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. How corporations manage their interactions with stakeholders powerfully contributes to business success or failure. Building positive and mutually beneficial relationships across organizational boundaries is a growing part of management's role. 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:

- Understanding the relationship between business and society, and the ways in which they are part of an interactive system.
- Considering the purpose of the modern corporation.
- Knowing what is a stakeholder, and who are a corporation's market and nonmarket stakeholders.
- Conducting a stakeholder analysis, and understanding how it can be used to build collaborative relationships.
- Analyzing the forces of change that continually reshape the business and society relationship.

Wal-Mart has been called "a template for 21st century capitalism." In each period of history, a single company seems to best capture 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 2000s, it is Wal-Mart.[1]

In 2006, Wal-Mart was the largest private employer in the world, with 1.3 million employees in the United States alone. The company operated 3,800 facilities and had annual sales of $312 billion. The retailer was enormously popular with customers, drawing them in with its great variety of products under one roof and "always low prices" policy; 175 million customers worldwide shopped there every week. Economists estimated that Wal-Mart had directly through its own actions and indirectly through its impact on its supply chain saved American shoppers $263 billion in 2004, about $895 for every person in the country.[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 a high of $63 in 2002. Wal-Mart was a major customer for 61,000 suppliers worldwide, ranging from huge multinationals to tiny one-person operations.

Yet, Wal-Mart had become a lightning rod for criticism from many quarters, charged with hurting local communities, discriminating against women, and driving down wages and working conditions. Consider that:

- In 2004, the City Council in Inglewood, California, a predominantly African-American and Hispanic suburb of Los Angeles, voted down a proposed Wal-Mart mega-store on a 60-acre parcel near the Hollywood racetrack. The city expressed concern that the development would adversely impact small businesses, traffic, public safety, and wages. (This case is further discussed in Chapter 2.) This was only one of many communities that mobilized to block Wal-Mart's entry in the mid-2000s.
- The same year, a federal judge ruled that a lawsuit charging Wal-Mart Stores with discrimination against women could go forward as a class action. The case charged that women at Wal-Mart were paid less than men in comparable positions, received fewer promotions into management, and waited longer to move up than men did. (This case is further discussed in Chapter 19.) If the decision ultimately went against Wal-Mart, the cost to the company could be in the hundreds of millions of dollars.
- In 2005, a critical documentary called "Wal-Mart: The High Cost of Low Prices," was released, with a trailer showing the company's yellow smiley-face character as a rapacious plunderer. Thousands of people saw the movie at community screenings and discussed it on the website, *www.walmartmovie.com*. Among the embarrassing allegations made by the filmmakers was that many workers had to apply for public assistance because their wages, which averaged less than $10 an hour, were so low.

Lee Scott, the company's CEO, commented in an interview with *BusinessWeek* in late 2005, "We always believed that if we sat here in Bentonville [the company's headquarters] and took care of our customers and took care of associates that the world itself would leave us alone." That, he acknowledged, was no longer the case. "We have to continue to evolve in how we operate and how we interface with society," he said.[3] In an effort to shore up its reputation, the company increased its health insurance for workers, offered grants to small businesses, and donated to wildlife habitat restoration. It also convened a rapid-response public relations team in an office in its Arkansas headquarters, dubbed the "war room" by *The New York Times*, to coordinate its response to critics.[4]

Wal-Mart'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, and local communities all had a stake in Wal-Mart's decisions. Wal-Mart in the mid-2000s was learning, sometimes painfully, just how difficult it could be simultaneously to 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 Wal-Mart, more than a 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 to understand as both a citizen and a manager.

Business and Society

Business today is one of the dominant institutions in society, all around 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 over 5 million businesses, based on the number that file tax returns with the government, 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 86,000 workers and earns annual revenues approaching $300 billion in 200 nations worldwide.

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 example that opened this chapter illustrates, business and society are highly interdependent. Business activities impact others 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. 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, the media, 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 are 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

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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 returns to shareholders; that is, to make the most money it can for the people 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, shareholders' 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, commercial partners, government authorities, and the public. Success in its business ventures depends upon maintaining the trust of these essential stakeholders."[6]

Supporters of the stakeholder theory of the firm make three core arguments for their position: *descriptive, instrumental,* and *normative*.[7]

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The *instrumental argument* says that stakeholder management is more effective as a corporate strategy. Companies that take into consideration the rights and concerns of multiple groups perform better, over the long run, than those that do not. For example, a study of 500 large companies found that those that stated their commitment to a code of conduct and to their stakeholders in their annual reports performed better financially than those that did not.[8] This finding makes sense, because good relationships with stakeholders are themselves a source of value for the firm. This issue has been widely studied; some of the other empirical evidence for this proposition is presented in Chapter 3.

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.

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. 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, Holland, 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 of 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.[9] The word *stake*, in this context, means 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, stockholders, the media, governments, 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 opening 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.

Market and Nonmarket Stakeholders

Business interacts with society in a many diverse ways, and a company's relationships differ with various stakeholders. **Market stakeholders** are those that engage in economic transactions with the company as it carries out its primary purpose of providing society with goods and services. (For this reason, market stakeholders are also sometimes called *primary* stakeholders.)

Figure 1.2 shows the market stakeholders of business. Each relationship 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. 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, 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. These are the fundamental market interactions every business has with society.

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. Figure 1.3 shows the nonmarket stakeholders of business (also called *secondary* stakeholders by some theorists). Nonmarket stakeholders include the community, various levels of government, activist groups and nongovernmental organizations, the media, business support groups, and the general public. The natural environment is generally not considered a stakeholder, because it is not a social group, but is represented in Figure 1.3 by activists, who include environmentalists.

The classification of government as a nonmarket, or secondary, 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* sell directly to the government and receive payment for goods and services rendered. For this reason, a few theorists have called government a market stakeholder of business. The unique relationship between government and business is discussed throughout this book.

Both Figures 1.2 and 1.3 should be understood as very simplified ways of understanding the real world. These diagrams show the business firm as, in effect, the center of a system, like the sun with its planets in the solar system. They also illustrate the firm's relationship to each stakeholder, but not stakeholders' relationships with each other. Some theorists have suggested that a more accurate way to visualize the relationship is to show the business firm embedded in a complex network of stakeholders, many of which have independent relationships with each other.[10] This alternative image of the business firm and its stakeholders—as a network with many nodes—is shown in Figure 1.4.

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. For example, as described in a case study at the end of this book, Shell Oil was forced to shut down part of its operations in Nigeria after widespread community protests there against its environmental and social policies. In this instance, the community was able to block the company's operations, even though it did not have a market relationship with it. Moreover, market and nonmarket areas of involvement are not always sharply distinguished; often, one shades into the other. For example, the environmental effect of an automobile may be of concern both to a customer (a market stakeholder) and to the entire community (a nonmarket stakeholder), which experiences cumulative air pollution emitted from cars.

Of further note, some individuals or groups may play multiple stakeholder roles. Some theorists use the term *role sets* to refer to this phenomenon. For example, one person may work at a company, but also live in the surrounding community, own shares of company stock in his or her 401(k) retirement account, and even purchase the company's products from time to time. This person's stakes in a company's actions are several.

Later sections of this book (especially Chapters 15 through 20) will discuss in more detail the relationship between business and its various stakeholders.

Stakeholder Analysis and Engagement

An important part of the modern manager's job is to identify relevant stakeholders and to understand both their interests and the power they may have to assert these interests. This process is called **stakeholder analysis**. It asks four key questions, as follows.

Who are the relevant stakeholders?

The first question requires management to identify and map the relevant stakeholders. Figures 1.2 and 1.3 provide a guide. However, not all stakeholders listed in these figures will be relevant in every management situation. For example, a privately held firm will not have stockholders. Some businesses sell directly to the public, and therefore will not have wholesalers or retailers. In other situations, a firm may have a stakeholder—say, a creditor that has loaned money—but this group is not relevant to a particular decision or action that management must take.

But stakeholder analysis involves more than simply *identifying* stakeholders; it also involves understanding the nature of their interests, power, and links with one another.

Stakeholder Interests and Power

What are the interests of each stakeholder?

Each stakeholder has a unique relationship to the organization, and managers must respond accordingly. **Stakeholder interests** are, essentially, the nature of each group's stake. What are their concerns, and what do they want from their relationship with the firm?[11]

[illegible]

What is the power of each stakeholder?

Stakeholder power means the ability to use resources to make an event happen or to secure a desired outcome. Experts have recognized four types of stakeholder power: *voting power, economic power, political power,* and *legal power*.

Voting power means that the stakeholder has a legitimate right to cast a vote. Stockholders typically have voting power proportionate to the percentage of the company's stock he or she owns. Stockholders typically have an opportunity to vote on such major decisions as mergers and acquisitions, as well as various social issues that may come before the annual meeting. (Stockholder voting power should be distinguished from the voting power exercised by citizens, which is discussed below.)

In 2002, a group of stockholders at Hewlett Packard (HP) tried to exercise their voting power to block a proposed merger with Compaq Computer. The

company's CEO and a majority of its board believed that a merger would benefit both firms by allowing them to bring together their capabilities in printers, peripherals, and computers. But one member of HP's board, Walter Hewlett, a son of the company's founder, opposed the merger on the grounds that it would destroy the egalitarian culture that was a core part of company's legacy. As required by law, the matter was put to a vote of the stockholders. In a series of letters, advertisements, and meetings, Hewlett organized other stockholders to vote against management's proposal. Ultimately, stockholders approved the merger—but by a very narrow margin.

Customers, suppliers, and retailers have *economic power* with the company. Suppliers can withhold supplies or refuse to fill orders if a company fails to meet its contractual responsibilities. Customers may refuse to buy a company's products or services if the company acts improperly. Customers can boycott products if they believe the goods are too expensive, poorly made, or unsafe. Employees, for their part, can refuse to work under certain conditions, a form of economic power known as a strike or slowdown. Economic power often depends on how well organized a stakeholder group is. For example, workers who are organized into unions usually have more economic power than do workers who try to negotiate individually with their employers.

Governments exercise *political power* through legislation, regulations, or lawsuits. While government agencies act directly, other stakeholders use their political power indirectly by urging government to use its powers by passing new laws or enacting regulations. Citizens may also vote for candidates that support their views with respect to government laws and regulations affecting business, a different kind of voting power than the one discussed above. Stakeholders may also exercise political power directly, as when social, environmental, or community activists organize to protest a particular corporate action.

Finally, stakeholders have *legal power* when they bring suit against a company for damages, based on harm caused by the firm. These include lawsuits brought by customers for damages caused by defective products, brought by employees for damages caused by workplace injury, or brought by environmentalists for damages caused by pollution or harm to species or habitat. After Enron collapsed, many institutional shareholders, such as state pension funds, joined together to sue to recoup some of their losses.

Some scholars have suggested that managers pay more attention to stakeholders possessing greater salience. (Something is *salient* when it stands out from a background.) Stakeholders stand out to managers when they have power, legitimacy, and urgency. The more of these attributes a stakeholder possesses, the more managers are likely to notice and respond. Stakeholders possessing all three attributes are called *definitive* stakeholders; those possessing two attributes are called *expectant* stakeholders.[12]

Activists often use this insight about salience when they want to change a company's policy. For example, human rights activists wanted to bring pressure on Unocal Corporation to change its practices in Burma, where it had entered into a joint venture with the government to build a gas pipeline. Critics charged that many human rights violations occurred during this project, including forced labor and relocations. In an effort to pressure Unocal to change its behavior, activists organized protests at stockholder meetings (*voting power*), called for boycotts of Unocal products (*economic power*), promoted local ordinances prohibiting cities from buying from Unocal (*political power*), and brought a lawsuit for damages on behalf of Burmese villagers (*legal power).* These activists became salient because they were able to mobilize many kinds of power and to press their claims with great urgency. This combination of tactics eventually forced Unocal in 2005 to pay compensation to people whose rights had been violated and to fund education and health care projects in the pipeline region.[13]

Exhibit 1.B provides a schematic summary of some of the main interests and powers of both market and nonmarket stakeholders.

Stakeholder Coalitions

An understanding of stakeholder interests and power enables managers to answer the final question of stakeholder analysis: *How are coalitions likely to form?*

Not surprisingly, stakeholder interests often coincide. For example, consumers of fresh fruit and farmworkers who harvest that fruit in the field may have a shared interest in reducing the use of pesticides, because of possible adverse health effects from exposure to chemicals. When their interests are similar, stakeholders may form coalitions, temporary alliances to pursue a common interest. **Stakeholder coalitions** are not static. Groups that are highly involved with a company today may be less involved tomorrow. Issues that are controversial at one time may be uncontroversial later; stakeholders that are dependent on an organization at one time may be less so at another. To make matters more complicated, the process of shifting coalitions does not occur uniformly in all parts of a large corporation. Stakeholders involved with one part of a large company often have little or nothing to do with other parts of the organization.

In recent years, coalitions of stakeholders have become increasingly international in scope. Communications technology has enabled like-minded people to come together quickly, even across political boundaries and many miles of separation. Wireless telephones, the Internet, and fax machines have become powerful tools in the hands of groups that monitor how multinational businesses are operating in different locations around the world.

> In the late 1990s, [illegible] Pacific coast of Mexico. The proposed plant was a joint venture of Mitsubishi (a multinational corporation based in Japan) and the Mexican government. Together, they wanted to create jobs, taxes, and revenue by mining naturally occurring salt deposits along the Baja California coast. Environmentalists attacked the venture on the grounds that it would hurt the gray whales that migrated every year to a nearby lagoon to give birth to their young. In the past, such objections would probably have attracted little attention. But critics were able to use the Internet and the media to mobilize over 50 organizations worldwide to threaten a boycott of Mitsubishi. One million people sent protest letters to "save the gray whale." Faced with this global outcry, in 2000 the Mexican government cancelled its plans for the salt plant.[14]

This example illustrates how international networks of activists, coupled with the media's interest in such business and society issues, make coalition development and issue activism an increasingly powerful strategic factor for companies. Nongovernmental organizations regularly meet to discuss problems such as global warming, human rights, and environmental issues, just as their business counterparts do. Today, stakeholder coalitions are numerous in every industry and important to every company.

Once managers have answered these four questions, how can they best use this information? Stakeholder analysis is just the first step. It provides a useful tool for managers to help them engage collaboratively with stakeholders to create value, a topic discussed in the next section.

Stakeholder Engagement

Over time, the nature of business's relationship with its stakeholders has changed in important ways. Several experts have observed a shift from an *inactive* to a *reactive* to a *proactive* to an *interactive* relationship.[15]

- *Inactive* companies simply ignore stakeholder concerns. These firms may believe—often incorrectly—that they can make decisions unilaterally, without taking into consideration their impact on others. For example, in the 1970s a company called A. H. Robins manufactured a contraceptive device called the Dalkon Shield, which was inserted into a woman's uterus to prevent pregnancy. The device apparently had not been adequately tested and allowed bacteria to enter the body. When reports began to surface that many women with Dalkon Shields had developed pelvic infections and even infertility, the company's initial response was simply to deny there was a problem.

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- *Proactive* companies try to anticipate stakeholder concerns. These firms often have specialized departments, such as public affairs, community relations, consumer affairs, and government relations to identify issues that are, or may become, of concern to key stakeholders. These firms are much less likely to be blind-sided by crises and negative surprises. Stakeholders and their concerns are still, however, considered a problem to be managed, rather than a source of competitive advantage.
- Finally, an *interactive* stance means that companies actively engage with stakeholders in an ongoing relationship of mutual respect, openness, and trust. Firms with this approach recognize that positive stakeholder relationships are a source of value and competitive advantage for the company. They know that these relationships must be nurtured over time. The term **stakeholder engagement** is used to refer to this process of ongoing relationship building between a business and its stakeholders.

The process of engagement can take many forms, but it often involves dialogue with stakeholders. One management theorist has defined dialogue as "the art of thinking together."[16] In **stakeholder dialogue**, a business and its stakeholders come together for face-to-face conversations about issues of common concern. There, they attempt to describe their core interests and concerns, define a common definition of the problem, invent innovative solutions for mutual gain, and establish procedures for implementing solutions. To be successful, the process requires that participants express their own views fully, listen carefully and respectfully to others, and open themselves to creative thinking and new ways of looking at and solving a problem. The promise of dialogue is that together, they can draw on the understandings and concerns of all parties to develop solutions that none of them, acting alone, could have envisioned or implemented.[17]

> BC Hydro, the third-largest electric utility in Canada, serves residents in British Columbia and sells power to other provinces and states throughout the Pacific Northwest. Over 90 percent of the company's output comes from hydroelectric dams. In 1995, BC Hydro ran into stiff opposition from locals when it set out to build a new power plant on the Alouette River. Rather than ignore these complaints, the company convened a stakeholder committee, with representation from the local community, First Nations bands (aboriginal peoples), environmentalists, and local regulators. Over many months of dialogue, the committee hammered out a plan for the river that permitted more power generation, but also provided for protection of fish and wildlife, recreational use, and flood control. The group also set up an ongoing governance process, so stakeholders could continue to be consulted in future decisions. Today, BC Hydro has stakeholder dialogues in progress in many locations across the province.[18]

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The important question of what *organizational* steps businesses need to take to enhance their capacity to respond to and interact with stakeholders in a positive manner is further explored in Chapter 4.

The Dynamic Environment of Business

A core argument of this book is that *the external environment of business is dynamic and ever changing*. Businesses and their stakeholders do not interact in a vacuum. On the contrary,

most companies operate in a swirl of social, ethical, global, political, ecological, and technological change that produces both opportunities and threats. Figure 1.5 diagrams the six dynamic forces that powerfully shape the business and society relationship. Each of these forces is introduced briefly below and will be discussed in more detail later in this book.

Changing societal expectations. Everywhere around the world, society's expectations of business are changing. People increasingly expect business to be more responsible, believing companies should pay close attention to social issues and act as good citizens in society. Increasingly, business is faced with the daunting task of balancing its social, legal, and economic obligations, seeking to meet its commitments to multiple stakeholders. Various evaluation standards have been developed to provide business with objective ways to measure how well it has responded to stakeholders. These changes in society's expectations of business, and how managers have responded, are described in Chapters 2, 3, and 4.

Growing emphasis on ethical reasoning and actions. The public also expects business to be ethical and wants corporate managers to apply ethical principles—in other words, guidelines about what is right and wrong, fair and unfair, and morally correct—when they make business decisions. Fair employment practices, concern for consumer safety, contribution to the welfare of the community, and human rights protection around the world have become more prominent and important. Business has created ethics programs to help ensure employees are aware of these issues and act in accordance with ethical standards. The ethical challenges faced by business, both domestically and abroad—and business's response—are further discussed in Chapters 5 and 6.

Globalization. We live in an increasingly integrated world economy, characterized by the increasing movement of goods, services, and capital across national borders. Today, economic forces truly play out on a global stage. Large transnational corporations do business in scores of countries. Products and services people buy every day in the United States or Germany may have come from Indonesia, Haiti, or Mexico. A currency crisis in Russia, Argentina, or Thailand can affect stock values and interest rates halfway around the world. Globalization is more than just an economic phenomenon, however; it also involves rapid cultural change, the migration of people, and pressures for political reform. Chapter 7 addresses globalization and its impact on the business and society relationship.

Evolving government regulation of business. The role of government has changed dramatically in many nations in recent decades. Governments around the world have enacted myriad new policies that have profoundly constrained how business is allowed to operate. Government regulation of business periodically becomes tighter, then looser, much as a pendulum swings back and forth. Because of the dynamic nature of this force, business has developed various strategies to influence elected officials and government regulators at federal, state, and local levels. Government may also restrict business if it believes fair competition has been hindered by monopolistic practices. The changing role of government, its impact, and business's response are explored in Chapters 8, 9, and 10.

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Explosion of new technology. Technology is one of the most dramatic and powerful forces affecting business and society. New technologies harness the human imagination to create new machines, processes, and software that address the needs, problems, and concerns of modern society. In recent years, the pace of technological change has increased enormously. From genetically modified foods to the Internet, from nanotechnology to wireless communications, change keeps coming. The extent and pace of technological innovation provide massive challenges for business, and sometimes government, as they seek to manage this dynamic force. As discussed in Chapters 13 and 14, new technologies often force managers and organizations to examine seriously the ethical implications of their use.

Creating Value in a Dynamic Environment

These powerful and dynamic forces—fast-paced changes in societal and ethical expec[illegible]—establish the context in which businesses interact with their many stakeholders, as discussed in Chapters 15 through 20. This means that the relationship between business and society is continuously changing in new and often unpredictable ways. Environments, people, and organizations change; inevitably, new issues will arise and challenge managers to develop new solutions. To be effective, corporations must meet the reasonable expectations of stakeholders and society in general. A successful business must meet *both* its economic and social objectives. A core argument of this book is that *the purpose of the firm is not simply to make a profit, but to create value for all its stakeholders.* Ultimately, business success is judged, not simply by a company's financial performance, but by how well it serves broad social interests.

Discussion Case: *Cisco in the Coyote Valley*

Cisco Systems, based in San Jose, California, is a worldwide leader in high technology business. Founded by a group of scientists in 1984, the company designs and makes hardware for the Internet—the routers, servers, switches, cables, and modems that connect the world's computers. The company employs about 35,000 people globally. Of these, over 40 percent work in or near corporate headquarters in the Silicon Valley, making Cisco the region's largest private-sector employer.

As the Internet took off and demand for its products boomed in the late 1990s, Cisco quickly began to outgrow its urban office space. In 1999, the company proposed a solution: a massive industrial park to be constructed in a semi-rural area called the Coyote Valley, just inside San Jose's southern border. The largely undeveloped 400-acre site was then a mix of orchards and oak-studded grasslands, punctuated by several creeks.

Cisco's plan called for construction of a $1 billion multiple-building campus that would house up to 20,000 employees, with parking spaces for 22,000. The company said it would set aside 270 acres as open space and an additional 90 acres for landscaping and recreation. It also pledged to invest an additional $122 million in public roads, a freeway interchange, and a fire station. The proposed development was so large that locals quickly dubbed it "Cisco City."

Cisco believed that it needed to expand quickly to compete effectively with larger rivals such as Nortel and Lucent. Building in the Coyote Valley would enable it to keep core employees in its home community, as well as to continue to recruit in an area known for its highly skilled workforce. "It's part of our overall strategic plan to really grow where the talent is," said a company vice president.

The company's expansion plan was praised by the San Jose Chamber of Commerce, an organization of local businesses. "Cisco's private investment in public infrastructure is unprecedented in San Jose," said the president of the Chamber. "Cisco's campus will not only pay for itself, it will pay for a lot more." The Coyote Valley development was also supported by trade unions in the construction industry, and by many local politicians who argued that it would bring jobs and tax revenue to the city and county.

The community was divided. In the immediate vicinity, many seemed enthusiastic. "Cisco will add value to our neighborhood and help improve neighborhood services for all San Jose residents," said the president of a local neighborhood association. "South San Jose overwhelmingly supports Cisco."

Outside the city, however, opposition flared. The development plan did not include a provision for housing, and many wondered where the 20,000 or so workers at the Coyote Valley site would live. The towns of Salinas, Watsonville, and Hollister—historically agricultural communities south of San Jose—expressed concern that Cisco employees would move in, driving up housing prices, clogging roads, and putting pressure on already strained local services. "It's a cynical effort to reap the economic benefits of this huge office development for San Jose, but impose the economic burdens . . . on other communities to the south," said an attorney retained by these communities.

Environmentalists also lined up against the project. Chapters of the Sierra Club, the Audubon Society, and a local group called the Committee for Green Foothills charged that the development would pollute the air with automobile emissions, destroy valuable habitat, and contribute to urban sprawl. They pointed out that the site was far from mass transit. "It would be an environmental disaster . . . in terms of air quality, loss of wonderful agricultural land, and traffic," said a spokesperson for the Sierra Club. The environmentalists joined the southern communities and affordable housing activists to bring a lawsuit to block the development.

As the controversy headed for the courts, Cisco managers considered what steps they could take to increase the chances their proposal would succeed. “We are disappointed that these parties have chosen litigation over collaboration,” said a company spokesperson. “We have remained willing to work together out of the courts.”

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

[2] [illegible]

[3] “Can Wal-Mart Fit into a White Hat?” *BusinessWeek,* October 3, 2005, p. 94; and extended interview with Lee Scott available online at *www.businessweek.com.*

[4] “Wal-Mart Offers Aid to Rivals,” *The New York Times,* April 5, 2006, p. C1; “A New Weapon for Wal-Mart: A War Room,” *The New York Times,* November 1, 2005, pp. A1, C4.

FIGURE 1.1

Business and Society: An Interactive System

[5] One summary of contrasting theories of the purpose of the firm appears in Margaret M. Blair, “Whose Interests Should Corporations Serve,” Ch. 6 in Margaret M. Blair and Bruce K. MacLaury, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington, DC: Brookings Institution, 1995), pp. 202–34. More recently, these questions have been taken up in James E. Post, Lee E. Preston, and Sybille Sachs, *Redefining the Corporation: Stakeholder Management and Organizational Wealth* (Palo Alto, CA: Stanford University Press, 2002).

[6] Novartis Corporation Code of Conduct, online at: *www.novartis.com.*

[7] 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.

[8] Curtis C. Verschoor, “A Study of the Link Between a Corporation’s Financial Performance and Its Commitment to Ethics,” *Journal of Business Ethics* 17 (1998), pp. 1509–16.

[9] 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 a more recent summary 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, and Max B. E. Clarkson, ed., *The Corporation and Its Stakeholders: Classic and Contemporary Readings* (Toronto: University of Toronto Press, 1998).

FIGURE 1.2

Market Stakeholders of Business

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 15. 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 perimeter of the stakeholder wheel, as shown in Figure 1.2.

One 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 in the center of the stakeholder wheel, as representatives of the firm.

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 Enron, WorldCom, and Tyco, 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 15.

FIGURE 1.3

Nonmarket Stakeholders of Business

[10] Timothy J. Rowley, “Moving Beyond Dyadic Ties: A Network Theory of Stakeholder Influence,” *Academy of Management Review* 22, no. 4 (October 1997).

FIGURE 1.4

A Stakeholder Network

Source: Adapted from Ann C. Svendsen and Myriam Laberge, "Convening Stakeholder Networks: A New Way of Thinking, Being, and Engaging," *Journal of Corporate Citizenship* 19 (Autumn 2005). Used by permission.

[11] A full discussion of the interests of stakeholders may be found in R. Edward Freeman, *Ethical Theory and Business* (Englewood Cliffs, NJ: Prentice Hall, 1994).

[12] Ronald K. Mitchell, Bradley R. Agle, and Donna J. Wood, "Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts," *Academy of Management Review* 22, no. 4 (1997), pp. 853–86.

[13] Further information about the campaign against Unocal is available at: *www.earthrights.org/unocal.*

Nature of Power_a **Nature**
of Interest_ **Stakeholder Influences** **Stakeholder** **Stakeholder Wishes To:** **Company By:**

Market Stakeholders

Employees n Maintain stable employment n Union bargaining power in firm
n Work actions or strikes
n Receive fair pay for work n Publicity
n -Work in safe, comfortable environment

Stockholders n -Receive a satisfactory return n Exercising voting rights on investments
(dividends) based on share ownership
n -Realize appreciation in stock n Exercising rights to inspect value over time
company books and records

Customers n -Receive fair exchange: value n Purchasing goods from -and quality for money
spent competitors
n Receive safe, reliable products -n -Boycotting companies whose products are
unsatisfactory or whose policies are unacceptable

Suppliers n Receive regular orders n Refusing to meet orders if for
goods conditions of contract are n Be paid promptly for
breached
supplies delivered n Supplying to competitors

Retailers/ n Receive quality goods in a n Buying from other suppliers Wholesalers
timely fashion at reasonable if terms of contract are cost
unsatisfactory n Offer reliable products that n
Boycotting companies consumers trust and value whose
goods or policies are unsatisfactory

Creditors n Receive repayment of loans n Calling in loans if payments n
Collect debts and interest are not made
n -Utilizing legal authorities to repossess or take
over property if loan payments are severely delinquent

Nature of Power_a **Nature**
of Interest_ **Stakeholder Influences** **Stakeholder** **Stakeholder Wishes To:** **Company By:**

Nonmarket Stakeholders

Communities n Employ local residents in n Refusing to extend the
company additional credit
n Ensure that the local n Issuing or restricting operat-
environment is protected ing licenses and permits
n Ensure that the local area n Lobbying government for is
developed -regulation of the company's policies or methods of land use and waste disposal

Activist Groups n Monitor company actions and n Gaining broad public support
-policies to ensure that they through publicizing the issue conform to legal
and ethical n Lobbying government for standards, and that they protect regulation of the
company the public's safety

Media n Keep the public informed on all n Publicizing events that affect issues
relevant to their health, the public, especially those well-being, and economic status
that have negative effects
n Monitor company actions

Business Support	n Provide research and information which will help the company or -industry perform in a changing development efforts	n Using its staff and resources Groups (e.g., trade to assist company in associations) business endeavors and environment n -Providing legal or "group" political support beyond that which an individual company can provide for itself
Governments	n Promote economic development n Encourage social improvements n Raise revenues through taxes	n [illegible] n Issuing licenses and permits n -Allowing or disallowing industrial activity
The General Public	n Protect social values n Minimize risks n Achieve prosperity for society	n Supporting activists n Pressing government to act n -Condemning or praising individual companies

[14] H. Richard Eisenbeis and Sue Hanks, "When Gray Whales Blush," case presented at the annual meeting of the North American Case Research Association, October 2002.

[15] This typology was first introduced in Lee Preston and James E. Post, *Private Management and Public Policy* (Englewood Cliffs, NJ: Prentice Hall, 1975). For a more recent discussion, see Sandra Waddock, *Leading Corporate Citizens: Visions, Values, and Value Added,* 2nd ed. (McGraw-Hill, 2006), Ch. 1.

[16] William Isaacs, *Dialogue and the Art of Thinking Together* (New York: Doubleday, 1999).

[17] This section draws on the discussion in Anne T. Lawrence and Ann Svendsen, *The Clayoquot Controversy: A Stakeholder Dialogue Simulation* (Vancouver: Centre for Innovation in Management, 2002). The argument for the benefits of stakeholder engagement is fully developed in Ann Svendsen, *The Stakeholder Strategy: Profiting from Collaborative Business Relationships* (San Francisco: Berrett-Koehler, 1998).

[18] We are indebted to Ann Svendsen for this example. More information is available at *www.bchydro.com.*

FIGURE 1.5

Forces That Shape the Business and Society Relationship

- Business firms are organizations that are engaged in making a product or providing a service for a profit. Society, in its broadest sense, refers to human beings and to the social structures they collectively create. Business is part of society and engages in ongoing exchanges with its external environment. Together, business and society form an interactive social system in which the actions of each profoundly influence the other.
- According to the stakeholder theory of the firm, the purpose of the modern corporation is to create value for all of its stakeholders. To survive, all companies must make a profit for their owners. However, they also create many other kinds of value as well for their employees, customers, communities, and others. For both practical and ethical reasons, corporations must take all stakeholders' interests into account.
- Every business firm has economic and social relationships with others in society. Some are intended, some unintended; some are positive, others negative. Stakeholders are all those who affect, or are affected by, the actions of the firm. Some have a market relationship with the company, and others have a nonmarket relationship with it.
- Stakeholders can exercise their economic, political, and other powers in ways that benefit or challenge the organization. Stakeholders may also act independently or create coalitions to influence the company. Managers must learn how to engage interactively with stakeholders to create mutually beneficial outcomes. Positive relationships with stakeholders can create value.

- A number of broad forces shape the relationship between business and society. These include changing societal and ethical expectations; redefinition of the role of government; a dynamic global economy; ecological and natural resource concerns; and the transformational role of technology. To deal effectively with these changes, corporate strategy must address the expectations of all of the company's stakeholders.

Key Terms

business, *4*
general systems theory, *5*
interactive social system, *5*
ownership theory of the firm, *6*
society, *4*
stakeholder, *7*
stakeholder analysis, *11*
stakeholder coalitions, *13*
stakeholder dialogue, *17*
stakeholder engagement, *17*
stakeholder interests, *11*
stakeholder (market), *8*
stakeholder (nonmarket), *9*
stakeholder power, *12*
stakeholder theory of the firm, *6*

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Internet Resources

Discussion Questions

1. What is Cisco's objective?
2. Who are the relevant market and nonmarket stakeholders in this situation?
3. What are their interests? Please indicate if each stakeholder is in favor of, or opposed to, the Coyote Valley development project, and why.
4. What would be the advantages and disadvantages to the company of working collaboratively with its stakeholders to resolve this dispute?
5. What possible solutions to this dispute do you think might emerge from dialogue between Cisco Systems and its stakeholders?