A Stakeholder Theory of the Modern Corporation

by

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Remember --

(Milton) Friedman ≠ (Edward) Freeman

Shareholder ≠ Stakeholder

Milton (Friedman) vs. Edward (Freeman)

- Milton (Friedman)
  - The only group that has a moral claim on the corporation is the people who own shares of the stock (that is, the **shareholders**).
- Edward (Freeman)
  - Many groups have a moral claim on the corporation because the corporation has the potential to harm or benefit them (call these groups **stakeholders**).

Who are these stakeholders?

- Owners (that is, the shareholders).
- The corporate managers themselves.
- The local community (and at least sometimes a broader community – regional, national, global).
- The customers.
- The employees.
- The suppliers.

What characterizes these stakeholders?

- They are vital to the survival and success of the corporation.
- Their relationship with the corporation enables them to be benefited by the corporation’s actions and operations.
- This relationship also makes it possible for the corporation to harm them or to violate their rights.

For example, the last UAW-GM strike.

- GM obviously could not operate without a workforce (UAW is vital to GM's success).
- The UAW workers could receive substantial benefits from GM – high wages, job security, retiree benefits, etc.
- GM could substantially harm UAW workers, and vice versa.
- So, the UAW workers were a legitimate stakeholder group for GM, and GM consequently had to take them into account in making its corporate decisions.

What is Edward (Freeman’s) argument for his theory?

- The “legal argument” – Society has substantially limited the unrestricted pursuit of profit *via* laws and regulations. This means Milton (Friedman’s) theory is hypothetical and essentially useless.
- The “economic argument” – Milton (Friedman’s) theory assumes there are no economic externalities, moral hazards in the form of pass-along costs, or monopolies. But all of these really exist, so his shareholder theory is false.

So, what does Edward (Freeman's) theory require corporations to do?

- Corporations have to take **<u>all</u>** of the stakeholder groups into account when making a decision.
- But, there are many different ways to take them into account – for example,
  - Kantian ethics
  - Utilitarian ethics
  - Rawls' theory about justice

Edward (Freeman's) Kantian example.

- Paying attention to customer's needs → stable business processes (sales of products and purchases of raw materials).
- But paying attention to customer's needs IS a Kantian treatment of the customer as an end rather than exploiting them as a means only.

Edward (Freeman's) Rawlsian example.

- View the mutual relationships among a corporation's stakeholders as a set of contracts. Then ask, "What would assure the fairness of these?"
  - Basic equality among the stakeholders in terms of their moral rights (each "contract" is as morally important as the others).
  - Inequalities in the amount of benefits to the stakeholder groups demonstrably raise the level of the least well-off stakeholder group.

How do Friedman and Freeman differ in analyzing a case?

- (Milton) Friedman says to maximize profit a) within the law and b) without violating social standards.
  - So, in looking at a business decision (or analyzing a case), identify relevant laws and regulations – and also identify current social standards and opinions.
  - Maximize profit without breaking laws/regulations AND without "disturbing" society so much that it decreases profits.
- (Edward) Freeman says to a) identify stakeholder groups and b) make a decision that "takes them into account."
  - So, in looking at a business decision (or analyzing a case), identify all stakeholder groups.
  - Identify available options and determine the effect they will have on the stakeholders.
  - Select and apply an ethical theory to these options to determine the best one.