therefore of corporate activity—has also gradually been enlarged, even in those parts of the world where it was once severely restricted. But even as the global corporate system evolves, questions about its nature and purpose become more complex and challenging, and the public debate about the corporation in society grows more intense.

The corporate form originated in medieval times, when it was used by governments to grant special institutional status to cities, religious institutions,
and universities. During the 18th and 19th centuries, business corporations were increasingly chartered in North America and Europe, typically in order to pursue narrow purposes—financing ocean voyages and building canals, turnpikes, or railroads, for example. By the 20th century governments in many countries were granting corporate charters with broad and general purposes—such as “to carry on business for a profit.” As a result, corporations operating within market-oriented environments became free to pursue almost any legal business activity and to change their purposes, activities, and organizational structures almost at will. Freedom of action is, of course, more limited for corporations operating within authoritarian settings. However, the scope of market processes has been widening globally—and the extent of government control over business correspondingly declining—for a couple of decades, and this trend is expected to continue.

This book presents a view of the corporation quite different from its medieval origins—in which social purpose was the dominant consideration—and also different from both the model of comprehensive social control by government and the currently prominent “ownership” model that places primary emphasis on the private interests of investors. Our analysis is based on the empirical proposition that “Corporations ARE what they DO.” The modern corporation is the center of a network of interdependent interests and constituents, each contributing (voluntarily or involuntarily) to its performance, and each anticipating benefits (or at least no uncompensated harms) as a result of the corporation’s activities. Our proposed redefinition of the corporation, and our ideas about the ways in which corporations can and should be managed, are based on this observation.

The purpose of the business enterprise is to create wealth. Corporations create wealth in many different forms—earnings for investors, compensation for employees, benefits in excess of costs for customers and others. The attraction of the corporate form of enterprise, as it has emerged in advanced industrial countries, lies in its capacity to amass capital from multiple sources and to spread financial risks, always for the purpose of creating wealth. The diverse and flexible variants of the corporation that emerged during the 20th century proved uniquely appropriate, and highly successful, in accomplishing this objective. Recent improvements in global wealth, welfare, and opportunity are
most likely to be sustained in the 21st century by an economic system that operates on market principles and provides ample opportunity for creation of new enterprises, as well as the growth of established firms. And the long-term success of the corporate system requires greater and systematic managerial attention to the interests and concerns of the diverse individuals and groups who are voluntarily or involuntarily affected by corporate activity.

The reasons for the corporation’s extraordinary success in creating new wealth for its constituents are well known. One is that most of the corporation’s primary constituents—investors, employees, customers, and suppliers—voluntarily contribute resources to the corporation in pursuit of their own interests. And, as Adam Smith long ago recognized, the pursuit of individual benefits through such arrangements often generates benefits for all. A second reason for the success of the corporate system is its general openness to competition and innovation. Businesses compete not only for customers in the marketplace, but also for investors, employees, locations, ideas, and every other resource needed to pursue their productive purposes. Resource providers—including host communities and sometimes customers—compete for the benefits provided by the firm. When competition is absent or weak, the corporation is no more immune from corruption and inefficiency than any other form of bureaucracy. But when the competitive environment is open and active, the pursuit of individual gain through market processes—including the introduction of innovative technologies and the creation of new enterprises and industries—has usually produced widespread economic and social benefits.

Although the ultimate justification for the existence of the corporation is its ability to create wealth, the legitimacy of the contemporary corporation as an institution within society—its social charter, or “license to operate”—depends on its ability to meet the expectations of an increasingly numerous and diverse array of constituents. The modern, large, professionally managed corporation is expected to create wealth for its constituents in a responsible manner (that is, not by theft or deception). The connection between wealth and responsibility has been stressed by both business leaders and critics for more than a century, and if the corporation can continue to survive and succeed today it must continue to adapt to social change. United Nations Secretary-General Kofi Annan
recently challenged leading multinational corporations to subscribe to a new “Global Compact” expressing their responsibility for labor practices, human rights, and environmental protection throughout the world.

This chapter explains why the corporation needs to be redefined in the minds of its managers and constituents, and ultimately in law and public policy. Done correctly, this redefinition will clarify the role and purpose of the corporation within the evolving global social and economic system. This chapter introduces the stakeholder model of the firm, already established in the literature, and in chapter 2 it is extended to develop the stakeholder view of the corporation as a distinctive perspective on strategic management. The stakeholder view shows how stakeholder linkages can contribute to organizational wealth and to the overall well-being and success of the corporation.

Subsequent chapters explore and illustrate the value of a broad constituent-oriented approach to management as reflected in the experience of three firms that have made serious efforts to establish and incorporate stakeholder principles and procedures into their operations.

Of course, some of these initiatives have not been successful, even when well intentioned, and various mistakes have been made. But the companies profiled in this study have redefined themselves in ways that take overt and explicit account of the value derived from their linkages with multiple and diverse constituencies. In line with this broader and more accurate organizational identity, these firms have expanded their criteria of success—and therefore the goals of their operations—to include a wide range of performance criteria that are consistent with the stakeholder view of the corporation presented here.

THE CASE FOR REDEFINITION

In spite of the overall success of the corporation as an agent of beneficial long-term economic and social change, there is a need to reassess and redefine the large, well-established corporation, for two principal reasons:

• *Size and socioeconomic power:* Leading global corporations have access to vast resources (including specialized knowledge), overwhelming bargaining power with respect to most of their constituents, and
extraordinary ability to influence their environments. They are not microscopic economic actors at the mercy of market forces and omnipotent governments.

• *Inaccuracy of the “ownership” model and its implications:* Shareowners hold securities, but they do not own the corporation in any meaningful sense, nor are they the only constituents vital to its existence and success. The notion that shareowner interests should dominate those of all other corporate constituents is inconsistent with the observed behavior of successful firms. Therefore, the conventional shareowner-dominant model of the corporation is unrealistic, as well as normatively unacceptable.

**Size and Power**

The size, bargaining power, and impact of major multinational firms, both individually and collectively, strongly suggest the need for a redefinition of their political and legal status, and for the scope of their managerial responsibilities. Far from being independent actors on the global playing field, these firms by their very presence alter the environments—social and political, as well as physical—in which they operate. Many of these impacts are welcomed by some or all of their constituents, but the point is that these broad impacts—favorable or unfavorable to others—have to be considered as part of the output of the firm, and therefore within the scope of responsibility of its managers. Moreover, there is an extraordinary imbalance of knowledge, resources, and power between the corporation and most of its constituents, sometimes even including the governments that ostensibly provide the legal framework for its operations. Some of the voluntary constituents of the firm (such as employees and customers) may have little access to or knowledge about competitive alternatives, and therefore become subject to inequitable treatment. Some employees have limited bargaining power because firm-specific competencies are of little value in alternative settings. In addition, some members of society, outside the network of expressed and implied contracts that frames the corporation, may be involuntarily affected by corporate activity; some of these involuntary and noncontractual impacts, both physical (pollution, for example) and cultural, may be unwanted or even harmful.
Government regulation has been the usual means of addressing such issues and providing protection for potentially disadvantaged corporate constituents (including shareowners), both internal and external. However, regulatory protections have often proved to be costly, controversial, and less than fully effective, even in advanced industrial countries. In less-advanced countries the ability of governments to bargain effectively and to control the activities of large multinational firms is often inadequate. Furthermore, influencing public policy and regulatory activity on behalf of corporate interests (in the form of lobbying) has now evolved into a highly skilled—and highly paid—profession. Hence, the notion that corporations are generally dominated by constituent-oriented governments is fallacious. Nor is the redress of grievances through the courts a realistic alternative in many jurisdictions. Even where such redress is available, legal actions are costly, time-consuming, and highly problematic—and always *ex post*, hence incapable of heading off undesirable outcomes in advance (except when a large penalty serves as an object lesson for others).

Many inequitable or harmful impacts of corporate activity could more cheaply, and probably more effectively, be reduced through adaptive behavior by managers, *if* (and this is a big “if”) they were motivated to do so. Hence, one goal of redefining the corporation is to bring the legitimate concerns of both voluntary corporate constituents and involuntary, noncontractual parties—as well as those of the larger community as a whole—more clearly within the purview of managers.

**The Ownership Model**

The second stimulus for redefinition is that, at least in the Anglo-American tradition, the legal framework of the corporation and the great bulk of legal and managerial rhetoric are cast in terms of an ownership model in which the corporation is seen as an extension of a basic human right to own property. If individual citizens possess such a right and voluntarily collaborate to own property in common, then the corporation is simply another form of personal property ownership. Some societies severely limit citizens’ rights of property ownership, and even the most property-oriented European and Asian traditions emphasize that critical features of the corporate form—legal status, unlimited life, and limited liability—are *not* natural attributes of the individual,
but extraordinary privileges granted by the state on behalf of the larger host society.

As early as 1946 Peter Drucker dismissed the argument that the corporation is “nothing but the sum of the property rights of the individual shareholders” as a “crude old legal fiction” (p. 30). In spite of the relative ease with which corporations are formed, dissolved, and reorganized in many countries, the core image of the corporation has to include the fact that the corporate form is socially created and thus not a natural phenomenon. Therefore, conformance with broad social norms and values is an inherent requirement for the corporate system as a whole.

Uncritical acceptance of the ownership model of the corporation is often accompanied by ignorance of the societal privilege, and associated responsibilities, that the corporate form involves. Analysts and critics have attempted to instruct managers about the extent and importance of these responsibilities for many decades (Clark, 1916; Dodd, 1932; Bowen, 1956) and stressed the “interconnectedness” of owners with other constituents (Follett, 1918). More recently, both commercial and nonprofit organizations have begun to offer training programs and practical assistance for firms that wish to address these issues. For example, Business for Social Responsibility (BSR), an organization established in 1994 that now has more than 1,400 member firms, offers programs and information intended to “help companies be commercially successful in ways that demonstrate respect for ethical values, people, communities and the environment” (www.BSR.org).

Adherence to the ownership model is also often associated with imprecise reference to a managerial goal of “maximization,” whether of profit, value, or some other measure. The concept of profit maximization originally entered the literature of economics as an assumption, intended to explain the behavior of firms as viewed by outside observers. More recently, in the context of a highly oversimplified legal-economic model of the firm, it has evolved into a normative goal, underlying the notion that the overriding objective of corporate management should be to generate wealth for shareowners (Boatright, 1996).

Sophisticated observers realize that no mathematical functions exist than can quickly and with detail describe the income- or wealth-producing possibilities of any real organization. Nor can an overall maximum for any significant
performance variable be readily computed. This means that, despite the rhetoric, comprehensive “maximization” practices are rarely observed. As Michael Jensen has written (2000, pp. 49–50):

Value maximization tells the participants in an organization how they will assess their success in achieving a vision or implementing a strategy. But value maximization says nothing about how to create a superior vision or strategy. . . . It only tells us how we will measure success in the activity. . . . Defining what it means to score to a goal in football or soccer, for example, tells the players nothing about how to win the game. It just tells them how the score will be kept.

Jensen correctly states that a better description of what corporations do, and what they can and should do, is to “seek value.” That is, within the limitations of their knowledge and skills, and within limited and often ill-defined time horizons, they attempt to make and implement decisions that will increase their value over the long run.

Are shareowners entitled to returns on their investments? Of course. They are significant stakeholders, contributing to the success of the corporation and therefore fully deserving of rewards. In particular, individuals who contribute funds to start or expand businesses, often at considerable risk, should expect to reap significant benefits. However, new, innovative, and high-risk ventures, though vital for the maintenance of a dynamic economy over the long term, account for only a small part of total shareowner investment. The great bulk of investment is in established companies of substantial size, and much of this investment is channeled through fiduciary institutions that greatly attenuate the relationship between the individual saver-investor and the firm. Even then shareowners properly expect to receive returns on their capital, but the distinction between shareowners and bondholders (that is, between owners and lenders) under these circumstances becomes very weak. Both are concerned with the level and stability of their earnings and are also concerned with possibilities for capital appreciation and protection against loss. In spite of the spectacular investment gains and losses that some people experience, the actual returns that owners and lenders receive on their capital depend primarily on the composition of their portfolios and on systemic and macroeconomic factors.
Shareowners, of course, are not all alike. Those of family-owned and employee-owned enterprises may be intimately involved in corporate affairs, and some very large shareowners and fiduciary interests occasionally attempt to have direct influence on the operations of larger firms. These situations are, however, exceptions to the norm for large investor-owned corporations and their passive, and often indirect, investors. Hence the ownership status of individual shareowners and their agents in large, ongoing corporations—and therefore in the corporate system as a whole—is largely an artifact. The shareowner cannot actually do anything with any part of the corporation, nor does he or she ordinarily have any expectation or desire to do so. In fact, even the ability of individual shareowners to gain information about a company, or to raise questions about its operations, is severely limited.

What the shareowner owns is really a piece of paper—or an entry in a computer database—that grants two significant entitlements: ¹

1. To receive fractional distributions of income from the corporate source—if, in fact, there is any income available for distribution, and only to the extent that the officers and directors of the corporation choose to authorize such distributions.

2. To sell this token of ownership to someone else on any terms that the two trading parties may voluntarily establish.

These entitlements are not trivial, but obviously most large corporations need not (and do not) manage themselves primarily for the benefit of individuals who are in this passive and often indirect ownership role. Charles Handy (1997), in a paper marking the 75th anniversary of the Harvard Business Review, said: “The idea of a corporation as the property of the current holders of its shares is confusing because it does not make clear where the power lies. . . . A public corporation should now be regarded not as a piece of property but as a community . . . created by a common purpose.” As Jensen (2000, p. 50)

¹To emphasize exactly what ownership of a share of stock involves—and to correct the common misconception that shareholders and stakeholders have opposing interests even though the former are part of the latter—we use the term “shareowner” throughout this book. In addition to the two entitlements mentioned, shareowners are also entitled to vote in the election of directors and occasionally for other, usually minor, purposes.
clearly states: Although the long-term value of a firm’s securities is an important indicator of its overall economic value, “stockholders are not some special constituency that ranks above all others.”

Rejection of the conventional ownership model of the corporation does not, however, mean “the death of property rights,” as one commentator on the 1992 American Law Institute Principles of Corporate Governance declared (Carney, 1993), nor does it presage “the end of shareholder value” as suggested by Allan Kennedy (2000). On the contrary, the stakeholder perspective emphasizes the similarity and mutuality of interests among the diverse constituents of the corporation, and the many forms that ownership may take. In the modern theory of the firm, ownership is seen in cognitive and behavioral, as well as physical and legal, terms. An individual owns his or her own knowledge and capabilities, and groups of people own the common understandings and routines that they have learned to rely on over time. Commitment to working within and among specific organizations, and development of situation-specific capabilities that serve organizational purposes, involves investments comparable to—and possibly rarer and more valuable than—the financial investments of shareowners (Blair, 1995). The implications of these realities are included within the redefinition of the corporation proposed in this book, and will be further discussed in connection with the concept of organizational wealth in the next chapter.

**A New Definition**

The conventional concept of the corporation is descriptively inaccurate and ethically unacceptable. The corporation requires and receives inputs, some of them involuntary, from multiple sources, and has an impact on many constituents, favorable or otherwise. The corporation cannot—and should not—survive if it does not take responsibility for the welfare of all of its constituents,

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2Evidence that investors will respond to promises of value, as reflected in dividends and/or stock prices and divorced from the fiction of property rights, is provided by the current popularity of “tracking stocks.” Owners of these tradable securities anticipate gains or dividends related to the performance of a particular subsidiary or line of business within a company, but have no control over the underlying assets.
and for the well-being of the larger society within which it operates. The contractual agreements and government regulations it must follow are not always enough.

Fortunately, in spite of “shareholder value” rhetoric, many large corporations are managed (as all of them should be) such that they serve the interests of a broad range of constituents, both internal and external. We refer to these constituents as stakeholders, and we believe that a new concept of the corporation is needed to recognize their relationship with the firm. This new concept should be based on the obvious fact that corporate activity involves the collaboration, both voluntary and involuntary, active and passive, of numerous and diverse constituents; and it should acknowledge that these constituents have good reason to expect benefits, not harm, from their association with the corporation. Hence, we express the stakeholder view of the corporation in the following definition:

_The corporation is an organization engaged in mobilizing resources for productive uses in order to create wealth and other benefits (and not to intentionally destroy wealth, increase risk, or cause harm) for its multiple constituents, or stakeholders._

This definition provides a more accurate description of reality and offers better guidance for managers and directors in the discharge of their responsibilities. Its most important implication is that corporate performance should be appraised from multiple perspectives. The interests of shareowners are, of course, among these, but they are not always primary and never exclusive. A further implication is that corporate managers should attempt to identify their significant and legitimate stakeholders (particularly those who are noncontractual and involuntary, and hence easily overlooked), and to listen and respond to their interests and concerns.

Our definition of the corporation is congruent with the ideas presented in a publication by the Organization for Economic Cooperation and Development (1999, p. 18), which includes the following statement:

_The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and_
stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises.

This document offers no formal definition of the term “corporate governance,” and formal definitions are hard to find in the voluminous literature that has recently appeared on this subject. Williamson (1998, p. 76), writing about transactions-cost economics that recognizes the dual principles of conflict and mutuality in every transaction, defines governance as “the means by which order is accomplished,” so that conflict can be reduced and mutual gains realized. Preston (2002) suggests a broad concept of “governance,” defined as “the set of institutional arrangements that legitimates and directs the corporation in the performance of its functions.” He describes the diverse ways in which various classes of stakeholders actually participate in governance in this broad sense, and in both collaborative and adversarial ways, in the varied types of corporate structures that are currently operating all over the world.

The OECD document also offers no formal definition of the term “stakeholders”; in fact, a definition congruent with the most frequent use of this term in the management literature has proved elusive. Schilling recently discovered that Mary Parker Follett fully developed the stakeholder concept, although without using the term, in her 1918 book *The New State*. She forecasted the concept of “interpenetrating systems” and saw stakeholder networks as a subset of these more general phenomena. She pointed out that the purpose, structure, and management of business organizations could be redefined in terms of “interconnectedness,” and that the role of managers is to *integrate* diverse efforts and interests for mutual benefit (Schilling, 2000). The term “stakeholder” was first popularized in the strategic management literature by Freeman in 1984; he subsequently emphasized that a stakeholder perspective required a redefinition of the firm itself, emphasizing that its purpose is “to serve as a vehicle for coordinating stakeholder interests” (Evan and Freeman, 1993, pp. 102–3).

Most subsequent analysts have paraphrased Freeman’s loose statement that a “stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the activities of an
organization” (1984, p. 46). However, this broad definition would include entities, such as competitors, whose interests are directly opposed to those of the focal corporation (but who nevertheless can affect or be affected by it). This inclusiveness would make the usual use of the term in the management literature, as presaged by Follett’s analysis, inappropriate; it would turn into an absurdity the OECD statement that corporations and their stakeholders should “cooperate in creating wealth, jobs,” etc. Thus the notion that corporations should aim for mutually beneficial (and certainly not harmful) relationships with their stakeholders requires a definition with narrower scope. Here is the definition used in this book:

The stakeholders in a corporation are the individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and that are therefore its potential beneficiaries and/or risk bearers.

The fundamental idea is that stakeholders have a stake in the operation of the firm, in the same sense that business partners have a common stake in their venture or players on a team a common stake in the outcome of a game. Stakeholders share a common risk, a possibility of gaining benefits or experiencing losses or harms, as a result of corporate operations. Their common desire is that the corporation should be run in such a way as to make them better off, or at least no worse off, than they would be otherwise. Our definition of the term “stakeholders” emphasizes both benefits and risks, and is congruent with the most frequent use of the term in the management literature, including the OECD document. Our definition is also consistent with the recent work of Kochan and Rubenstein (2000, p. 373), who suggest three criteria for identifying significant stakeholders:

1. They supply resources that are critical to the success of the enterprise.
2. They place something of value “at risk”; that is, their own welfare is directly “affected by the fate of the enterprise.”
3. They have “sufficient power” to affect the performance of the enterprise, either favorably or unfavorably.
The resources provided by stakeholders can include social acceptance, the “license to operate,” as well as more obvious contributions such as capital, labor, and revenue. The risks include not only financial exposure but employment and career opportunities, the quality of products and services, environmental and community impacts, and so forth. The power of stakeholders may arise from their ability to mobilize social and political forces as well as their ability to withdraw resources from the firm.

Investors, employees, and customers associate themselves voluntarily with the corporation in the hope of obtaining benefits. Other stakeholder individuals and groups adversely affected by pollution or congestion may be involuntarily involved with the firm, and may seek to minimize its negative impact on their welfare. However, their tacit acceptance of the firm’s license to operate is nevertheless a significant contribution to its welfare. The status and interests of some classes of stakeholders (shareowners and employees, for example) are at least partially protected by law in most advanced countries, and most stakeholders have recourse to the courts to resolve any serious conflicts between themselves and the corporation. However, the possibility of receiving greater or lesser harms or benefits applies to all stakeholders; some, perhaps many, may receive both benefits and harms at the same time. From the perspective of any class of stakeholder, the term “corporate performance” properly includes the impact of corporate activity on themselves.

Freeman points out that “management theory is inherently prescriptive” (p. 47). The prescriptive implication of the stakeholder concept is that corporate managers should take into account the interests of those stakeholders that may be impacted, either favorably or unfavorably, by their decisions and actions. Hence, the term stakeholder management refers to management practices that reflect awareness of and response to the legitimate concerns of the multiple constituencies of the corporation. Note that the term does not refer, in this book, to the manipulation of stakeholders for narrow organizational purposes—that is, the management of stakeholders. We believe that effective stakeholder management is a critical requirement for sustaining and enhancing the wealth-creating capacity of the corporation.

Comprehensive stakeholder management requires recognition of stakeholders who voluntarily associate themselves with the corporation in pursuit
of their own interests, and other persons and entities that are involuntarily impacted by corporate activity. With respect to voluntary constituents, the key managerial concept is obviously mutual benefit. Constituents such as investors, employees, and customers stand to gain from the success of the firm in creating new wealth through productivity improvements, innovations, and increasing customer acceptance (an indicator of increasing—or at least increasingly recognized—customer benefits). Their continued voluntary involvement with the firm—including their cooperation as it adapts to change—rests on their perception that they do, in fact, benefit as a result. With respect to individuals and groups involuntarily impacted by corporate activity, in particular those subject to pollution, congestion, unwelcome cultural influences, or the like, the critical management goals have to be avoidance of harm, reduction of risk, and/or creation of offsetting benefits, so that the continued operation of the individual enterprise—its “license to operate”—remains acceptable to all parties. In democratic political systems, which are uniquely hospitable to market-oriented economic arrangements, no business activity that causes substantial negative impact on any significant group of people or interests can be expected to survive, unless it offers conspicuous and broadly distributed offsetting benefits.

These points may seem obvious—and they are certainly well-understood by many sophisticated corporate managers and analysts—but they are entirely at odds with much contemporary corporate rhetoric, which places almost exclusive emphasis on the primacy of investor interests and short-term, bottom-line results. In fact, companies in Europe, Asia, and other places where a broader social role for the firm has been traditionally recognized are now being urged by management consultants and pressed by financial analysts to adopt more Western—that is, shareowner oriented—strategies. The influence of Western management modes is also increased, of course, by the long-term globalization trend, in which U.S.-based companies with conventional shareowner-focused management practices have played a pattern-setting role. These international pressures are well documented from a European perspective by Mills and Weinstein (2000, p. 89), who nevertheless argue that current shareholder value imperatives and constituency interests can be reconciled because “stakeholders play a key role in the value creation process.”
THE STAKEHOLDER MODEL

A conventional diagram of the stakeholder model, intended to describe the multiple linkages between the corporation and its diverse stakeholders, is presented in Figure 1.1. Several points about this conception should be noted.

Benefit Flows

The flows between the firm and its stakeholders run in both directions; each stakeholder is perceived as contributing something and receiving something from the corporation. (Even involuntary and essentially passive stakeholders contribute by tolerating the existence and operation of the firm, and receive some combination of benefits and harms as a result.)

Multiple Linkages

All of the linkages may be operational at once; hence, contact with the firm creates indirect linkages or networks among the various stakeholders themselves—who may also, of course, be linked in other ways (as members of the same

Figure 1.1 The Corporation and Its Stakeholders.
community, for example). The frequently encountered statement that “the corporation is a nexus of contracts” sometimes suggests that the firm is engaged in a series of unrelated bilateral arrangements with various parties that have no relationship with each other. This is not an accurate description of stakeholder relationships for two reasons.

First, it omits the interests of involuntary and passive stakeholders, who may lack even an implied contractual relationship to the firm. Second, it fails to recognize the fact that, because of their mutual connection with the firm, all stakeholders are linked—at least indirectly, and often quite importantly—with each other. As the OECD notes: “Corporate governance is affected by the relationships among participants in the governance system.” In addition to shareowners, the text lists creditors, employees, and governments among those playing important roles (OECD, 1999, p. 10).

**Simultaneous Roles**

Particular individuals and groups may simultaneously occupy several roles—employee, customer, shareowner, neighbor, and the like. Recognition of these overlaps should lead both managers and constituents to acknowledge the varied impacts of corporate activity, and to think of corporate performance in multidimensional and comprehensive terms, rather than from the perspective of any single interest. It should also be noted that competitors do not appear among the classes of stakeholders shown in Figure 1.1. The competitors of a particular firm contribute no stake to its operation and are more likely to benefit from its failure than from its success; they are therefore not stakeholders in it, as that term is used here. Of course, firms in the same or related industries, competitive or not, may develop a common stake in some industry-wide concern, such as support of R&D efforts or specific public policy issues.

**Issue Variance**

Finally, relationships between corporations and their stakeholders vary from issue to issue and from time to time. Some issues are more important to one class of stakeholders than to another. Concerns and priorities change over time; new classes and configurations of stakeholders appear in response to
changing circumstances. Long-term relations, favorable or unfavorable, with various categories of stakeholders are path-dependent; trust builds over time, and so does distrust and opposition. Hence, the stakeholder map for any particular firm is not a permanent chart in which each recognized interest has a fixed weight or priority, but rather a flexible vision of a dynamic situation, akin to a hologram.

The stakeholder model contrasts sharply with the ownership model of the firm in both its Adam Smith and Karl Marx versions. The Adam Smith version presents the firm as an input-output system through which various resources are brought together in order to generate products and services for the benefit of customers. Those contributing inputs to this process receive benefits because they have provided goods and services that others want; customer demand both directs the flow of activity and determines its success. The Karl Marx version presents the ownership model in its most extreme form, with all involved parties, including the customers, contributing resources, effort, and money in order to generate benefits for owner-investors. This view of ownership may be morally repugnant, but is not too different from some commonly held conceptions. As a practical matter, even the simplest forms of corporate law and regulation protect at least some interests other than shareowners (for example, lenders and employees); and most stakeholders can take their claims to the courts if necessary. Some legal provisions even protect the corporate entity from the shareowners themselves.

**Descriptive Evidence**

There is ample case and anecdotal evidence of the descriptive accuracy of the stakeholder model from corporate sources. The widely cited Caux Roundtable *Principles for Business* (1994) recognizes a conventional list of stakeholder interests. The Hitachi Foundation’s 1997 *Global Corporate Citizenship—Rationale and Strategies* presents a strong case for the strategic importance of corporate citizenship, and focuses attention on the challenges of working with specific stakeholder groups.

Individual corporations often state their commitment to stakeholders. For example, Novartis, a global pharmaceutical firm, published the following statement on its web site (1999): “We aspire to capture and hold a leadership
position in all of our businesses with a strong, sustainable performance based on continuous innovation. Our long-term success is founded on meeting the expectations of all our stakeholders—our customers, our people, our shareholders and the communities in which we live.” The purpose of such codes, statements, and policies is to codify the importance and role of stakeholders to the corporation. This idea was expressed by Bell Atlantic CEO Ivan Seidenberg, who stated (1998, p. 11) that his firm (now called Verizon) was developing “new ways of behavior that give people—our customers, the government, our stakeholders and suppliers—confidence that we know how to act (to do what is right). . . . That marketplace confidence becomes our competitive edge.” The prevalence of these expressions is reported among major corporations in Europe (Wheeler and Sillanpaa, 1997) and Australia (Suggett, 2000) as well as the United States.

In a particularly interesting case, Tom Chappell, founder and president of Tom’s of Maine, a consumer health products firm, recounts his own discovery of the philosophical notion of “being as relation” in a course at the Harvard Divinity School, and tells how this idea caused him to reinterpret the status of his own firm “not only as a private entity but in relation to many other entities” (1993, pp. 15–19). His book gives a short sketch of his beliefs, which are essentially the same as the stakeholder model pictured in Figure 1.1.

Formal survey studies over a span of several decades show that many managers describe their operations in similar “relational” terms (Baumhart, 1968; Brenner and Molander, 1977; Posner and Schmidt, 1984; Wang and Dewhirst, 1992). Three recent studies confirm and strengthen these results. Steger (1998) gathered responses from about 300 European managers through questionnaires, interviews, and focus groups; and a similar study by Agle, Mitchell, and Sonnenfeld (1999) analyzed questionnaires returned by 80 CEOs of major U.S. firms. The main conclusion of both of these studies is that senior managers recognize both business-sector and external stakeholders, and that they view the former—shareowners, employees, customers—as more important than the latter. Similar results were obtained from a smaller sample of firms, plus selective interviews, by Logsdon and Lewellyn (2000), who found that stakeholder-performance measures concentrated on shareowners, customers, and employees.
These findings are not surprising. Stakeholders functionally linked to the firm through the value chain have obvious roles in organizational stability, growth, and wealth creation. Moreover, managers have many more numerous and frequent contacts—and therefore more possibilities for favorable or unfavorable outcomes—with shareowners, employees, and customers than with other stakeholders. However, all of these studies also found that there is considerable variation in the perceived importance of particular types of stakeholders among firms and industries. For example, external stakeholders such as governments and regulatory agencies are highly salient for corporations operating in regulated industries, as Robert Miles’s classic study of the insurance industry (1987) clearly demonstrates.

Common experience, as well as our own research, reveals that the relative importance of different kinds of stakeholders varies greatly among firms, as well as among various critical management issues. Customers are probably more important for product quality issues, employees for workplace safety issues, communities and governments for environmental issues, and so forth. The importance of particular issues to particular stakeholders also varies over time, and different groups have different time horizons. The important point for management is that stakeholder concerns and priorities are varied and dynamic; hence, stakeholder management is necessarily an ongoing process, flexible and situation specific. Every class of stakeholders could probably identify some specific category of potential benefit or harm as being of top priority; each could probably identify implicit or explicit cutoff points at which they would cease to cooperate with the firm if minimum expectations are not met.

**Instrumental Implications**

The descriptive accuracy of the stakeholder model as a picture of the modern corporation implies that management policies and practices that take account of multiple stakeholder interests will prove advantageous. If corporate performance depends upon favorable interactions with multiple stakeholders, then strengthening linkages with critical stakeholders should result in firmwide benefits. Thus, stakeholder management should contribute to stability, growth, profitability, and other commonly recognized indicators of business success.
Wheeler and Sillanpaa (1997) demonstrate this, and the philosophy is reflected in many corporate documents and reports (such as Hitachi Foundation, 1997) and academic analyses (Jones, 1995).

The strategic connection between stakeholder management and the overall performance of the corporation is, in fact, the principal focus of this research. That the relationship between the two is strong is enshrined in a long tradition of corporate rhetoric. As early as 1950, General Robert E. Wood, then CEO of Sears, identified customers, employees, community, and stockholders as the “four parties to any business,” adding, “I have named them in what I regard as the order of their importance.” He believed that “if the other three parties . . . are properly taken care of, the stockholder will benefit in the long pull” (quoted in Worthy, 1984, p. 64). More recently, John Kay (1995, p. 8), an experienced U.K.-based analyst and consultant, stated: “A firm adds value through the distinctive character of the relationships it establishes with its stakeholders—its employees, customers, shareholders, and suppliers.” And Jensen’s concept of “enlightened stakeholder theory” arises from the observation (2000, p. 50) that “it is obvious that we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency.”

Over the past few decades, the possibility that there might be some association between conventional indicators of corporate performance and the presence or absence of stakeholder-oriented policies and practices has been extensively explored in the academic literature. The most comprehensive survey lists 83 published studies on this topic during 1972–2000 (Margolis and Walsh, 2001). Some of these studies utilize data purporting to reflect corporate attention to particular stakeholder interests (employees or communities, for example), whereas others are based on broader indicators of general social performance and reputation. Some of the individual studies report diverse (and sometimes inconsistent) results.

Margolis and Walsh conclude that 48 of 83 studies reveal positive relationships between indicators of social and financial performance; 17 show mixed results; and 19 show no relationships at all. Only three studies conclude that social and financial performance are negatively associated (poor social performance accompanied by good financial performance). An earlier study of 50 published studies produced similar results (Roman, Hayibor, and Agle, 1999).
One of the most recent studies focusing on the 500 largest public corporations found that those that mentioned their commitment to stakeholder interests and codes of conduct in their annual reports (more than 100 firms) reported superior financial performance to those that did not (Verschoor, 1998). Another study, based on new data and methodology, indicates that managerial attention to employee and customer stakeholders is associated with favorable financial performance, but no other stakeholder-related effects are observed (Berman, Wicks, Kotha, and Jones, 1999).

All of these studies are subject to serious criticisms about data reliability and completeness, time period of coverage, statistical methodology, and interpretation of results. The safest generalization from them is that the empirical evidence on this matter is somewhat unreliable and the results mixed. However, it is important to note that there is very little evidence of a negative association between social and financial performance—that is, that undesirable social performance is profitable. To put it another way, the empirical studies do not prove that corporations can “do well by doing good,” but neither do they disprove that view, and there is no substantial evidence that corporations can “do well by doing harm” (Frooman, 1997).

Even a relatively weak “doing well and doing good” interpretation of the statistical results raises a significant cause-effect issue. Do companies do well financially because they recognize and respond to the concerns of diverse stakeholders, or do they adopt broad and socially responsive practices because they are financially secure and able to do so? Some studies have attempted to address this question through lead-lag analysis (Preston and O’Bannon, 1997), but the statistical problems are so great that the results cannot be taken too seriously. Burke and Logsdon (1996) have developed a plausible theoretical argument that various types of socially responsible behavior can be favorably linked to various dimensions of corporate strategy. We extend their analysis in our discussion of stakeholder relations and organizational wealth in the next chapter.

**Normative Implications**

The accuracy of the stakeholder model also carries normative implications; that is, it suggests guidelines for the behavior of all parties involved,
particularly managers. If the corporation is a network of linkages with and among stakeholders and requires their support for its existence and operation, then it follows that this network should be managed, if possible, to provide the stakeholders collectively with benefits. When viewed this way, one tends to wonder how else it would be managed. Indeed, it might be argued that basic stakeholder-corporation relationships are essentially “natural” phenomena, arising from the inherent characteristics of the corporate system. The American Law Institute commentary on Principles of Corporate Governance (1992, p. 72, italics added) affirms this position:

The modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern, such as employees, customers, suppliers, and members of the communities in which the corporation operates.

Following this line of thought, Donaldson and Preston (1995) assert two fundamental propositions:

1. Stakeholders identify themselves because of their interest in the corporation (regardless of the corporation’s functional interest or lack of interest in them).
2. The interests of all stakeholders have intrinsic value and merit consideration (although not all of the desires of every group of stakeholders can or should be satisfied.)

Acceptance of these two propositions defines a kind of organizational morality that forms the normative “core” of the stakeholder model: legitimate stakeholder interests require managerial recognition and attention as a matter of moral right. (An analogy to the two-way moral relationship between child and parent is too strong, but suggests the idea. It is morally unacceptable for either party to say “I don’t care” about the other, but not inevitable that either will accede willingly to all of the other’s demands.)

A recent article by Jones and Wicks (1999) argues that neither the instrumental view (stakeholder management is economically sound management) nor the normative view (stakeholder management is ethically “good” management) is complete in itself. They believe that the two perspectives can be
integrated through a focus on relationships emphasizing trust and cooperation rather than contracts and transactions. Their presentation has touched off an ongoing round of controversy and comment, and it is not certain that a theoretical perspective fully integrating the two themes will emerge. This book conforms to Jones and Wicks’ position insofar as the instrumental and normative implications of the stakeholder model are entirely compatible with each other. The two perspectives are often mixed—and sometimes fully integrated—in the company practices revealed in our own field studies.

Problems with the Model

The stakeholder model of the corporation appears to be plausible and relevant. However, when utilizing the model as a framework for management decision making, some important issues have to be addressed.

Identifying Stakeholders and Balancing Interests

Who are the stakeholders, and how can their interests be taken into account? Although the conventional classes of stakeholders—employees, customers, and so on—are universally recognized, their desires and levels of concern in many areas of management decision making are difficult to ascertain and may conflict. Establishing priorities and making choices among trade-offs are not easy, leading some managers to believe that comprehensive stakeholder management is impossible. Jensen strongly criticizes conventional stakeholder analysis for refusing to specify appropriate trade-offs among competing interests, so as to define a single-valued function suitable for maximizing (or at least increasing). He writes (2000, p. 52): “The absence of a scorecard makes it easier for people to engage in intense value claiming activities at the expense of value creation.” This is certainly true, but trade-offs among stakeholder interests vary from case to case; there is no universal way to generate a single-valued “corporate performance” function. Hence, identifying critical stakeholders and properly evaluating their concerns are always part of managers’ role, whether or not they officially accept the stakeholder management approach. It seems likely that such situations can be dealt with more effectively and fairly—and possibilities for mutually satisfactory solutions more clearly examined—if they are identified and examined through managerial procedures, rather than addressed ex post and under crisis conditions. (For specific suggestions about
stakeholder identification and prioritizing, see Mitchell, Agle, and Wood, 1997; Cummins and Doh, 2000.)

**Shareowners as Stakeholders**

The passive, attenuated, and frequently transient character of most shareowners’ ownership relationship to the corporation has already been pointed out. But note, in addition, that shareowners are unique among contractual stakeholders in that the specific benefits they gain from association with the firm are residual—in other words, they come only after all other claims have been settled. This applies not only to the distribution of net income after the discharge of all costs, but also to the appreciation or depreciation of capital values as well. As a result, the situation of shareowners, who appear to be the stakeholders most closely linked to the firm because of their ownership and formal (but largely irrelevant) role in corporate governance, is much like that of noncontractual involuntary third parties, such as communities. Each is affected by whatever the firm intentionally or inadvertently produces, but has very little effect on the firm itself except through quasi-political and ex post processes. (Shareowners can, of course, easily withdraw from their corporate relationships; many involuntary stakeholders cannot.)

The representation of shareowner interests through third-party fiduciaries, the largest of which often pursue their own agendas, further complicates the shareowners-as-stakeholders situation. Some of the largest fiduciaries—CalPERS and NYCERS, TIAA-CREF, and church-related funds—have actively advocated broader and more long-term management perspectives, closely akin to stakeholder management principles. Many have chosen to limit their range of investment choices through “screens” and decision criteria that support their policy positions (Kinder, Lydenberg, and Domini, 1993) Thus, whether shares are owned directly or through third parties, it is difficult for corporate managers to know what goals the shareowners of the firm would like to pursue. Similarly, it can be difficult for the shareowners to make their views known, or even to know whether desired goals have actually been achieved.

**Managers as Stakeholders**

The normative implications of the stakeholder model give rise to a serious dilemma about the role of managers within the corporate system. (Throughout
this book, “manager” refers to a person or group vested with decision-making authority and consequent responsibility, regardless of level or title.) On one hand, managers are stakeholders in their own right and can reasonably be expected to try to advance their own interests. But they are also arbiters and mediators of all stakeholder interests, and are responsible for the success and viability of the enterprise as a whole (Jones and Hill, 1992). There is often a conflict between these two roles. Both survey and anecdotal evidence, to say nothing of current news stories, provide ample evidence of the tendency of top-level managers to treat their own wealth and well-being as the primary goal of the firm.

Complex compensation schemes have been designed to overcome the so-called “principal-agent” problem, and to motivate managers to pursue objectives that are consistent with those of shareowners. Arrangements to assure managerial attention to the concerns of employees, customers, or others are still rare, but even minimum recognition of the stakeholder network probably exerts some influence on the actions of managers. The possibility of strikes, law suits, lost markets, and regulatory proceedings precipitated by nonowner stakeholders doubtless creates pressure for managers to attend to their interests. This is true even though most of these actions, like those of dissatisfied shareowners, occur after the fact and have uncertain outcomes.

The loyalty managers owe to the firm is a matter of law, and managers who place their firm in jeopardy are often sacked, and sometimes fined or even jailed. But beyond these formal constraints, managers have an obligation to all stakeholders, even when it requires balancing their own stakeholder interests against those of others. The reason for attracting more explicit attention and commitment to the concept is to increase managerial attention to the diversity of stakeholder interests and to the possibility of mutual gains and unavoidable tradeoffs in the distribution of benefits among stakeholders, including themselves (see Jones, 1995).

CONCLUSION

The conventional notion that the corporation should create wealth only for its shareowners is incorrect. The corporation should be redefined to emphasize
its relationships with and responsibilities toward all stakeholders, both voluntary and involuntary. This broader definition is consistent with widely held views about the nature of the corporation, and also with some empirical studies of corporate performance. The stakeholder model of the corporation fits in with broadly accepted normative and ethical considerations.

Chapter 2 integrates the stakeholder model with a broad conception of organizational wealth to develop an original “stakeholder view” of the corporation.