The Stakeholder Theory in the Modern Global Business Environment

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Abstract

The stakeholder theory made popular during the 1980s suggested that corporations should look beyond the shareholder theory of profit maximisation, and take into consideration other stakeholder groups that the corporation is associated with, and who contribute to the company’s achievements.

This paper examines why the shareholder theory of the traditional Anglo-American model of corporate governance failed to overcome the problems of unethical business practices of corporate boards and their managements. Overall, this paper argues that the application of deontological and teleological ethical theories could help boards of directors manage their companies’ stakeholder issues to the benefit of the company and its stakeholders.

Introduction

The traditional Anglo-American model of corporate governance is based on profit maximisation which claims to protect shareholders interests whereas, the German model considers that corporations are run in the interests of stakeholders i.e. shareholders, employees, management, creditors, public and society in general. The former has been labelled shareholdership (shareholder theory) and the latter stakeholdership (stakeholder theory). This paper will investigate how deontological and teleological ethical perspectives can be applied to stakeholdership and shareholdership in both theoretical and practical contexts.

The current history of stakeholder theory has been well documented by Donaldson and Preston (1995). Indeed, vestiges of the concept may be found in many areas of business from finance, strategic management, and corporate governance. (Meson and Mitroff, 1982; Keasey, et al 1997), organisation theory (Dill, 1975); and business ethics (Sherwin, 1983, Freeman, 1984, 1994, 1996; Blair, 1995; Phillips, 1997 and 2003).

Since the 1980s stakeholder theory has developed the thesis that the organisation has a moral relationship with groups other than shareholders (Freeman, 1984). This is based on the assumption that an organisations as well as individuals, possess moral status and therefore should act in a moral responsible manner. Evan and Freeman (1993) considered that acting in a moral responsible manner entailed two significant principles. The first principle involved harming the rights of others and was based on deontological ethical reasoning. The second principle being responsible for the effect of the organisation’s actions and was based on teleological ethical reasoning. Each of these moral perspectives will be used in this paper to analyse stakeholder theory in the modern global business environment and investigate how this may assist corporations to manage the interests of their stakeholder groups in more effective ways. First, this paper overviews stakeholdership and shareholdership and analyses these in relation to ethical perspectives of corporate governance. Second, through a case study of HSBC bank it outlines and discusses some dilemmas facing the definition of stakeholder in a changing global environment. Finally this paper discusses the implications a global environment has for ethical perspectives regarding business decisions and corporate behaviour.
Shareholdership and Stakeholdership: Identifying Distinctions

The issue of corporate governance has centred on whether shareholdership or stakeholdership was best for corporations and society and which the company board should follow in managing the affairs of the company (Sun, 2002). The ruling paradigm of the traditional Anglo-American model of corporate governance held that those who invest their capital into whatever kind of business and by that token, risked losing their investment in part or in total have an entitlement (and an obligation) to govern the business in which they have invested. Capital investors, shareholders and principals, either govern the business themselves, or they do so with support of appointed agents (directors). In this context, Etzioni (1998) pointed out “this understanding of principals’ rights roots is basically a mere extension of their natural right to own private property” (cited in Scholl, 2002; p 5). Furthermore, Scholl (2002) stated that the straightforward, unlimited transferability of individual property rights into the dimension of a corporation and its governance is increasingly questioned in the literature of various disciplines.

The idea of shareholder theory took-off following Friedman (1970), when he claimed that,

…there is one and only one social responsibility of business - to use its resources to engage in activities designed to increase its profits as long as it stays within the rule of the game, which is to say, engages in open and free competition, without deception or fraud, (p. 7).

It could be said that this view is premised on the idea of a market economy, which may be defined as an economic system combining the private ownership of productive enterprises with competition between them in the pursuit of profit. The advantage of this formulation is that it picks out the three aspects which are generally accepted as defining features of the market system. These are private ownership, competition and the profit motive. Profit maximisation is the offspring of a market system governed by the price mechanism. Implicit in this model is the belief that individual entrepreneur's profit maximisation does maximise the overall economic welfare of society (Smith 1776). However, this interpretation of shareholdership is sometimes lost and “the conventional model of the corporation, in both legal and managerial forms ... failed to discipline self-serving managerial behaviours”, (Donaldson and Preston, 1995; p 87). Since Friedman (1970) interest on shareholder value has increased. Influences such as the globalisation of capital markets, a proliferation of institutional investors, greater shareholders activism and the growing importance of corporate governance issues have all been stated as factors in this increase in shareholder wealth (Omran, Atrill and Pointon, 2002; Mills, 1998; Fera, 1997).

Shareholdership is underpinned by the Principal-Agent or Finance model, which in the main considered that the purpose of the corporation was the maximisation of shareholder wealth because shareholders are the owners of the corporation and bear the highest risks (Sun, 2002). This created the agency problem where managers push short-term policies that lead to their own interests against the long-term profits objectives of the shareholders, (Manne, 1965; Friedman, 1970; Jenson and Meckling, 1976). Furthermore, there exists the Myopic Market model, which claims that the purpose of corporations is the maximisation of shareholder wealth as well as the pursuit of short-term market value of the company for the benefits of directors and management, (power, financial rewards through share options, and job security...
of managers and directors (Charkham 1989, 1994a; Sykes, 1994). However, following fraudulent activity relating to events like the Maxwell Corporation, Polly Peck, BCCI and Baring Bank question marks were formed regarding unrestrained profit maximisation. Corporate failures such as these led to discussions relating to corporate governance codes which intensified following Enron, WorldCom, and Andersen. Indeed, the latter failures led to the Sarbanes-Oxley Act in the US and further corporate governance codes in the UK following Higgs and Smiths committee reports in 2003. Overall, there has been increased research into the kinds of behaviour that might constitute ethical and corporate social responsibility and the extent to which such activities are legally permissible under English Company Law.

On the other hand Phillips (2003) argued that stakeholdership involved a theory of organisational management and ethics which was distinct because it addressed morals and values as explicit central features of organisational management. He also pointed out that:

Managing for stakeholders involved attention to more than simply maximising shareholder wealth. Attention to the interests and well-being of those who can assist or hinder the achievements of organisation’s objectives is the central admonition of the theory. In this way, stakeholder theory is similar in large degree with alternative models of strategic management such as resource dependence theory, (p. 16).

Stakeholder theory attempted to describe, prescribe, and derive alternatives for corporate governance that included and balanced a multitude of interests. The theory has drawn considerable attention and support since its early formulation.

Stakeholder theory incorporates the executive power model, which claimed that the purpose of a corporation is the maximisation of corporate wealth. However, this intensified the problem directors acting in their own self-interest, as they support policies that led to the protection of their positions and powers in the company (Hutton, 1995; Kay and Silberston, 1995). Indeed, the executive power model claimed that the purpose of corporation is the maximisation of stakeholders’ wealth as a whole. However, this involved the absence of stakeholder involvement in the running of the company, giving directors the opportunities to push policies that do not take the needs of the company’s stakeholders into consideration, (Freeman, 1984; Evan and Freeman, 1993; Blair, 1995; Phillips, 1997; 2003).

Analytical Approach to Stakeholder Theory

Donaldson and Preston, (1995), suggested that the research on stakeholder theory has proceeded along three often confused lines. First, there is instrumental stakeholder theory, which assumes that if managers want to maximise the objective function of their firms, then they must take stakeholder interests into account. The second, there is the descriptive research about how managers, firms, and stakeholders in fact interact. The third, there is a normative sense of stakeholder theory that prescribes what managers ought to do. To this framework we could add a fourth dimension, the ‘metaphorical use of stakeholder’ which describes the idea as a figure in a broader narrative about corporate life. The first two senses of stakeholders could be call the analytical approach to stakeholder theory while the second, senses could be call the narrative approach to stakeholder theory.
Freeman (1984), proposed a framework, which fits three levels of stakeholder analysis – rational, process and transactional levels. At the **rational level**, an understanding of who are the stakeholders of the corporation and what their perceived stakes are is necessary. As a technique, he used a generic stakeholder map as a starting point. It is also possible to prepare a stakeholder map around one major strategic issue.

At the **process level**, the author claims that it is necessary to understand how the organisations either implicitly or explicitly manages its relationships with its stakeholders and whether these processes fit with the rational stakeholder map of the organisations. And that existing strategic processes that work reasonably well could be enriched with a concern for multiple stakeholders.

At the **transactional level**, we must understand the set of transactions or bargains among the corporation and its stakeholders and deduce whether these negotiations fit with the stakeholder map and the organisational processes for stakeholders. According to Freeman successful transactions with stakeholders are built on understanding the legitimacy of the stakeholders and having processes to routinely surface their concerns.

Elias and Cavana, (2003) point out that another interesting characteristic of the stakeholder concept is the **dynamics of stakeholders**, that over time, the mix of stakeholders may change. New stakeholders may join and wish to be included in any considerations, while others may drop out, through no longer being involved in the process. The concept of the dynamics of stakeholders was also acknowledged by Freeman, and according to him, in reality stakeholders change over time, and their stakes change depending on the strategic issue under consideration. (Aikhafaji, 1989) also contributes to the understanding of this concept of dynamics of stakeholders; to explain it he defined stakeholders as the “group to whom the corporation is responsible”.

Phillips (2003: 5), calls for the principle of fair play by corporations towards its stakeholders – “the principle of stakeholder fairness – provides a defensible source of moral obligations among stakeholders that has been therefore missing in the literature on stakeholder theory”. **Stakeholder Identification**, - who are those groups and individuals who can affect and are affected by achievement of a corporation’s purpose? How can we construct a stakeholder map of a corporation? What are the problems in constructing such a map?

Hampel Committee (1998) in its final report stated that:

> corporate governance must contribute both to business prosperity and accountability..... and that the purpose of those responsible for corporate governance is to safeguard the interests of shareholders and to protect and promote the interests of other stakeholders, such as managers, employees, customers, suppliers, governments and the communities where the company operates, (para. 15).

Metcalfe (1998) argues that in a corporate context, stakeholder theory states that:

> a stakeholder is entitled to consideration in some ways similar to a shareholder, and stakeholders may thus include employees,
customers, shareholders, suppliers, the state, and the local communities, (p. 12).

To these lists we could add bankers, financiers, special interest groups, the environment, Media, and technological progress. Both Hampel and Metcalf lists of stakeholder groups can be shown in the following diagram.

A map of global –stakeholder groups of a multinational corporation

A Board of Directors of a global corporation should not have profits for shareholders as its only responsibility. Each group in the above diagram takes part and contributes to the success of the corporation, and without their contribution there would be no profit for shareholders.

General Ethical Theories

It can bee seen from the different models under the shareholder and stakeholder theories that unethical behaviour benefits management rather than shareholders or stakeholders. Therefore, it is in the interests of all stakeholders, including shareholders that the corporation follows ethical codes regarding how the company is run when realising corporate purposes. In their broadest sense, ethics refer to the normative appraisal of the actions and character of individuals and social groups. Ethics is the study of moral human conduct or the rules of conduct recognised as appropriate to a particular profession or area of life. It relates to the issue of moral principles or conscience (Kant, 1930; Sherwin, 1983; Singer, 1993, 1998).

Deontological and Teleological ethical approaches are the two most common perspectives used to explain moral reasoning. The deontological theory states that duty is the basic moral category, independent of the consequences of the action. It has its foundations in the works of Immanuel Kant (1724-1804). He argued that “we should impose on ourselves the demand that all our actions should be rational in form”, (quoted in Burns, 2000: 28).
In teleological ethical theory an action is deemed moral or immoral by examining the consequences of the action (Beu et al, 2003). In most cases the deontological and teleological approaches to moral evaluation of actions will result in similar moral judgements (DeGeroge, 1999). This is because both approaches attempt to systematise and explain moral judgements. These general ethical theories provide useful information for analysing everyday ethical dilemmas such as the stakeholder theory.

Application of the Deontological Ethical Theories to the Stakeholder Theory

Focusing on the normative claim, the idea that stakeholders have intrinsic moral rights in relation to the managements of corporations is primarily derived from non-consequentialist or deontological ethical theory. The arguments in support of the stakeholder concept are rooted in the theories of duties and rights, (Beer, 2004). The idea that a person, by virtue of being a person, possesses intrinsic moral rights can be traced back to Immanuel Kant who developed a theoretical framework through which these principles could be derived, called the categorical imperative. By this, he meant that this theoretical framework should be apply to every moral issue regardless of who is involve, who profits, and who is harm by the principles once they have been applied in specific situations (Howell and Letza, 2000).

The categorical imperative consists of three parts (see De George, 1999). The first maxim states; act only according to that maxim by which one can at the same time will that it should become a universal law. This is the ‘litmus of test’ of ethical behaviour which states that we should all act in such a way that we would have moral agents act, (Gibson, 2000; Beer, 2004). The second maxim states; act so that you treat humanity, whether in one’s own person or in that of another, always as an end and never as a means only. That is that all individuals have equal moral worth and have an intrinsic right to be treated as ‘ends in themselves’ and not as a ‘mean’ to an end, (Rowan, 2000; Beer, 2004). The third maxim, state; act only so that the will through its means could regard itself at the same time as universally law given. One might come to the conclusion that a certain principle could be followed consistently by every human dignity.

The application of the deontological ethical theories to the modern business environment provided the initial bridgehead upon which stakeholder theory has subsequently been developed. The claim is that all individuals have the basic moral right to be treated by business organisations in a way that respects their interests, rather than as a means to achieving the ultimate corporate goals of profit maximisation.

A major purpose of stakeholder theory is to help board of directors and managements understand their stakeholders’ environments and manage more effectively within the terms of the relationships that exist for their companies. It is also the purpose of stakeholder theory to help directors and managers improve the value of the consequences of their actions, and minimise the harms to stakeholders.

Thus teleological ethical approach could be applied to the stakeholder theory in which the consequences of any actions taken by the managements are judged whether they benefit more stakeholders of their companies. In utilitarianism terms the more the outcomes of decisions taken by the boards result to happiness to the majority of the stakeholders the better it is for the company and its stakeholders. The whole point of stakeholder theory, in fact, lies in what happens when organisations and stakeholders act out their relationships. As (Logsdon and Wood, 1997) point out,
stakeholder theory can contribute to corporation’s performance and redefining the
corporation through a focus on performance measurement. Furthermore, Wheeler
and Sillanpaa, (1998) point out that stakeholder rights are generally conceived as
group based rights, as individuals typically interact with business organisations as
members of wider generic groups, as shown on the stakeholder map above.

The possession of intrinsic moral rights by stakeholders generates corresponding
duties on behalf of the corporations. Therefore, directors have a duty to acknowledge
the validity of various stakeholders’ interests and accommodate stakeholders’ rights
in a supportive manner. (Donaldson and Preston, 1995). This deontological or ‘duty
based’ approach has proved to be a significant development, superseding traditional
theories of the firm stipulating that managers only own a fiduciary responsibility to act
in the interests of the company’s shareholders.

Criticism of Stakeholder Theory

Why should managers pay attention to stakeholders? Phillip (2003), point out that the
most fundamental challenge to stakeholder theory is establishing a justification for
managerial attention to stakeholders akin to that justifying maximising shareholder
wealth. “Any convincing justification for maximising shareholder wealth must, at its
core, be a moral argument”. (p. 156). Jensen, (2001: 1), proposes value
maximisation of stakeholder theory, stating that “a firm cannot maximise value if it
ignores the interests of its stakeholders”, He points out that the big challenge facing
corporate boards and managements is determining the trade-off between the firm’s
objectives and the interests of its stakeholder groups.

Stakeholder theory argues that managers should make decisions that take the
interests of the company’s stakeholders into consideration. Since there are no
specific one interest of the stakeholder groups (such as the profit maximisation of the
shareholder theory), it is difficult for managements to determine one stakeholder
interest that will meet the firm’s objectives and the interests of all its stakeholders.
Even within the stakeholder theory, the interests of individual groups compete with
each other’s interests, “leaving managers with a theory that makes it impossible for
them to make purposeful decisions”, (Jensen, 2001: 1). Trying to meet the needs of
different stakeholders’ interests, the stakeholder theory can lead to managers being
unaccountably for their actions. Such theory can be attractive to the self-interest of
managers and directors. (Sternberg, 2004).

If the stakeholder theory is not good for companies why do so many boards of
directors and managements of corporations embrace it? One answer lies in directors
and managers undercover of stakeholder theory follow polices that meet their
personal interests instead of polices that meet the company’s long-term objectives
and the interests of its stakeholders. Without criteria for performances the
stakeholder theory allows managers to purse their own interests at the expense of
the firm’s financial claimants,

The main debate on stakeholder theory should be the ethical question. What are the
companies for? Do they exist simply to make money for shareholders or do they
have a wider role? There is a need for balance between the needs of both
shareholders and stakeholders within the company. Some criticisms of stakeholder
theory have suggested that it provide unscrupulous directors and managers with a
ready excuse to act in their own self-interests. Thus resurrecting the agency
problems that the shareholder wealth maximisation imperative was designed to
overcome. Opportunistic directors and managements could more easily act in their
own self-interest, by claiming that their actions actually benefit some stakeholder groups, ((Phillips; 2003; Marcoux, 2000; Sternberg, 2000 and 2004).

In as much as the shareholder model may be considered moral, in practice there are the problems that do not benefit everyone. There are shortcomings on both the shareholder and stakeholders models, as each creates its own problems for the boards of directors. Finding solutions to the above problems created by both the shareholder and stakeholder models call for directors to take ethical and moral issues into considerations when setting their business objectives. It is a balancing act that looks good in theory but difficult to deal with in practice, as directors are faced with the problems of determining not only who their companies’ stakeholders are but what their interests actually entail. As global change intensifies organisation stakeholders and their interests change more rapidly. For instance if we look at HSBC and the movement of a number of jobs from the UK to India we can explicitly observe some of these difficulties.

The Case of HSBC Bank and its Global –Stakeholders

HSBC also claimed that through moving UK based call centres to India where efficiency and productivity were very high, (a call centre worker in India is a graduate, works long-hours and is paid £4,000 per year), the bank’s performance would improve and enable it to meet the needs of global customers, and global stakeholders including those local stakeholders in both India and UK. Those stakeholders in the UK who lost their jobs, it claimed, would be retrained for other positions.

As for the ethical and moral arguments regarding the movement of hundreds of thousands of jobs from developed countries to developing countries, the corporation and supporters of such decisions may claim that it is a teleological ethical decision and motivated by the needs to help LDCs to provide for themselves instead of depending on handouts from developed countries. The real fact is that these multinational corporations do not care about the so call global-stakeholders just as they did not care about those stakeholders in developed countries who lost their jobs, and the communities suffer as a result. Moving call centres and service operations to developing countries have only one aim to cut cost and save their shareholders millions of pounds by paying workers in developing countries less than £2 per day even though most of them are graduates. The HSBC Bank is not alone in this argument other major high street Banks in the UK have all moved their call centres to India. Furthermore, most of the FTSE-100 companies in the UK have already moved their call centre operations to India, and other Asian countries.

The Fortune Business Magazines of July 2004 produced a special edition on “The World’s 500 Largest Corporations” in which it stated that the global corporations have created over 2 million jobs in developing countries as a result of outsourcing their productions and service operations. Indeed, these efficiency drives have saved shareholders billions of pounds. The USA business magazines also stated that in
2003 “the total revenues of the world’s largest corporations are 14.9 trillion US dollars (14,873 billion dollars), up 8% over that of 2002 with growth of profits change from 2002 up by 48%”. The majority of profit increases are not due to business performances but the result of savings made from job losses in developed economies as they are moved to low cost areas of the world.

What are the global multinational corporations doing with these savings? Are they reinvesting them in developed countries to help those millions who lost their jobs as a result? There is little evidence that this is the case, rather the poor in society are getting poorer while the rich corporations and their directors and shareholders are getting richer. How can 500 groups of CEOs control and sit on 14.9 trillion dollars while millions of workers after contributing to such achievements lost their jobs and continue to suffer in the name of maximising shareholders value?

**Conclusion**

This paper has argued that corporations cannot afford to ignore the issues of its stakeholder interests if it is to maximise its shareholder wealth because all stakeholder groups contribute to the success of the corporation. Therefore it is necessary that boards and management take deontological or teleological ethical theories into consideration when setting company objectives. The stakeholders of a corporation change from time to time due (in part) to the decisions taken by management or as a result of external events which are outside its control. It is up to management to find out who their company stakeholders are and what their needs involve.

As noted in the introduction, the traditional Anglo-American model of corporate governance focuses on the maximisation of shareholder wealth, with little or no interest for the needs the stakeholders. The directors of global corporations require ethical decisions that take into account global-stakeholders. Simply moving operations from one part of the globe to another in the interest of shareholder value cannot solve the problems of increasing global-stakeholders problems. A board that ignores the interests of its stakeholders cannot maximise its shareholder value.

The application of deontological and teleological ethical approaches to business ethics decisions, which take account of the company’s global-stakeholder interest’s could help such corporations maximise their shareholder value, and go along way to meeting stakeholder interests. This may be possible when directors are able to take radical business ethics decisions that enable them to see global-stakeholders as assets and “market winners” and not just means for cost cuttings and saving billions of pounds for shareholders.

This paper acknowledges the criticisms of the stakeholder theory, and considers whether the so-called ‘global-stakeholders’ interests presents its own problems for management. However, doing nothing is not the best way for multinational corporations and its boards of directors. The solutions to ‘global-stakeholders’ interests requires management to take into account global business and make ethical decisions beyond shareholder profit objectives. It is not enough to say that the business of multinational corporations is to create shareholder value without considering how such value creation will affect both local and global communities.
References


