Shareholders vs. stakeholders theory

[Business]

The very purpose of the firm, according to this view, is to serve and coordinate the interests of its various stakeholders. It is the moral obligation of the firm's managers to strike an appropriate balance among the five interests in directing the activities of the firm.

This understanding of the firm's purpose and its management's obligations diverges sharply from the understanding advanced in the shareholder theory of the firm. According to shareholder theorists such as Nobel laureate economist Milton Friedman, managers ought to serve the interests of the firm's owners, the shareholders. Social obligations of the firm are limited to making good on contracts, obeying the law, and adhering to ordinary moral expectations. In short, obligations to nonshareholders stand as side constraints on the pursuit of shareholder interests. This is the view that informs American corporate law and that Friedman defends in his 1970 New York Times Magazine essay, " The Social Responsibility of Business Is to Increase Its Profits." (Thomas. J. Donaldson, 1994)

Stakeholder theory seeks to overthrow the shareholder orientation of the firm. It is an outgrowth of the corporate social responsibility (CSR) movement to which Friedman's essay responds. According to CSR, the firm is obligated to " give something back" to those that make its success possible. The image of the firm presented in CSR is that of a free rider, unjustly and uncooperatively enriching itself to the detriment of the community. Socially responsible deeds (such as patronizing the arts or mitigating unemployment) are necessary to redeem firms and transform them into good citizens.

One wonders, however, why firms are obligated to give something back to those to whom they routinely give so much already. Rather than enslave their employees, firms typically pay them wages and benefits in return for their labor. Rather than steal from their customers, firms typically deliver goods and services in return for the revenues that customers provide. Rather than free ride on public provisions, firms typically pay taxes and obey the law. Moreover, these compensations are ones to which the affected parties or their agents freely agree. (Thomas. J. Donaldson, 1994)

Stakeholder theory constitutes at least something of an advance over CSR. Whereas CSR is fundamentally antagonistic to capitalist enterprise, viewing both firm and manager as social parasites in need of a strong reformative hand, stakeholder theory takes a different tack. Rather than offer stakeholder theory as a means of overthrowing capitalist enterprise, stakeholder theorists profess to offer theirs as a strategy for improving it. As Robert Phillips of the University of Pennsylvania's Wharton School writes, " One of the goals of the stakeholder theory is to maintain the benefits of the free market while minimizing the potential ethical problems created by capitalism."