ANNE T. LAWRENCE | JAMES WEBER

BUSINESS and SOCIETY

Stakeholders, Ethics, Public Policy

FIFTEENTH EDITION

Mc Graw Hill Education

Business and Society

Stakeholders, Ethics, Public Policy

Fifteenth Edition

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San José State University

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BUSINESS AND SOCIETY: STAKEHOLDERS, ETHICS, PUBLIC POLICY, FIFTEENTH EDITION

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Anne T. Lawrence is a professor of management at San José State University. She holds a Ph.D. from the University of California, Berkeley, and completed two years of postdoctoral study at Stanford University. Her articles, cases, and reviews have appeared in many journals, including the *Academy of Management Review, Administrative Science Quarterly, Case Research Journal, Journal of Management Education, California Management Review, Business and Society Review, Research in Corporate Social Performance and Policy,* and *Journal of Corporate Citizenship.* Her cases in business and society have been reprinted in many textbooks and anthologies. She has served as guest editor of the *Case Research Journal* for two special issues on business ethics and human rights, and social and environmental entrepreneurship. She served as president of both the North American Case Research Association (NACRA) and the Western Casewriters Association and is a Fellow of NACRA, from which she received a Distinguished Contributor Award in 2014. She received the Emerson Center Award for Outstanding Case in Business Ethics (2004) and the Curtis E. Tate Award for Outstanding Case of the Year (1998, 2009, and 2015). At San José State University, she was named Outstanding Professor of the Year in 2005. In 2015, she received a Master Teacher in Ethics Award from The Wheatley Institution at Brigham Young University.

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Preface

In a world economy that is becoming increasingly integrated and interdependent, the relationship between business and society is becoming ever more complex. The globalization of business, the emergence of civil society organizations in many nations, and new government regulations and international agreements have significantly altered the job of managers and the nature of strategic decision making within the firm.

At no time has business faced greater public scrutiny or more urgent demands to act in an ethical and socially responsible manner than at the present. Consider the following:

- The global financial crisis—highlighted by the failure of major business firms and unprecedented intervention in the economy by many governments—and its continuing aftermath as societies have struggled to recover have focused a fresh spotlight on issues of corporate responsibility and ethics. Around the world, people and governments are demanding that executives do a better job of serving shareholders and the public. Once again, policymakers are actively debating the proper scope of government oversight in such wide-ranging arenas as health care, financial services, and manufacturing. Management educators are placing renewed emphasis on issues of business leadership and accountability.
- A host of new technologies have become part of the everyday lives of billions of the world's people. Advances in the basic sciences are stimulating extraordinary changes in agriculture, telecommunications, and pharmaceuticals, which have the potential to enhance peoples' health and quality of life. Technology has changed how we interact with others, bringing people closer together through social networking, instant messaging, and photo and video sharing. These innovations hold great promise. But they also raise serious ethical issues, such as those associated with genetically modified foods, stem cell research, or use of the Internet to exploit or defraud others, censor free expression, or invade individuals' privacy. Businesses must learn to harness new technologies, while avoiding public controversy and remaining sensitive to the concerns of their many stakeholders.
- Businesses in the United States and other nations are transforming the employment relationship, abandoning practices that once provided job security and guaranteed pensions in favor of highly flexible but less secure forms of employment. The Great Recession caused job losses across broad sectors of the economy in the United States and many other nations. Many jobs, including those in the service sector, are being outsourced to the emerging economies of China, India, and other nations. As jobs shift abroad, transnational corporations are challenged to address their obligations to workers in far-flung locations with very different cultures and to respond to initiatives, like the Bangladesh Accord on Fire and Building Safety, which call for voluntary commitment to enlightened labor standards and human rights.
- Ecological and environmental problems have forced businesses and governments to take action. An emerging consensus about the risks of climate change, for example, is leading many companies to adopt new practices, and the nations of the world have recently adopted a groundbreaking agreement designed to limit the emissions of greenhouse gases. Many businesses have cut air pollution, curbed solid waste, and designed products and buildings to be more energy-efficient. A better understanding of how human

activities affect natural resources is producing a growing understanding that economic growth must be achieved in balance with environmental protection if development is to be sustainable.

- Many regions of the world and their nations are developing at an extraordinary rate. Yet, the prosperity that accompanies economic growth is not shared equally. Access to health care and education remain unevenly distributed among and within the world's nations, and inequalities of wealth and income have become greater than they have been in many years. These trends have challenged businesses to consider the impact of their compensation, recruitment, and professional development practices on the persistent—and in some cases, growing—gap between the haves and the have-nots.
- The tragic epidemic of Ebola in West Africa, as well as the continuing pandemic of AIDS in sub-Saharan Africa and the threat of a swine or avian flu outbreak have compelled drug makers to rethink their pricing policies and raised troubling questions about the commitment of world trade organizations to patent protection. Many businesses must consider the delicate balance between their intellectual property rights and the urgent demands of public health, particularly in the developing world.
- In many nations, legislators have questioned business's influence on politics. Business has a legitimate role to play in the public policy process, but it has on occasion shaded over into undue influence and even corruption. In the United States, recent court decisions have changed the rules of the game governing how corporations and individuals can contribute to and influence political parties and public officials. Technology offers candidates and political parties new ways to reach out and inform potential voters. Businesses the world over are challenged to determine their legitimate scope of influence and how to voice their interests most effectively in the public policy process.

The new Fifteenth Edition of *Business and Society* addresses this complex agenda of issues and their impact on business and its stakeholders. It is designed to be the required textbook in an undergraduate or graduate course in Business and Society; Business, Government, and Society; Social Issues in Management; or the Environment of Business. It may also be used, in whole or in part, in courses in Business Ethics and Public Affairs Management. This new edition of the text is also appropriate for an undergraduate sociology course that focuses on the role of business in society or on contemporary issues in business.

The core argument of *Business and Society* is that corporations serve a broad public purpose: to create value for society. All companies must make a profit for their owners. Indeed, if they did not, they would not long survive. However, corporations create many other kinds of value as well. They are responsible for professional development for their employees, innovative new products for their customers, and generosity to their communities. They must partner with a wide range of individuals and groups in society to advance collaborative goals. In our view, corporations have multiple obligations, and all stakeholders' interests must be taken into account.

A Tradition of Excellence

Since the 1960s, when Professors Keith Davis and Robert Blomstrom wrote the first edition of this book, *Business and Society* has maintained a position of leadership by discussing central issues of corporate social performance in a form that students and faculty have found engaging and stimulating. The leadership of the two founding authors, and later of

Professors William C. Frederick and James E. Post, helped *Business and Society* to achieve a consistently high standard of quality and market acceptance. Thanks to these authors' remarkable eye for the emerging issues that shape the organizational, social, and public policy environments in which students will soon live and work, the book has added value to the business education of many thousands of students.

Business and Society has continued through several successive author teams to be the market leader in its field. The current authors bring a broad background of business and society research, teaching, consulting, and case development to the ongoing evolution of the text. The new Fifteenth Edition of *Business and Society* builds on its legacy of market leadership by reexamining such central issues as the role of business in society, the nature of corporate responsibility and global citizenship, business ethics practices, and the complex roles of government and business in a global community.

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For Students

Business and Society has long been popular with students because of its lively writing, up-to-date examples, and clear explanations of theory. This textbook has benefited greatly from feedback over the years from thousands of students who have used the material in the authors' own classrooms. Its strengths are in many ways a testimony to the students who have used earlier generations of *Business and Society.*

The new Fifteenth Edition of the text is designed to be as student-friendly as always. Each chapter opens with a list of key learning objectives to help focus student reading and study. Numerous figures, exhibits, and real-world business examples (set as blocks of colored type) illustrate and elaborate the main points. A glossary at the end of the book provides definitions for bold-faced and other important terms. Internet references and a full section-by-section bibliography guide students who wish to do further research on topics of their choice, and subject and name indexes help students locate items in the book.

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New for the Fifteenth Edition

Over the years, the issues addressed by *Business and Society* have changed as the environment of business itself has been transformed. This Fifteenth Edition is no exception, as readers will discover. Some issues have become less compelling and others have taken their place on the business agenda, while others endure through the years.

The Fifteenth Edition has been thoroughly revised and updated to reflect the latest theoretical work in the field and the latest statistical data, as well as recent events. Among the new additions are:

- An all-new chapter for this edition on business and its suppliers, incorporating the latest thinking about social, ethical, and environmental responsibility in global supply chains.

- New discussion of theoretical advances in stakeholder theory, corporate citizenship, public affairs management, public and private regulation, corporate governance, social and environmental auditing, social investing, reputation management, business partnerships, and corporate philanthropy.
- Treatment of practical issues, such as social networking, digital medical records, bottom of the pyramid, gender diversity, political advertising and campaign contributions, as well as the latest developments in the regulatory environment in which businesses operate, including the Dodd-Frank Act and the Affordable Care Act.
- New discussion cases and full-length cases on such timely topics as worker safety in the garment industry in Bangladesh; the ignition switch recalls by General Motors; Google and the "right to be forgotten"; Uber's responsibilities toward its drivers, customers, and communities; the decision to raise wages at Gravity Payments; the regulation of e-cigarettes; security breaches that compromised customers' information at Target and other companies; the hacking of Sony Pictures' servers; the environmental impact of hydraulic fracturing; shareholder proxy access at Whole Foods; the sale of chemically tainted flooring by Lumber Liquidators; substandard wages and working conditions at nail salons; and JPMorgan Chase's reputational challenges.

Finally, this is a book with a vision. It is not simply a compendium of information and ideas. The new edition of *Business and Society* articulates the view that in a global community, where traditional buffers no longer protect business from external change, managers can create strategies that integrate stakeholder interests, respect personal values, support community development, and are implemented fairly. Most important, businesses can achieve these goals while also being economically successful. Indeed, this may be the *only* way to achieve economic success over the long term.

Anne T. Lawrence

James Weber

Acknowledgments

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These scholars' dedication to the creative teaching of business and society has been a continuing inspiration to us.

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Anne T. Lawrence

James Weber

Brief Contents

Contents

PART ONE

Business in Society

CHAPTER ONE

The Corporation and Its Stakeholders

Business corporations have complex relationships with many individuals and organizations in society. The term *stakeholder* refers to all those that affect, or are affected by, the actions of the firm. An important part of management's role is to identify a firm's relevant stakeholders and understand the nature of their interests, power, and alliances with one another. Building positive and mutually beneficial relationships across organizational boundaries can help enhance a company's reputation and address critical social and ethical challenges. In a world of fast-paced globalization, shifting public expectations and government policies, growing ecological concerns, and new technologies, managers face the difficult challenge of achieving economic results while simultaneously creating value for all of their diverse stakeholders.

This Chapter Focuses on These Key Learning Objectives:

LO 1-1 Understanding the relationship between business and society and the ways in which business and society are part of an interactive system.

LO 1-2 Considering the purpose of the modern corporation.

LO 1-3 Knowing what a stakeholder is and who a corporation's market and nonmarket and internal and external stakeholders are.

LO 1-4 Conducting a stakeholder analysis and understanding the basis of stakeholder interests and power.

LO 1-5 Recognizing the diverse ways in which modern corporations organize internally to interact with various stakeholders.

LO 1-6 Analyzing the forces of change that continually reshape the business and society relationship.

Walmart has been called "a template for 21st century capitalism." In each period of history, because of its size and potential impact on many groups in society, a single company often seems to best exemplify the management systems, technology, and social relationships of its era. In 1990, this company was U.S. Steel. In 1950, it was General Motors. Now, in the 2010s, it is Walmart.[1]

In 2015, Walmart was the largest private employer in the world, with 2.2 million employees worldwide. The company operated more than 11,000 facilities in 27 countries and had annual sales of $473 billion. The retailer was enormously popular with customers, drawing them in with its great variety of products under one roof and "save money, live better" slogan; 250 million customers worldwide shopped there every week. Economists estimated that Walmart had directly through its own actions and indirectly through its impact on its supply chain saved American shoppers $287 billion annually, about $957 for every person in the United States.[2] Shareholders who invested early were richly rewarded; the share price rose from 5 cents (split adjusted) when the company went public in 1970 to around $90 a share in early 2015, its all-time high. Walmart was a major customer for tens of thousands of suppliers worldwide, ranging from huge multinationals to tiny one-person operations.

Yet, Walmart had become a lightning rod for criticism from many quarters, charged with corruption; driving down wages, benefits, and working conditions; and hurting local communities. Consider that:

- On the Friday after Thanksgiving 2014—so-called Black Friday—thousands of protesters rallied at 1,600 Walmart stores across the United States, calling on the retailer to raise its workers' pay to at least $15 an hour and offer more of them full-time work and predictable schedules. Said one part-time cashier, "It is very hard on what I earn. Right now I'm on food stamps and applying for medical assistance." A month earlier, the company had announced it would no longer provide health insurance to associates working less than 30 hours a week.[3]
- In 2012, the company confronted shocking charges that it had conducted a "campaign of bribery" to facilitate its rapid growth in Mexico. According to an investigation by *The New York Times,* Walmart had made $24 million in payments to government officials to clear the way for hundreds of new stores in what became the company's most important foreign subsidiary, in probable violation of both U.S. and Mexican law. Two years later, the company had spent more than $400 million to investigate the bribery allegations, and faced numerous lawsuits from irate shareholders and an ongoing U.S. government investigation.[4]
- In 2013, local activists protested the opening of a Walmart neighborhood market in Los Angeles's Chinatown, carrying large puppets dressed as the ghosts of small businesses. It was the latest of many incidents in which communities resisted the arrival of the retail giant, saying it would hurt local shopkeepers.[5] Economists studying Walmart's impact in Chicago, for example, found that about one-quarter of neighborhood retailers near a new Walmart had gone out of business, causing a loss of 300 jobs.[6]

In a continuing effort to improve its social performance, Walmart offered grants to small businesses, donated to wildlife habitat restoration, and announced a plan to lower

[1] Nelson Lichtenstein, "Wal-Mart: A Template for Twenty-First Century Capitalism," in *Wal-Mart: The Face of Twenty-First Century Capitalism,* ed. Nelson Lichtenstein (New York: The New Press, 2006), pp. 3–30.

[2] Global Insight, "The Price Impact of Wal-Mart: An Update through 2006," September 4, 2007.

[3] "Wal-Mart Cutting Health Benefits to Some Part-Time Employees," *Bloomberg,* October 7, 2014, and "On Black Friday, Walmart Is Pressed for Wage Increases," *The New York Times,* November 28, 2014.

[4] "Wal-Mart Hushed Up a Vast Mexican Bribery Case," *The New York Times,* April 21, 2012; "After Bribery Scandal, High-Level Departures at Walmart," *The New York Times,* June 4, 2014.

[5] "Walmart in LA's Chinatown Has Opened, Despite Major Protest," September 13, 2013, *www.huffingtonpost.com*.

[6] Julie Davis et al., "The Impact of an Urban Wal-Mart Store on Area Businesses: An Evaluation of One Chicago Neighborhood's Experience," Center for Urban Research and Learning, Loyola University Chicago, December 2009.

the salt, fat, and sugar in many of its packaged foods. The company strengthened its ethics and compliance program. It also pursued ambitious environmental goals to reduce waste, use more renewable energy, and sell more sustainable products, and began reporting to the public on its progress.[7] "Reputation is very important to Wal-Mart," said a historian who had studied the company. "They put a lot of money into building it."[8]

Walmart's experience illustrates, on a particularly large scale, the challenges of managing successfully in a complex global network of stakeholders. The company's actions affected not only itself, but also many other people, groups, and organizations in society. Customers, suppliers, employees, stockholders, creditors, business partners, governments, and local communities all had a stake in Walmart's decisions. Walmart had to learn just how difficult it could be to simultaneously satisfy multiple stakeholders with diverse and, in some respects, contradictory interests.

Every modern company, whether small or large, is part of a vast global business system. Whether a firm has 50 employees or 50,000—or, like Walmart, more than 2 million—its links to customers, suppliers, employees, and communities are certain to be numerous, diverse, and vital to its success. This is why the relationship between business and society is important for you to understand as both a citizen and a manager.

Business and Society

Business today is arguably the most dominant institution in the world. The term *business* refers here to any organization that is engaged in making a product or providing a service for a profit. Consider that in the United States today there are 6 million businesses, according to government estimates, and in the world as a whole, there are uncounted millions more. Of course, these businesses vary greatly in size and impact. They range from a woman who helps support her family by selling handmade tortillas by the side of the road in Mexico City for a few pesos, to ExxonMobil, a huge corporation that employs 75,000 workers and earns annual revenues approaching $412 billion in almost every nation in the world.

Society, in its broadest sense, refers to human beings and to the social structures they collectively create. In a more specific sense, the term is used to refer to segments of humankind, such as members of a particular community, nation, or interest group. As a set of organizations created by humans, business is clearly a part of society. At the same time, it is also a distinct entity, separated from the rest of society by clear boundaries. Business is engaged in ongoing exchanges with its external environment across these dividing lines. For example, businesses recruit workers, buy supplies, and borrow money; they also sell products, donate time, and pay taxes. This book is broadly concerned with the relationship between business and society. A simple diagram of the relationship between the two appears in Figure 1.1.

As the Walmart example that opened this chapter illustrates, business and society are highly interdependent. Business activities impact other activities in society, and actions by various social actors and governments continuously affect business. To manage these interdependencies, managers need an understanding of their company's key relationships and how the social and economic system of which they are a part affects, and is affected by, their decisions.

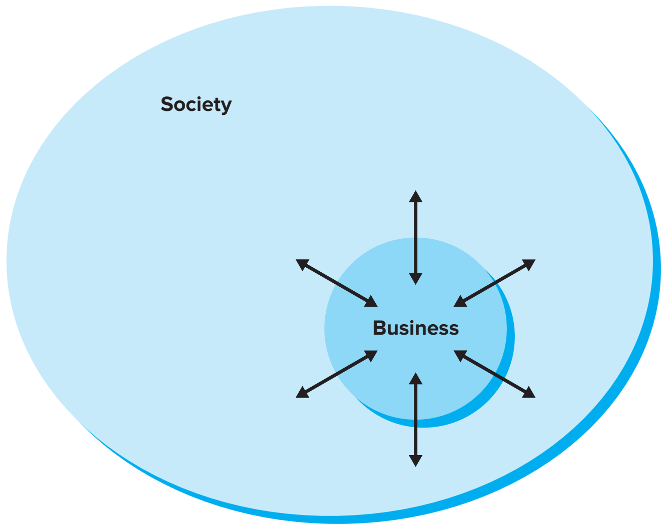
A Systems Perspective

General systems theory, first introduced in the 1940s, argues that all organisms are open to, and interact with, their external environments. Although most organisms have clear boundaries, they cannot be understood in isolation, but only in relationship to their surroundings.

[7] "2014 Global Responsibility Report," *http://corporate.walmart.com/global-responsibility/environment-sustainability/global-responsibility*.

[8] "Wal-Mart's Good-Citizen Efforts Face a Test," *The New York Times*, April 30, 2012.

FIGURE 1.1
Business and Society: An Interactive System



This simple but powerful idea can be applied to many disciplines. For example, in botany, the growth of a plant cannot be explained without reference to soil, light, oxygen, moisture, and other characteristics of its environment. As applied to management theory, the systems concept implies that business firms (social organisms) are embedded in a broader social structure (external environment) with which they constantly interact. Corporations have ongoing boundary exchanges with customers, governments, competitors, suppliers, communities, and many other individuals and groups. Just as good soil, water, and light help a plant grow, positive interactions with society benefit a business firm.

Like biological organisms, moreover, businesses must adapt to changes in the environment. Plants growing in low-moisture environments must develop survival strategies, like the cactus that evolves to store water in its leaves. Similarly, a long-distance telephone company in a newly deregulated market must learn to compete by changing the products and services it offers. The key to business survival is often this ability to adapt effectively to changing conditions. In business, systems theory provides a powerful tool to help managers conceptualize the relationship between their companies and their external environments.

Systems theory helps us understand how business and society, taken together, form an **interactive social system**. Each needs the other, and each influences the other. They are entwined so completely that any action taken by one will surely affect the other. They are both separate and connected. Business is part of society, and society penetrates far and often into business decisions. In a world where global communication is rapidly expanding, the connections are closer than ever before. Throughout this book we discuss examples of organizations and people that are grappling with the challenges of, and helping to shape, business–society relationships.

The Stakeholder Theory of the Firm

What is the purpose of the modern corporation? To whom, or what, should the firm be responsible?[9] No question is more central to the relationship between business and society.

[9] For summaries of contrasting theories of the purpose of the firm, see Margaret M. Blair, "Whose Interests Should Corporations Serve," in Margaret M. Blair and Bruce K. MacLaury, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington, DC: Brookings Institution, 1995), ch. 6, pp. 202–34; and James E. Post, Lee E. Preston, and Sybille Sachs, *Redefining the Corporation: Stakeholder Management and Organizational Wealth* (Palo Alto, CA: Stanford University Press, 2002).

In the **ownership theory of the firm** (sometimes also called property or finance theory), the firm is seen as the property of its owners. The purpose of the firm is to maximize its long-term market value, that is, to make the most money it can for shareholders who own stock in the company. Managers and boards of directors are agents of shareholders and have no obligations to others, other than those directly specified by law. In this view, owners' interests are paramount and take precedence over the interests of others.

A contrasting view, called the **stakeholder theory of the firm**, argues that corporations serve a broad public purpose: to create value for society. All companies must make a profit for their owners; indeed, if they did not, they would not long survive. However, corporations create many other kinds of value as well, such as professional development for their employees and innovative new products for their customers. In this view, corporations have multiple obligations, and all stakeholders' interests must be taken into account. This approach has been expressed well by the pharmaceutical company Novartis, which states in its code of conduct that it "places a premium on dealing fairly with employees, customers, vendors, government regulators, and the public. Novartis' success depends upon maintaining the trust of these essential stakeholders."[10]

Supporters of the stakeholder theory of the firm make three core arguments for their position: *descriptive, instrumental,* and *normative.*[11]

The *descriptive argument* says that the stakeholder view is simply a more realistic description of how companies really work. Managers have to pay keen attention, of course, to their quarterly and annual financial performance. Keeping Wall Street satisfied by managing for growth—thereby attracting more investors and increasing the stock price—is a core part of any top manager's job. But the job of management is much more complex than this. In order to produce consistent results, managers have to be concerned with producing high-quality and innovative products and services for their customers, attracting and retaining talented employees, and complying with a plethora of complex government regulations. As a practical matter, managers direct their energies toward all stakeholders, not just owners.

In what became known as the "dollar store wars," in 2014 two companies made competing bids to buy Family Dollar, a U.S. discount retail chain based in Charlotte, North Carolina—each with very different consequences for stakeholders. One suitor, Dollar Tree, offered $76.50 per share for the company, while the other, Dollar General, offered $80—seemingly a better deal for shareholders. But the Dollar General deal faced likely government antitrust scrutiny and would probably have required the closure of thousands of stores, throwing employees out of work and depriving low-income communities of access to a discount store. In the end, after considering the impact on all stakeholders, Family Dollar's management recommended the lower-priced offer, and three-quarters of its shareholders agreed.[12]

The *instrumental argument* says that stakeholder management is more effective as a corporate strategy. A wide range of studies have shown that companies that behave responsibly toward multiple stakeholder groups perform better financially, over the long run, than those that do not. (This empirical evidence is further explored in Chapter 3.) These findings make sense, because good relationships with stakeholders are themselves a source of value for the firm. Attention to stakeholders' rights and concerns can help produce

[10] "Code of Conduct: Values to Live By," online at *www.novartisvaccines.com*.

[11] The descriptive, instrumental, and normative arguments are summarized in Thomas Donaldson and Lee E. Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications," *Academy of Management Review* 20, no. 1 (1995), pp. 65–71. See also, Post, Preston, and Sachs, *Redefining the Corporation,* ch. 1.

[12] "Family Dollar Shareholders Approve Sale to Dollar Tree," *Charlotte Observer,* January 22, 2015.

motivated employees, satisfied customers, committed suppliers, and supportive communities, all good for the company's bottom line.

The *normative argument* says that stakeholder management is simply the right thing to do. Corporations have great power and control vast resources; these privileges carry with them a duty toward all those affected by a corporation's actions. Moreover, all stakeholders, not just owners, contribute something of value to the corporation. A skilled engineer at Microsoft who applies his or her creativity to solving a difficult programming problem has made a kind of investment in the company, even if it is not a monetary investment. Any individual or group who makes a contribution, or takes a risk, has a moral right to some claim on the corporation's rewards.[13]

A basis for both the ownership and stakeholder theories of the firm exists in law. The legal term *fiduciary* means a person who exercises power on behalf of another, that is, who acts as the other's agent. In U.S. law, managers are considered fiduciaries of the owners of the firm (its stockholders) and have an obligation to run the business in their interest. These legal concepts are clearly consistent with the ownership theory of the firm. However, other laws and court cases have given managers broad latitude in the exercise of their fiduciary duties. In the United States (where corporations are chartered not by the federal government but by the states), most states have passed laws that permit managers to take into consideration a wide range of other stakeholders' interests, including those of employees, customers, creditors, suppliers, and communities. (Benefit corporations, firms with a special legal status that obligates them to do so, are further discussed in Chapter 3.) In addition, many federal laws extend specific protections to various groups of stakeholders, such as those that prohibit discrimination against employees or grant consumers the right to sue if harmed by a product.

In other nations, the legal rights of nonowner stakeholders are often more fully developed than in the United States. For example, a number of European countries—including Germany, Norway, Austria, Denmark, Finland, and Sweden—require public companies to include employee members on their boards of directors, so that their interests will be explicitly represented. Under the European Union's so-called harmonization statutes, managers are specifically permitted to take into account the interests of customers, employees, creditors, and others.

In short, while the law requires managers to act on behalf of stockholders, it also gives them wide discretion—and in some instances requires them—to manage on behalf of the full range of stakeholder groups. The next section provides a more formal definition and an expanded discussion of the stakeholder concept.

The Stakeholder Concept

The term **stakeholder** refers to persons and groups that affect, or are affected by, an organization's decisions, policies, and operations.[14] The word *stake,* in this context, means

[13] Another formulation of this point has been offered by Robert Phillips, who argues for a principle of stakeholder fairness. This states that "when people are engaged in a cooperative effort and the benefits of this cooperative effort are accepted, obligations are created on the part of the group accepting the benefit" [i.e., the business firm]. Robert Phillips, *Stakeholder Theory and Organizational Ethics* (San Francisco: Berrett-Koehler, 2003), p. 9 and ch. 5.

[14] The term *stakeholder* was first introduced in 1963 but was not widely used in the management literature until the publication of R. Edward Freeman's *Strategic Management: A Stakeholder Approach* (Marshfield, MA: Pitman, 1984). For summaries of the stakeholder theory literature, see Thomas Donaldson and Lee E. Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence, Implications," *Academy of Management Review,* January 1995, pp. 71–83; Max B. E. Clarkson, ed., *The Corporation and Its Stakeholders: Classic and Contemporary Readings* (Toronto: University of Toronto Press, 1998); Abe J. Zakhem, Daniel E. Palmer, and Mary Lyn Stoll, *Stakeholder Theory: Essential Readings in Ethical Leadership and Management* (Amherst, NY: Prometheus Books, 2008); and R. Edward Freeman, *Stakeholder Theory: The State of the Art* (Cambridge, UK: Cambridge University Press, 2010).

an interest in—or claim on—a business enterprise. Those with a stake in the firm's actions include such diverse groups as customers, employees, shareholders (also called stockholders), governments, suppliers, professional and trade associations, social and environmental activists, and nongovernmental organizations. The term *stakeholder* is not the same as *stockholder,* although the words sound similar. Stockholders—individuals or organizations that own shares of a company's stock—are one of several kinds of stakeholders.

Business organizations are embedded in networks involving many participants. Each of these participants has a relationship with the firm, based on ongoing interactions. Each of them shares, to some degree, in both the risks and rewards of the firm's activities. And each has some kind of claim on the firm's resources and attention, based on law, moral right, or both. The number of these stakeholders and the variety of their interests can be large, making a company's decisions very complex, as the Walmart example illustrates.

Managers make good decisions when they pay attention to the effects of their decisions on stakeholders, as well as stakeholders' effects on the company. On the positive side, strong relationships between a corporation and its stakeholders are an asset that adds value. On the negative side, some companies disregard stakeholders' interests, either out of the belief that the stakeholder is wrong or out of the misguided notion that an unhappy customer, employee, or regulator does not matter. Such attitudes often prove costly to the company involved. Today, for example, companies know that they cannot locate a factory or store in a community that strongly objects. They also know that making a product that is perceived as unsafe invites lawsuits and jeopardizes market share.

Different Kinds of Stakeholders

Business interacts with society in many diverse ways, and a company's relationships with various stakeholders differ.

Market stakeholders are those that engage in economic transactions with the company as it carries out its purpose of providing society with goods and services. Each relationship between a business and one of its market stakeholders is based on a unique transaction, or two-way exchange. Stockholders invest in the firm and in return receive the potential for dividends and capital gains. Creditors loan money and collect payments of interest and principal. Employees contribute their skills and knowledge in exchange for wages, benefits, and the opportunity for personal satisfaction and professional development. In return for payment, suppliers provide raw materials, energy, services, finished products, and other inputs; and wholesalers, distributors, and retailers engage in market transactions with the firm as they help move the product from plant to sales outlets to customers. All businesses need customers who are willing to buy their products or services.

The puzzling question of whether or not managers should be classified as stakeholders along with other employees is discussed in Exhibit 1.A.

Nonmarket stakeholders, by contrast, are people and groups who—although they do not engage in direct economic exchange with the firm—are nonetheless affected by or can affect its actions. Nonmarket stakeholders include the community, various levels of government, nongovernmental organizations, business support groups, competitors, and the general public. Nonmarket stakeholders are not necessarily less important than others, simply because they do not engage in direct economic exchange with a business. On the contrary, interactions with such groups can be critical to a firm's success or failure, as shown in the following example.

Exhibit 1.A

Are Managers Stakeholders?

Are managers, especially top executives, stakeholders? This has been a contentious issue in stakeholder theory.

On one hand, the answer clearly is "yes." Like other stakeholders, managers are impacted by the firm's decisions. As employees of the firm, managers receive compensation—often very generous compensation, as shown in Chapter 13. Their managerial roles confer opportunities for professional advancement, social status, and power over others. Managers benefit from the company's success and are hurt by its failure. For these reasons, they might properly be classified as employees.

On the other hand, top executives are agents of the firm and are responsible for acting on its behalf. In the stakeholder theory of the firm, their role is to integrate stakeholder interests, rather than to promote their own more narrow, selfish goals. For these reasons, they might properly be classified as representatives of the firm itself, rather than as one of its stakeholders.

Management theory has long recognized that these two roles of managers potentially conflict. The main job of executives is to act for the company, but all too often they act primarily for themselves. Consider, for example, the many top executives of Lehman Brothers, MF Global, and Merrill Lynch, who enriched themselves personally at the expense of shareholders, employees, customers, and other stakeholders. The challenge of persuading top managers to act in the firm's best interest is further discussed in Chapter 13.

In 2001, a company called Energy Management Inc. (EMI) announced a plan to build a wind farm about six miles off the shore of Cape Cod, Massachusetts, to supply clean, renewable power to New England customers. The project, called Cape Wind, immediately generated intense opposition from residents of Cape Cod and nearby islands, who were concerned that its 130 wind turbines would spoil the view and get in the way of boats. A nonprofit group called Save Our Sound filed dozens of lawsuits, charging possible harm to wildlife, increased electricity rates, and danger to aircraft. In early 2015, EMI appeared blocked on all sides, as local utilities withdrew their commitments to buy power from the wind farm, which one local newspaper called the final "death blow."[15]

In this instance, activists were able to block the company's plans for more than a decade—and possibly permanently—even though they did not have a market relationship with it.

Theorists also distinguish between **internal stakeholders** and **external stakeholders**. Internal stakeholders are those, such as employees and managers, who are employed by the firm. They are "inside" the firm, in the sense that they contribute their effort and skill, usually at a company worksite. External stakeholders, by contrast, are those who—although they may have important transactions with the firm—are not directly employed by it.

The classification of government as a nonmarket stakeholder has been controversial in stakeholder theory. Most theorists say that government is a nonmarket stakeholder (as does this book) because it does not normally conduct any direct market exchanges (buying and selling) with business. However, money often flows from business to government in the form of taxes and fees, and sometimes from government to business in the form of subsidies or incentives. Moreover, some businesses—defense contractors for example—*do*

[15] "Renewable Energy: Wind Power Tests the Waters," *Nature,* September 24, 2014; "Cape Wind's Future Called into Question," *The Boston Globe,* January 8, 2015; and "Cape Wind Becalmed," *Providence Journal,* January 21, 2015. The website of the project is at *www.capewind.org*. The story of the opposition to Cape Wind is told in Robert Whitcomb and Wendy Williams, *Cape Wind: Money, Celebrity, Energy, Class, Politics, and the Battle for Our Energy Future* (New York: PublicAffairs, 2008).