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Stakeholder theory: Some revisionist suggestions
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A R T I C L E   I N F O

Article history:
Received 4 October 2011
Received in revised form 1 November 2012
Accepted 12 November 2012

Keywords:
Narrow stakeholders
Compatible ethics
Business strategy
Governance

A B S T R A C T

The article argues for the use of a narrow stakeholder definition. It also adds one group – managers – that generally is not considered as being a stakeholder group. Here it is suggested that control of this stakeholder group holding the executive power should be a central topic for stakeholder theory. The article supports the common idea that the business discourse and the moral discourse should be integrated in stakeholder theory, not treated as separate tracks. The issue is then how to mold the substance for such integration. This article argues that the priority of stakeholders implies a distancing from general altruistic philosophy that argues against – not for – giving special consideration to the company's stakeholders. Both the moral substance and the business potential lie in the special and close relationship with these partners. Stakeholder theory needs a more compatible ethical theory.

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1. Introduction

A starting point for this paper is an article named “Dialogue: Toward Superior Stakeholder Theory” (Agle et al., 2008) written by some of the most distinguished researchers in this field. I have taken two positions in that paper to heart. One is Edward Freeman’s inclusion of shareholder protagonists such as Milton Friedman, Oliver Williamson and Michael Jensen as stakeholder theorists. A discourse can hardly thrive by excluding one position in what is perhaps the most discussed issue, so it seems wise to consider the ‘Primus stakeholder’ model as one stakeholder theory, not only multi-fiduciary stakeholder models. The second position is Jensen’s claim in a similar inclusive spirit: “Enlightened value maximization is equivalent to enlightened stakeholder theory” (2008, p. 168). This statement might be a correct judgment, but it includes crucial demands for going from theoretical potential to reality.

It seems to me that there is a real potential in this enlightened merger, but that presently there are also some serious problems with constructing a satisfactory model. This article will address such problems and it will also, in this process, suggest some remedies. Each of these problems might deserve an article of their own, but they are also connected to each other and need to be seen together. A central part of the theory concept is that a theory is not just a number of separate issues brought together, as say a party platform, but rather a chain where the links are most dependent on the strength of the other links. This article brings up some important issues each one in need of improvement in order to bring the stakeholder theory closer to the ambitions of an enlightened level. The article continues with the issue of deciding which groups should be included in the stakeholder concept. The third section discusses the business case for stakeholder theory: the loyalty strategy. The forth issue is the governance issue, how should the stakeholder be brought into the decision process? The fifth section discusses the philosophical case; which philosophical positions are compatible with stakeholder theory. The discussion of these four issues is followed by sixth section connecting the shareholder perspective with other economic approaches. Then the article concludes in a summary section.

2. Which groups are stakeholder groups?

Many articles have addressed the question of which groups are to be considered stakeholders, and the most frequent shortcoming is that many do not sufficiently specify who is not a stakeholder. In many situations, not least in business ethics, there is a problem with definitions blurring differences when including too much in a concept. The vanishing difference between CSR and Sustainability is one example. I see no advantage in a semantic shift describing the field of business ethics in stakeholder terms. Clarkson formulated this point succinctly: “Stakeholder theory should not be used to weave a basket big enough to hold the world’s misery” (Phillips, 2003, p. 30). Definitional discussions are seldom inspiring, so I think it is appropriate to stress that this is not a project seen as an end in itself, but relevant for the following analysis. Later on, more specific advantages will follow from the narrow definition of stakeholders suggested below.

A reasonable demand for being a stakeholder is to have a stake in the company. This is to be understood as making a significant input to the company and also being a part of its output. There has to be
a reciprocal link. The stakeholder theory is to address the problem of cooperation between crucial partners, where a conflict is likely to cause the company serious harm and smooth cooperation is of vital interest for both parties. A common distinction between different stakeholder groups lies in ‘influencers’, who are powerful and important to the company, and ‘claimants’, who are less powerful and more likely to be victimized by some of the company actions. Kaler (2002) suggests a restrictive definition of the stakeholder concept and recommends excluding influencers, including only qualified claimants. I agree to the first step and suggest the term ‘power holders’ for these groups that might exercise power over the company, but are not strongly tied to it. In this group, I list the state, competitors, NGOs and media. This is not implying that the company should ignore them, only that it should not see them as stakeholders. ‘Claimants’ are often used to describe a large group, and a first reaction is that a claim is not a justified claim or a stakeholder claim. In an indirect way, almost everybody can be seen as affected by a company to some degree. But without making a contribution or having a specific role in the company, this should not be considered sufficient. Kaler (2004) suggests a ‘contributing principle’ as a requirement for being a stakeholder. The definition of ‘stakeholder’ suggested here, using the terms influencers and claimants, can be classified as a combinatory definition – one that requires a stakeholder to be both an influencer and a claimant, rather than the inclusive definition also accepting only having one of the two roles.

It is a long way from making a claim to having a legitimate right, but even having such a right does not qualify one for becoming a stakeholder. However, with or without specific claimants, the company has to address a number of issues I call ‘external issues and effects’. These can be addressed as environmentalism, humanism, human rights, patriotism, negative externalities and positive externalities. They can be lumped together and called CSR or corporate responsibilities. They are not specific questions for the stakeholders, though, but more general issues. There is no shortage of claims for perfect duties or compensation for negative externalities, but these should be addressed in other discourses. Nature and future generations might have a lot of self-appointed spokespersons making claims, but these are not stakeholders according to the view proposed here. All issues of company embeddedness and economic policy should not be brought into a stakeholder framework.

This restrictive view results in a short-list with the most popular stakeholders: shareholders, customers, employees, suppliers and, in some situations, the community as a fifth. This is most similar to what most theorists consider to be the 4 or 5 core stakeholders. This核心 group is described in different terms as ‘primary’ (Waddock, 2002; Carroll and Buchholtz, 2003; Moon and Bonny, 2001), ‘narrow’ (Evan and Freeman, 1993), ‘definitive’ (Mitchell et al., 1997), ‘normative’ (Phillips, 2003). Mitchell et al. (1997) made an investigation of the stakeholder concept and came up with 28 different definitions. Harrison and Qureshi (2000) conclude that the selection of stakeholder groups has tended to be an arbitrary process and a more systemic approach is needed. The suggestions outside the core are more deviant, as is the rationale given by different theorists for including them. A good general rule is to reduce a definition to the core content, instead of stretching inclusiveness to the detriment of usefulness.

To this short-list, I want to add one additional stakeholder – management. One justification for such a view came already in 1941 with James Burnham’s book The Managerial Revolution. The managers are not mere servants of the formal owners, but are the ones becoming the sovereigns. The conventional theory and the present public perception might see the owners and the managers as one group, but the many scandals in the last decade have demonstrated that managers are a group with the possibility to successfully favor their self-interest over the interests of the shareholders. Theorists seeing shareholders as the Primus stakeholder, like Jensen (2008), and skeptics toward the stakeholder perspective, like Heath (2006), have devoted attention to the need of controlling managers’ use of their power for their personal benefit. In contrast, multi-fiduciary theorists like Freeman often have a very optimistic view of top managers, expecting them to take on a very demanding and selfless role as a ‘metaphysical director’ (Freeman, 1984). Assuming characters similar to King Salomon will cause problems when managers show very different sets of traits. One reason to include the Primus-stakeholder theorists in the stakeholder tent is that they actually have spent concerns on the cooperation and conflict between these two major stakeholders that other theorists have paid less attention to.

3. The what and how of stakeholder theory – the loyalty strategy

An important point made in the stakeholder debate is to stress the limits of profit maximization as a guideline for business activity. It is a good indicator of a healthy company, but it is a result rather than a goal. Henry Ford is an authority stressing that a striving for profit is insufficient as a business mission. A comparison can be made with happiness, which for an individual might be as greatly desired as profit is for a company; but happiness needs to take the backseat for more operational ideas. Freeman (2008) refers to Aristotle and Mill making this point. Later a person can evaluate and consider his emotional reaction to the choices made. Is he happier now, in the new situation, than in the previous one? But this feedback might be an insufficient guide for strategic decisions.

Several forces support the short-term focus of managers. The CEO has become preoccupied with investor relations since financial reporting has become more voluminous and more frequent. There is a demand for mergers and acquisitions that can make a major direct impact on the share price. The CEO has become more of a celebrity and is lavishly celebrated when the going is good, but patience is limited, so a CEO cannot deliver more than a few disappointing quarterly reports before being dumped. If most of the success of the company is attributed to a specific person, this person will also be blamed for hardships; the negative side of becoming the star of the company is that the star will be dismissed if the shine fades. The CEO compensation has increased substantially while the average time of reign for a CEO has declined from 10 years in the 1970s to presently 6 years (The Economist, 2009).

A relevant experience is the common evaluation of conglomerates. The enthusiasm for them is based on the idea that companies could be run by a top management mastering the financial tools. Different divisions in the company could sell steel and soap respectively, but that was considered of limited importance. Cash flow, inventory turnover, and other measurement gave management the tools it needed. This enthusiasm has now vanished and the present trend is to break up conglomerates (Davis et al., 1994). The financial know-how is not sufficient, but it is vital that management master substantially more knowledge. However, this conclusion of experience has been restricted to companies of this kind rather than resulting in a more general skepticism about the potential of financial tools and top-level restructuring.

The basic practical idea of stakeholder theory is that the success of a company is very dependent on smooth cooperation with its stakeholders. From that follows the advice to pay close attention to the needs and wants of these stakeholders. A practical program with links to a stakeholder philosophy is the concept of Balanced Scorecard (Kaplan and Norton, 1992). To a large extent the main idea is to organize attempts to get out of an egocentric and short-term perspective to find solutions to a wider range of problems.

It needs to be remembered that the profit of the company is a goal that implies a conflict with the interests of most stakeholders. The preference of customers is lower prices; the employees...
want higher wages and the suppliers strive for higher prices; and such adjustments, all other things equal, are hurting the bottom line. There is a need to find solutions bringing in synergy gains so that resources are created which can contribute to all the different conflicting interests, making everybody better off, and subdue the competitive situation. This is a combined conflict and cooperation situation, and a stakeholder view is to search for cooperative possibilities and balance conflicting interests in keeping the alliance working. Selling more of the same products, raising prices and cutting costs can be seen as the standard profit-increasing possibilities. Other models, like the balanced scorecard program, search for quality improvements and income expansion. What can we do for our stakeholders with the explicit or implicit expectation that good deeds done to them will be rewarded by reciprocal deeds?

Williamson (1984) contributes to the stakeholder debate with a perspective from a transaction cost perspective. From an economist’s point of view, it is not unnatural to start with the market and its maximal flexibility as the default alternative, exchange implying that one-deal contracts at current prices are the standard. Individuals can come together when a specific project needs several different competences. But why should projects be more permanent and result in companies? Coase (1937) and Williamson (1984) explain this outcome by noting that, for some economic projects, transaction costs for mono-deal contracts through the market are higher than long-term multi-action contracts organized in companies. There are of course also costs with organizing and maintaining an organization, so in a liberal economy there is a continuous comparison between the costs of performing tasks by organization in a company and the costs of doing so by exchange in the market. It can be useful to see the stakeholder model as a way to establish a long-term cooperation that cuts transaction costs to a lower level than more short-term and flexible pure market solutions do.

The balance in society between stable organizational solutions and changing market solutions is evolving, and some companies might have the wrong fit. The shift to outsourcing implies the judgment that a market relation with a sub-contractor is expected to be more cost-efficient than running the production plant integrated in the organization. A common development in the opposite direction is the increasing emphasis on “supply chain responsibility”. Even if the supplier is a separate company, there is strong linkage between them, not least for the trademark of the company selling to the consumer.

Suppliers become less traditional providers of base material or generic products and increasingly contributors of vital special components; even research and product development is often outsourced. The traditional idea of a vertical company buying iron and selling cars is changed into companies producing just gearboxes, or car assembly factories putting together a car constructed by products they do not produce but buy. The relation has less characteristics of a commodity market and more those of a long-term marriage: a smooth or thorny relationship with a divorce alternative.

There are a number of possible advantages in repeated business with employees, suppliers and customers. It takes time to train employees in skills, and even if they are skilled, it takes time for mutual social adjustments to create a team out of a group of individuals. This is the human capital that can be increased or reduced e.g. by outsourcing. A supplier can provide standard goods at market prices, but there might be a comparative advantage in cooperating closely with the supplier and developing specially made components. Often, it takes sales efforts and special discounts to make a potential new customer willing to try a new company. Reichheld (1996) presents several instructive examples about the advantages of maintaining perennial customers. But these potential advantages have not resulted in a general development of ties becoming ever stronger. Rather it seems reasonable to see development in the modern world as moving away from loyalty and stability toward shifting loyalty and a strong appetite for change. This concerns a broad spectrum of human choices, from spouses to shampoo. Is our destiny a market society where everything is flexible and on the market? Each person checks her possibility of trading up and her risk of being traded down. But flexibility has a price and the person herself must preserve a high capacity to master change – to be ‘employable’. If there is a tidal wave moving from loyalty to exchange, it might be said that the company has no other possibility than following the flow. However, I think there are choices.

It is not unusual that there is a loyalty surcharge. The customer renewing his remuneration is not getting the special price offered to newcomers. It is hard for an existing employee to get a raise, since the company expects her to stay even without a wage increase, while it is willing to give a more generous offer to an ex-employee that it tries to re-recruit. The actual supplier is seen as dependent, so that company might presently have no alternative than to accept a price cut. If there are such loyalty surcharges, these will make the loyalty option less attractive. However, it is important to realize that there are possibilities for the company to introduce a loyalty dividend in these relations. This should not be seen as a philanthropic alternative, but as a strategic alternative; there are loyalty effects to be gained and split. But if the company is trying to obtain a loyalty surcharge, there will be less interest in taking part in such a one-sided loyalty project. It takes two to tango.

The business idea of the stakeholder model is that there is a frequent preference for a less dynamic world and more stable relations. If the company can provide increased stability, there are possibilities for loyalty dividends for the partners. Trust is a kind of social capital and one of its merits is that it cuts costs of precaution, checking and safeguards. A legal contract eliminating all risk is hardly a possibility, and therefore past experience is an alternative. Stakeholder cooperation is a way to tie the company and its partners together. A constant company dilemma is avoiding the costs of idle employees and excess stocks on one hand and the risk of capacity shortage on the other. One solution is trying to get other stakeholders to take care of these problems. However, these partners have a limited enthusiasm for carrying the cost of extra capacity. They may leave for an alternative implying a more substantial offer. Often the company itself has the best possibilities to handle fluctuation and insisting on flexibility for itself will make the company an unreliable partner.

The dynamics of the market create situations in which development one or the other option is perceived as advantageous. There is a lot to be said for the exchange model, but there are reasons also to consider the organized cooperative option. Each step in negotiation and in organizing a production implies some friction cost before establishing who is out and who is in, and with what share. Even if one sees a general trend drifting against loyalty, there is no reason to discard the loyalty options. People will have different preferences, so it is reasonable to expect some self-selection of partners in line with the strategy taken. Perhaps the desirable consumer is not the flexible one, shifting the provider from one purchase to the next, but the consumer that would prefer not shopping around if she only judged the company trustworthy. Cooperation is a two-way street, but it is realistic to describe the situation as one in which the company has excellent possibilities to intensify the cooperation and strengthen the ties with its stakeholders.

One can claim that the loyalty to the company is already included in the standard contract between employee and employer. But as Akerlof (1984) points out, in situations with “incomplete contracts”, some extra payments might be needed to direct the efforts of the employee to be in line with company interests. The “efficient-wage theory” claims that such extra payments are taking place on a large scale. In the Keynesian tradition, this theory explains why the labor market does not clear, but there is
a surplus of unemployed. This unbalance is caused by companies paying more for labor than necessary, making just having a job a bit of a privilege to be careful about. The question arises why companies act in such an apparently irrational way. According to Maniakiew (2007) the efficient-wage theory suggests three positive effects regarding employee behavior: lower turnover, avoidance of adverse selection, and better motivation.

These goals seem similar to the ambitions of the stakeholder model. The two theories do not exclude each other, but there is some rivalry. Buying what you want is straightforward and familiar to a company executive, but it is easy for an employee to perceive a high wage as a confirmation of his high worth, rather than of being overpaid. If competing companies also “overpay”, this becomes the current market wage while the clear-market wage is only a theoretical hypothesis. The common evaluation is probably to perceive oneself as underpaid; an overpaying hypothesis might, at the most, apply to others. If the company fails to beat a competing pay offer the employee might leave.

The stakeholder model attempts to work up a credible goodwill and link that to commitments for the future. At its prime, IBM had a no lay-off policy and internal recruitment of vacancies up the organization. If the employee has been a trusted person engaged in and for the organization, he will abandon much personal and professional value if leaving the organization; these are ties that bind and reduce employee turnover. The “loyalty for loyalty” bond seems stronger than “loyalty for money”.

4. The governance issue: for, with and by the stakeholders?

A central issue has been in whose interests the managers should act. Boatright (2002) and Marcoux (2003) make good cases against the multi-fiduciary stakeholder position: it implies too many priorities. Heath and Norman (2004) make an interesting analogy with the past experiences of state companies that had a multiskill ambition resulting in lackluster performance. Multitask demands and multi-principals imply so many goals that management can find justification for any kind of action.

An argumentation against the mono-fiduciary model is that the “ready-market-for-shares” provides an exit for shareholders if they think management maltreat their interests (Marcoux, 2003). Therefore, special duties to shareholders are not necessary. However, the suggestion of this paper is to consider a strengthening of the voice of shareholders rather than being content if they have a smooth way out. Rather the problem is that the long-term shareholders lose influence on management compared to the short-term shareholders. A problem with the mono-fiduciary model is that there are increasing complications with the capacity of shareholders to control management.

There have been some major shifts in the way capitalism works that motivate some reflection about modifications in the governance model, which are of relevance for the stakeholders themselves and for stakeholder theory. There has been an implosion of direct private ownership. The number of companies controlled by a strong owner family is decreasing and we are getting a system of capitalism without capitalists but with increasing institutional ownership (Davis and Steil, 2004). This would not be very problematic if the sole effect was a shift toward meritocracy and fewer of the founder’s less competent relatives in important positions, but there are further changes. The goals of old capitalism were not very far off the theoretical goal of long-term value maximization; the business of business is staying in business, and this is obtained by financial consolidation, organic growth and development of its core business. In my view the consequences of the split between owners and managers would not be so problematic if it were not also affected by and intertwined with the “financial revolution” (Rajan and Zingales, 2001). The old ethos described above has been challenged.

One central idea in the financial turn is the claim that lower risks can be provided. Experience of the 2007–2008 meltdown indicates that risks were a lot higher and an unexpected systemic risk showed up. In this article, it is another aspect of risk that is of interest, and that is the idea of spreading risks per se. Portfolio diversification sound like a good prudent idea and being risk-averse can be seen as a virtue. Many investors have listened to this advice and spread their money between many different companies. However, such behavior is in conflict with the idea of focused strong owners. Having no more than one egg in a nest minimizes the loss if a nest is destroyed, but it also reduces interest in the specific nests. The company has acquired less concerned stockowners.

Instead of direct ownership, there is now an increasing share of indirect ownership through investment funds. These intermediaries are run by managers with timing as prime capability. The task is to be on board when the price is rising and to sell the shares before a fall. These owners are exercising the exit option, but seldom the voice option, when a company comes in trouble. Their investment policy is hardly long-term value maximization, but the fund’s management strives for a current result better than the index. There is also a strong motivation to favor circulation, since that generates additional income for associated financial firms. The traditional owners often shared the business idea and the mission of the company they held shares in, but the corresponding goals of an investment fund and its managers are to buy and sell shares at a profit. The turnover rate on many financial markets is increasing so one question arises, central to the governance issue at heart of stakeholder debate. Where is the long-term shareholder that disciplines the manager and keeps him focused on the beneficial objective of long-term value maximization?

Economists have frequently perceived the danger of manager disloyalty, but the remedies suggested have to a large degree been the introduction of economic incitements tied to company profits (Jensen and Murphy, 1990). An effect of these measures has supported the financial turn, which has shifted company policy into a short-term direction. There seem to be a number of issues to consider that could alter the short-term drift in the interaction between managers and shareholders.

A problem with governance by shareholders is that they are not a monolithic group. Especially ‘staying’ shareholders and ‘exit’ shareholders have different interests. The first group has no interest in a peaking share price, while the latter shareholder group has more short-term interest. The change in ownership to investment funds has an increased churn rate make the ‘exit’ shareholders relatively more important.

One can argue for such a special position from the point of view of rights generated by ownership, or from the point of view of the common good created by a decentralized system of companies striving for maximizing value. I support the latter consequentialist justification, which is more conditional for the owners than the deontological justification by rights according to Locke and Nozick (Nozick, 1974). A public servant has a primary duty to serve the public. He has also a duty to follow the directives given by superiors in the hierarchy, but the prime obligation is to serve the country, not the king. In analogy, I think the long-term interest of the firm is the main obligation for the employee of a corporation, not the interest of the shareholders (or top management). To motivate this reservation to stakeholder supremacy, I think it is appropriate to recall the legal restriction in many countries limiting the actions of shareholders on behalf of other stakeholders; for example, it is illegal to use the capital of the companies for loans to the shareholders, since this can undermine the capacity of the company to meet its obligations to employees and suppliers. But owners’ interest is generally rather compatible with that of the company and could be brought even closer with a little bit of social engineering. Choosing the goal of long-term value maximization
would clarify this conflict between two different shareholder preferences and the need to strengthen the staying shareholder.

There are not only problems with governance by the shareholders but also with governance by the stakeholders. When the purchase manager meets the supplying firm, I think it is clarifying that his counterpart is not also on the company board as the boss of his boss; separate identities are central for responsibility. For an employee in the organization long-term profitability is an instructive goal to which he can direct his own efforts and judge the decisions taken by his superiors. A multi–principal governance will make the goals more complicated and make himself more dependent on management instructions about how these goals should be properly understood. The issue in my mind is not to bring more parties into the principal position, but strengthening the principal position so that the goal of long-term profitability can restrain and control management. The stakeholder model suggested here is not a corporatist order.

In the stakeholder discourse, there is often an ideological enthusiasm for dialog and consensus on a high hierarchical level. The collective decision of a diverse collective is seen as carrying a special legitimacy. Much of this is illustrated by the corporative tradition of Sweden, which is generally perceived as an early stakeholder experiment (Borglund, 2006). At a time when socialism was an alternative, cooperation between the employers’ organization and the unions was a ‘third way’ compromise. The political left moved some influence from the party to its union arm, a safeguard against electoral defeat. The center–right parties and the employers saw a possibility to avoid state dirigisme, and were also pleased with the arrangement. Currently, there is a similar broad attraction; to some, the stakeholder model is supposed to prevent state intervention, and to others, it is an appealing way to proceed toward state intervention.

I would like to mention a separate but similar popular idea at that time, the ‘round-table conference’, which I think summarizes a governance idea with strong appeal. The idea was to bring representatives of all concerned organizations together to sort out a problem. This concept was a lot more pluralistic than the employer–union duopoly, and the term ‘round’ represented the idea that there was no privileged seating or position. The idea was a firm belief in consensus, but less so in transparency. The desired attitude was rather that the participants should all present themselves as satisfied and loyal supporters of the result, rather than grumbling compromisers with declared pre-meeting positions.

I bring up these two models since I think such views still have a lot of attraction. However, there are advantages for discussions, and not only for dialog and unity, since the consensus demand is also a request for conformity and finding the least controversial solution. I think it is advisable to keep separate identities for the company and its stakeholders. The interaction should be for mutual interest in dialog and also discussions, but not in a board with representatives for all the stakeholders. There are common interests between the stakeholders but also conflicting interests. Therefore, I see a disadvantage in trying to merge the parties in order to eliminate differences, and advantages in keeping identities apart. Transparency and some differences in opinions and preferences are not necessarily the starting point for a fundamental clash, but components in a fruitful pluralism. In any cooperation you need to see the difference between your own goal that you strive for and the restrictions being other peoples’ goals that you have to consider for finding a solution. Therefore, I support the model with management as the executive power supervised by the shareholders controlling the board.

The governance issue is central in principle to stakeholder theory, but my impression is that most contributions do not make suggestions of changes in governance by the stakeholders. Instead there is an emphasis on governance for the stakeholders.

An elaborated investigation by Matten and Crane reaches a similar judgment: “as yet, the concept of stakeholder democracy has remained at the fringes of these debates – occasionally alluded to but rarely if ever defined, dissected, or deliberated on” (Matten and Crane, 2005, p. 6). There is a lack of corporatist models at the company level that can be described as developed and popular alternatives. Therefore the interest turns toward possibilities to establish a corporatist order above the company level.

Many persons have high expectation upon international standards and guidelines taken by assemblies of meta-organizations with a claim to represent a variety of groups and interests. Their idea is that a web of high standards should constrain CEOs and management from making unwanted decisions. One can say that recommendations and restraints are more liberal than ruling by forcing directives, like in a planned economy, but is that enough for a justification?

When much of the economy becomes globalized and national rules lose their relevance, it is not unjustified that some international rules are introduced for harmonization and as replacements. But this concession is very far from endorsing the expanding “The Audit Society” (Power, 1999). International organizations, like ISO (International Standard Organization), and GRI (Global Reporting Initiative), are keen on introducing soft law, and institutions like the European Union push for a harmonization of legal rules, often entailing that the most detailed national legislation is exported to the other nations. This article is skeptic to an expansion of rules and regulations aimed at instructing the employees of the company on what to – or all things not to do. Here, the stakeholder theory is not used as justification for a neo-corporatist national or international order.

The stakeholder approach highlights the importance of relations to people and organizations not strictly under the command of the CEO. Above, I shortly mentioned the trend, from being a vertical integrated company, into becoming just a link in a value chain with many legally independent, but economically interdependent companies. These partners cannot be commanded and instructed, but have to be brought into a cooperative project by shared interests. As these interests are not identical, there has to be an agreement specifying a fair split of the efforts and the gains. The head agent of the principal, the CEO, cannot himself work out such agreements in a large number of relations so these should be taken by a large number of employees acting as agents for the long-term interest of the company.

If that objective links to the personal interest of the employee and the contract appears fair, it will motivate the employee and mobilize his moral and professional commitment. People indicate in surveys like World Value Studies that they are increasingly more inclined to “self–expressive values” (Inglehart, 1997). This implies that there is some resentment and objection to the authority embodied in a position like that of the CEO, as well as to the authority of international guidelines. I do not claim that conformism and “just following orders” is a behavior of the past, but that some social changes are taking place. The principal–agent agreement with the CEO is not sufficient, but the shareholders need a broader agreement and to commit themselves stronger to the company interest. There is a problem with capitalism without capitalists dedicated to the company.

I think it is appropriate to mention some suggestions for change of rules at the macro level to correct the short–term dominance caused by the financial turn. Large financial institutions could be less accepted as “exit shareholders” ready to leave at any time, and not participating in company governance by the board: such behavior can be seen as irresponsible free–riding. In some countries there are differentiated tax rates depending on the length of share ownership. Some tax advantage for major shareholders might also be helpful in motivating an upgrade from “index investment”
to become a focused “voice shareholder” making a long-term investment in the company.

5. Why? – The connection to philosophy

Some proponents of the stakeholder paradigm express, like Freeman (2008), a preference for a pragmatic rather than a philosophical justification: “There is no need for a ‘normative foundational justification’ as many have suggested. We do need some simple and very practical ideas” (Freeman, 2008, p. 163). However, I side with those seeking a philosophical justification – but after considering these efforts, there are reasons to ask whether the philosophical suggestions should not be compatible with the practical ones, rather than being an unconnected exercise.

Some researchers have a firm belief in the philosophical recommendation and suggest a large-scale adaptation of business values. Donaldson (2008) proposes intrinsic values and suggests that there will be a Normative Revolution in business of Copernican dimensions.

“The second key insight guiding the Normative Revolution is that managers must ascribe some intrinsic worth to stakeholders. That is to say, a stakeholder, such as an employee, must be granted intrinsic worth that is not derivative from the worth they create for others. Human beings have value in themselves. Their rights stand on their own. These rights themselves are morally and logically prior to the way in which respecting their right may generate more productivity for others or the cooperation. This is an inescapable truth for the current normative revolution” (Donaldson, 2008, p. 175–176).

A circumstance that might be seen as comforting, or arousing suspicions, is that business ethicists with different philosophical ideas come to similar conclusions. Marcoux observes: “In other words, by all accounts the stakeholder theory functions in a consequentialist manner, but its partisans advance theoretical bases for it that range all over the map of non-consequentialist ethical theories” (Marcoux, 2003, p. 22, note 14). Velasquez (2001), Boatright (1999), and De George (1999) are all “pluralists” having both Kantianism and utilitarianism as first principles. Utilitarianism, counting all as one and none as more than one, results in very altruistic recommendations, and also Kant proposes idealistic universalism.

A serious problem is that none of these philosophies give any reason for some specific obligations to company stakeholders. If the central stakeholder idea is a special relationship established by a role and a contribution, then general obligations, such as human rights, are simply irrelevant for that purpose. An employee is a human being and her human rights imply some obligations, but these obligations are toward all human beings and say nothing in addition about an interest in this employee. One effect of such limitless altruism is that it sustains the tendency to consider every human being a stakeholder. There is a tendency to dissolve stakeholder theory. Heath expresses the problem of stakeholder theory by presenting a conventional moral view: “From the moral point of view, a potential relationship can be just as important as an actual one” (Heath, 2006, p. 544). This becomes the case if an agent-neutral moral is assumed to be the moral position, and since most stakeholder theorists make that assumption, they get caught in contradiction. If stakeholder theory does not make a distinction between the real employee and the potential/hypothetical employee, it contradicts its central message. But if the special concern for the real employee is morally to be seen as immoral discrimination, this implies another problem. Therefore, such philosophical ideas are not supportive or compatible, but positively harmful for stakeholder theory. There are reasons to make a more skeptical analysis of the universal altruism that is so admired in moral philosophy.

It seems more appropriate to look closely at moral philosophies that are particularist, not idealistic universalism. A descriptive view of human morality cannot avoid the conclusion that the universal generalization of morals is, to a substantial degree, particularistic. Empirical universalism amounts to a priority of, not indifference to, closeness. Hume (1740) summarized morals as based on emotions, and these emotions are generated by closeness. The feeling of reciprocity was one of the two main sources of morals, and kinship the other. These ideas have been confirmed by anthropology and sociobiology (Ridley, 1996). David Gauthier (1986) made a distinction between ‘essential ethics’, which primarily is reciprocal ethics with a basis in nature and rationality, and ‘artificial ethics’, which includes the various ideas based on speculation about the supra-natural. Francis Bacon made a judgment long ago that still seems valid: “All good moral philosophy is but a handmaid to religion.” Secularization has made an impact in many areas, but when getting to the ultimate human rules, there is dominance for ideas about how God wants the creation in his own image to behave.

Freeman and colleagues make a sensible proposal for a kind of pragmatism that stands close to what I call empirical universalism.

“Werhane has suggested that Adam Smith saw the centrality of ethics for business, but not even Adam Smith saw the centrality of business for ethics. If the institution (i.e. business) in which most people spend the majority of their lives working, finding meaning (intrinsic and instrumental) and forging relationships with others is not central to the development of principles about how human beings interact, then the resulting ethics is likely to be sterile at best and extremely difficult to apply at worst” (Jones et al., 2002, p. 34).

I think the odd combination of stakeholder theory and idealistic universalism is an intriguing topic. Probably, several researchers start with reflecting upon an instrumental stakeholder theory and find good reasons for supporting such a strategy. But they also have the aim to provide an ethical theory, not only give some strategic advice. To reach that goal and find a normative foundation, the square idea from business has to be forced into the round altruistic hole preferred by moral philosophy. However, morals and ethics are not only a field for finding the good and the true, but also a field of deceptions, manipulation and self-promotion. A common tactic for promoters of altruism has been to take a step toward closeness in order to generate ethical emotions. People do feel obligations to mothers, neighbors and brothers. A common rhetorical tactic is to transfer feelings of sympathy and obligations by describing strangers and unrelated persons as metaphysical brothers and neighbors. If agitators in religion and politics routinely mix metaphorical and real terms, why should the business ethicist not be as cunning?

I think Werhane (1999) is quite right when discussing moral imagination; many disputable deeds are done because the manager did not see them as ethical issues. When the decision was taken, no ethical consideration was made. Like her, I see a lack of ethical imagination as a problem for real life. But this deficit can also be used as a tool that can help out when honored moral principles are destructive and yet the agent does not want to abandon or revise them. If lacking moral imagination, a manager can claim to have the same obligation to care as much for the potential employee as the real employee, but ‘moral intensity’ has made him think, feel, and act only for the former. A mistaken philosophy has less negative impact if the person ignores it and acts from a more intuitive morality. Such a beneficial outcome is, however, in conflict with the very ambition of philosophy; the reflective decision should be an improvement of the intuitive.
I have problems finding any ‘inescapable truth’ in statements like that of Donaldson quoted above. Such idealism can only be of rhetorical use in business and will support the tendencies toward hypocrisy. Nor is ‘human intrinsic value’ any support to stakeholder theory. I think there are obligations to the stakeholders, yet these are not given by any higher or divine logic, but are evolved by the dynamics in the relationship. The good deeds to be performed by the company are partly a payback, partly an investment in further interactions.

Freeman has repeatedly argued against what he calls “the Separation Thesis”, meaning treating the business discourse and the moral discourse separately. He claims that doing so is a fallacy and that a major purpose of stakeholder theory is an “integrative revolution” (Freeman, 2008). Such a project demands compatibility. The mismatch of altruistic philosophy, honoring a rule of agent-neutrality, and stakeholder theory, honoring a special relationship with some agents, is an intellectual problem. Many researchers try to find a way to bring the two together, but unfortunately that is a futile exercise. The integration ambition should not be abandoned, but it should be understood that it implies some major reconsideration of common philosophical positions.

6. Connections to other economic approaches

A number of suggestions have been presented and it is appropriate to look at those in comparison to other economic theories than those addressed in the stakeholder debate. What is the connection to other ideas and discourses like those with labels such as “institutional economics” and “behavioral economics”?

Institutional economics is a broad church and the most closely connected fraction stresses both the institutional and evolutionary aspects. In their most influential book, Nelson and Winter (1982) attribute much of a company’s assets to its culture of rules and practices. There is less enthusiasm for a revolutionary change than an evolutionary trial and error process. The force of selection is that profitable companies expand and are imitated, while the unsuccessful vanish. Hodgson (2004) expresses a similarly critical attitude to the “transformative leader” (Burns, 1978), more likely to destroy company culture than strengthening it. An important point is that the company is not only working within an environment of institutions, it is also creating a social and institutional subsystem, which will show its quality by succeeding or failing.

Institutions and institutional change are often described positively while “institutional competition” is regarded as negative. There is not only competition within a given set of rules but also between different sets of rules. Organizations at different levels of society, such as companies and states, all have the problem of handling the dynamics of cooperation and conflict both internally and externally. Ross (1919) describes the many ways the challenge from institutional competition is hindered by ruthless incumbents. Many politicians see institutional competition as “a race to the bottom” and they prefer harmonization, which could be described as “a process to the mean”. Not only politicians, but also many executives, perceive “a level playing field” as a major goal. Any further progress of institutions is connected to international multi-stakeholder top-level decisions. The evolutionary perspective employed in my version of stakeholder theory is much more inclined to endorse institutional competition. Innovation starts small, and there is also the possibility of learning from others, copy and modify. The feedback from reality is a most qualitative selection mechanism.

A field of considerable size focuses on the issue of trust. One position on trust advocated by e.g. Hardin (2002), Ostrom and Walker (2003), and Tullberg (2008) emphasizes the importance of trustworthiness. Then trust becomes the rational reaction toward an organization or a person that persistently fulfills promises. This view on trust is in harmony with the goodwill project in stakeholder theory; interaction makes trust a verified experience rather than a brave hope.

Behavioral economics often bring up the issue of fairness. Not least economic games illustrate how easily the will to contribute to a common project evaporates when other participants shirk from their contribution (e.g. Fehr and Gächter, 2000). In the ultimatum game, the receiving player does not follow the neoclassic advice that “something is better than nothing”, but instead often abstains from an offer perceived as unfairly small, resulting in both players receiving nothing (e.g. Güth and Tietz, 1990).

Another theme in behavioral economics has been the importance of bounded rationality in rules of thumb, contrasting actual decisions with unrealistic conditions such as perfect information and unrestricted processing capability. One tradition has been to highlight the irrational component in “fast and frugal” decision heuristics (Kahneman, 2011), and another has been to stress their rational component (Gigerenzer et al., 1999). To maintain rationality, it is important that companies do not manipulate the simplifying rules. Words such as “sale” and “volume discount” should have some substantial content, and headline promises should not be reversed in the fine print. If information and alternative composition make simple shortcut rules useless or destructive this will entail higher decision costs or mistaken decisions.

There are problems for bounded rationality to serve its user and the individual might need some assistance. Several authors have pursued a line they call “libertarian paternalism” and itscritics “soft paternalism”. The basic idea of Nurge (Thaler and Sunstein, 2008) is to present the alternatives in a way so that people will make the prudent choice, if not insisting on a specific alternative. Central to this idea is having a default alternative that is advantageous to the individual rather than being something costly with many extras. The minister for the financial sector in Sweden formulated the ambition for the regulation of the mandatory individual savings for pensions: “The system has to provide a good choice for people, who decide not to choose” (Norman, 2011).

I would claim that competition almost always is costly for the participants. The benefit is mainly for those the competition is competing for, e.g. consumers are offered better products at lower prices. However, in some situations the competition brings no third party advantages. Frank (2011) deviates from most behavioral economists by seeing actual individual decisions as more rational, but points at the excessive costs of competition. Can the rivalry be limited by some kind of arms race agreement? Dueling rules, with only one shot at a considerable distance, reduce the risk of actually being killed, but still serve the function of displaying regard for honor. People investing heavily in conspicuous consumption might not be so irrational, if signaling economic success is actually socially important. It can be said that it is rather the system that is irrational than the individual behavior. One way to both reduce and explore conspicuous consumption is to tax it; the “extra all” car will then cost a lot more, but that will also improve its status differentiating value. A non-idealistic idea of man is at the core of both stakeholder theory and behavioral economics. Man does not possess unlimited capacity nor is he psychologically amenable to some vision of a Homo ethicus or a Homo economicus. He is a self-centered being who acts rather rational in the social environment. The trick is to create an environment that enhances productive behavior.

A discrepancy in power makes the weaker party in a relationship cautious of mistreatment. Most people have little problem with companies acting for profit, but if companies cannot establish constraints in their striving, there will be conflicts. Fairness and loyalty should not be seen as benevolence, a one-way street for some rare altruists, but as a two-way street of common reciprocals. A reciprocal individual perceives the risk of being disappointed, but can reduce it by interacting with a company that has the competence...
to deliver and feels the moral obligation to fulfill its end of the bargain.

7. Summary

The aim of this article is to contribute to an upgrading of the Stakeholder model. This has been done by working out compatible suggestions regarding central issues: which groups are stakeholders, what is a loyalty strategy, how to govern, and the why of philosophical justification. Often these are discussed separately and the result becomes a mismatch between different suggestions. I agree with Agle and Mitchell’s conclusion: “the process of building-toward-elegance in stakeholder theory remains incomplete” (2008, p. 182). This article has made quite a few prescriptive suggestions that concern both endogenous and exogenous rules. According to the present analyses, some major revisions are needed.

There is an ongoing project that, a bit polemically, could be described as a “hara-kiri attempt by bulimia”. It is the inability to make a distinction, considering everybody a potential stakeholder. One of the basic rules of definitions is to be clear about what is included and what is excluded. The non-stakeholders are often an unspecified category, but there is a long list for inclusion and expressed concern to be especially attentive to those at the periphery. Here a selective membership is suggested, and managers are added to this short-list of stakeholders.

Stakeholder theory, as a business strategy focused on loyalty, has no problem on a rhetorical level. There is no shortage of homage to loyalty, but the conviction is partly missing. One tempting alternative is to be equally loyal/disloyal to all. The main threat to a loyalty strategy is the strong trend of quarterly-report capitalism stimulated by the financial turn, but there are also shifts in the economy, as expanding interdependence between companies, that supports the possibilities of loyalty strategies.

Central for the governance issue is the consequences of acknowledging management as a very influential stakeholder group. Rather than being the solution, management implies a set of conflicts of interest in the company. The managerial revolution should be considered. The establishment of a layer of investment managers between owners and company managers is another change having effects on company governance. My advice is to strengthen the position of the long-term shareholders so they can control the executive power, the management.

The philosophical reference to idealistic universalism is a serious mistake. The conclusion from such views is that there is no moral case for giving the actual stakeholders special attention compared to potential suppliers, customers and employees. A theory of focused attention is combined with a morality of equal concern, and such a mix causes serious intellectual problems. This conflict is ignored and that undercuts legitimacy, and therefore a more compatible philosophy for stakeholder theory is suggested. Comprised in one word, this word is reciprocity.

This article indicates that stakeholder theory has quite a distance to go before it can be described as superior or enlightened. But despite these shortcomings, I believe, there is an important potential contribution. Making money does not say much about mission or business ideas, but stakeholder theory provides a framework for rules and norms for the relationship with parties that are highly vital for the success of companies.

References
