BUSINESS ETHICS AND STAKEHOLDER ANALYSIS

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Abstract: Much has been written about stakeholder analysis as a process by which to introduce ethical values into management decision-making. This paper takes a critical look at the assumptions behind this idea, in an effort to understand better the meaning of ethical management decisions.

A distinction is made between stakeholder analysis and stakeholder synthesis. The two most natural kinds of stakeholder synthesis are then defined and discussed: strategic and multi-fiduciary. Paradoxically, the former appears to yield business without ethics and the latter appears to yield ethics without business. The paper concludes by suggesting that a third approach to stakeholder thinking needs to be developed, one that avoids the paradox just mentioned and that clarifies for managers (and directors) the legitimate role of ethical considerations in decision-making.

So we must think through what management should be accountable for; and how and through whom its accountability can be discharged. The stockholders' interest, both short- and long-term, is one of the areas. But it is only one.

Peter Drucker, 1988
Harvard Business Review

WHAT is ethically responsible management? How can a corporation, given its economic mission, be managed with appropriate attention to ethical concerns? These are central questions in the field of business ethics. One approach to answering such questions that has become popular during the last two decades is loosely referred to as "stakeholder analysis." Ethically responsible management, it is often suggested, is management that includes careful attention not only to stockholders *but to stakeholders generally* in the decision-making process.

This suggestion about the ethical importance of stakeholder analysis contains an important kernel of truth, but it can also be misleading. Comparing the ethical relationship between managers and stockholders with their relationship to other stakeholders is, I will argue, almost as problematic as ignoring stakeholders (ethically) altogether—presenting us with something of a "stakeholder paradox."

Definition

The term "stakeholder" appears to have been invented in the early '60s as a deliberate play on the word "stockholder" to signify that there are other parties having a "stake" in the decision-making of the modern, publicly-held corporation in addition to those holding equity positions. Professor R. Edward Freeman, in his book *Strategic Management: A Stakeholder Approach* (Pitman, 1984), defines the term as follows:

> A stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the organization's objectives. (46)

Examples of stakeholder groups (beyond stockholders) are employees, suppliers, customers, creditors, competitors, governments, and communities. *Exhibit 1* illustrates one way of picturing the conventional stakeholder groups along with the two principal channels through which they often affect the corporation, law and markets.

Another metaphor with which the term "stakeholder" is associated is that of a "player" in a game like poker. One with a "stake" in the game is one who plays and puts some economic value at risk.[1]

Much of what makes responsible decision-making difficult is understanding how there can be an ethical relationship between management and stakeholders that avoids being too weak (making stakeholders mere means to stockholders' ends) or too strong (making stakeholders quasi-stockholders in their own right). To give these issues life, a case example will help. So let us consider the case of General Motors and Poletown.

The Poletown Case[2]

In 1980, GM was facing a net loss in income, the first since 1921, due to intense foreign competition. Management realized that major capital expenditures would be required for the company to regain its competitive position and profitability. A $40 billion five year capital spending program was announced that included new, state-of-the-art assembly techniques aimed at smaller, fuel-efficient automobiles demanded by the market. Two aging assembly plants in Detroit were among the ones to be replaced. Their closure would eliminate 500 jobs. Detroit in 1980 was a city with a black majority, an unemployment rate of 18% overall and

30% for blacks, a rising public debt and a chronic budget deficit, despite high tax rates.

The site requirements for a new assembly plant included 500 acres, access to long-haul railroad and freeways, and proximity to suppliers for "just-in-time" inventory management. It needed to be ready to produce 1983 model year cars beginning in September 1982. The only site in Detroit meeting GM's requirements was heavily settled, covering a section of the Detroit neighborhood of Poletown. Of the 3,500 residents, half were black. The whites were mostly of Polish descent, retired or nearing retirement. An alternative "green field" site was available in another midwestern state.

Using the power of eminent domain, the Poletown area could be acquired and cleared for a new plant within the company's timetable, and the city government was eager to cooperate. Because of job retention in Detroit, the leadership of the United Auto Workers was also in favor of the idea. The Poletown Neighborhood Council strongly opposed the plan, but was willing to work with the city and GM.

The new plant would employ 6,150 workers and would cost GM $500 million wherever it was built. Obtaining and preparing the Poletown site would cost an additional $200 million, whereas alternative sites in the midwest were available for $65-80 million.

The interested parties were many—stockholders, customers, employees, suppliers, the Detroit community, the midwestern alternative, the Poletown neighborhood. The decision was difficult. GM management needed to consider its competitive situation, the extra costs of remaining in Detroit, the consequences to the city of leaving for another part of the midwest, and the implications for the residents of choosing the Poletown site if the decision was made to stay. The decision about whom to talk to and *how* was as puzzling as the decision about *what* to do and *why*.

I. Stakeholder Analysis and Stakeholder Synthesis

Ethical values enter management decision-making, it is often suggested, through the gate of stakeholder analysis. But the suggestion that introducing "stakeholder analysis" into business decisions is the same as introducing ethics into those decisions is questionable. To make this plain, let me first distinguish between two importantly different ideas: stakeholder analysis and stakeholder synthesis. I will then examine alternative kinds of stakeholder synthesis with attention to ethical content.

The decision-making process of an individual or a company can be seen in terms of a sequence of six steps to be followed after an issue or problem presents itself for resolution.[3] For ease of reference and recall, I will name the sequence PASCAL, after the six letters in the name of the French philosopher-mathematician Blaise Pascal (1623-62), who once remarked in reference to ethical decision-making that "the heart has reasons the reason knows not of."

(1) PERCEPTION or fact-gathering about the options available and their short- and long-term implications;
(2) ANALYSIS of these implications with specific attention to affected parties and to the decision-maker's goals, objectives, values, responsibilities, etc.;
(3) SYNTHESIS of this structured information according to whatever fundamental priorities obtain in the mindset of the decision-maker;
(4) CHOICE among the available options based on the synthesis;
(5) ACTION or implementation of the chosen option through a series of specific requests to specific individuals or groups, resource allocation, incentives, controls, and feedback;
(6) LEARNING from the outcome of the decision, resulting in either reinforcement or modification (for future decisions) of the way in which the above steps have been taken.

We might simplify this analysis, of course, to something like "input," "decision," and "output," but distinguishing interim steps can often be helpful. The main point is that the path from the presentation of a problem to its resolution must somehow involve gathering, processing, and acting on relevant information.

Now, by *stakeholder analysis* I simply mean a process that does not go beyond the first two steps mentioned above. That is, the affected parties caught up in each available option are identified and the positive and negative impacts on each stakeholder are determined. But questions having to do with processing this information into a decision and implementing it are *left unanswered.* These steps are not part of the *analysis* but of the *synthesis*, *choice*, and *action*.

Stakeholder analysis may give the initial appearance of a decision-making process, but in fact it is only a *segment* of a decision-making process. It represents the preparatory or opening phase that awaits the crucial application of the moral (or nonmoral) values of the decision-maker. So, to be informed that an individual or an institution regularly makes stakeholder analysis part of decision-making or takes a "stakeholder approach" to management is to learn little or nothing about the ethical character of that individual or institution. It is to learn only that stakeholders are regularly identified—*not why and for what purpose*. To be told that stakeholders are or must be "taken into account" is, so far, to be told very little. Stakeholder analysis is, as a practical matter, morally *neutral*. It is therefore a mistake to see it as a substitute for normative ethical thinking.[4]

What I shall call "stakeholder synthesis" goes further into the sequence of decision-making steps mentioned above to include actual decision-making and implementation (S,C,A). The critical point is that stakeholder synthesis offers *a pattern or channel by which to move from stakeholder identification to a practical response or resolution*. Here we begin to join stakeholder analysis to questions of substance. But we must now ask: What kind of substance? And how does it relate to *ethics*? The stakeholder idea, remember, is typically offered as a way of integrating *ethical* values into management decision-making. When and how does substance become *ethical* substance?

Strategic Stakeholder Synthesis

We can imagine decision-makers doing "stakeholder analysis" for different underlying reasons, not always having to do with ethics. A management team, for example, might be careful to take positive and (especially) negative stakeholder effects into account for no other reason than that offended stakeholders might resist or retaliate (e.g., through political action or opposition to necessary regulatory clearances). It might not be *ethical* concern for the stakeholders that motivates and guides such analysis, so much as concern about potential impediments to the achievement of strategic objectives. Thus positive and negative effects on relatively powerless stakeholders may be ignored or discounted in the synthesis, choice, and action phases of the decision process.[5]

In the Poletown case, General Motors might have done a stakeholder analysis using the following reasoning: our stockholders are the central stakeholders here, but other key stakeholders include our suppliers, old and new plant employees, the City of Detroit, and the residents of Poletown. These other stakeholders are not our direct concern as a corporation with an economic mission, but since they can influence our short- or long-term strategic interests, they must be taken into account. Public relation's costs and benefits, for example, or concerns about union contracts or litigation might well have influenced the choice between staying in Detroit and going elsewhere.

I refer to this kind of stakeholder synthesis as "strategic" since stakeholders outside the stockholder group are viewed instrumentally, as factors potentially affecting the overarching goal of optimizing stockholder interests. They are taken into account in the decision-making process, but as external environmental forces, as potential sources of either good will or retaliation. "We" are the economic principals and management; "they" are significant players whose attitudes and future actions might affect our short-term or long-term success. We must respect them in the way one "respects" the weather—as a set of forces to be reckoned with.[6]

It should be emphasized that managers who adopt the strategic stakeholder approach are not necessarily *personally* indifferent to the plight of stakeholders who are "strategically unimportant." The point is that *in their role as managers*, with a fiduciary relationship that binds them as agents to principals, their basic outlook subordinates other stakeholder concerns to those of stockholders. Market and legal forces are relied upon to secure the interests of those whom strategic considerations might discount. This reliance can and does take different forms, depending on the emphasis given to market forces on the one hand and legal forces on the other. A more conservative, market-oriented view acknowledges the role of legal compliance as an environmental factor affecting strategic choice, but thinks stakeholder interests are best served by minimal interference from the public sector. Adam Smith's "invisible hand" is thought to be the most important guarantor of the common good in a competitive economy. A more liberal view sees the hand of government, through legislation and regulation, as essential for representing stakeholders that might otherwise not achieve "standing" in the strategic decision process.

What both conservatives and liberals have in common is the conviction that the fundamental orientation of management must be toward the interests of stockholders. Other stakeholders (customers, employees, suppliers, neighbors) enter the decision-making equation either directly as instrumental economic factors or indirectly as potential legal claimants. (See again *Exhibit 1*.) Both see law and regulation as providing a voice for stakeholders that goes beyond market dynamics. They differ about how much government regulation is socially and economically desirable.

During the Poletown controversy, GM managers as individuals may have cared deeply about the potential lost jobs in Detroit, or about the potential dislocation of Poletown residents. But in their role as agents for the owners (stockholders) they could only allow such considerations to "count" if they served GM's strategic interests (or perhaps as legal constraints on the decision).

Professor Freeman (1984, cited above) appears to adopt some form of strategic stakeholder synthesis. After presenting his definition of stakeholders, he remarks about its application to any group or individual "who can *affect* or is *affected by*" a company's achievement of its purposes. The "affect" part of the definition is not hard to understand; but Freeman clarifies the "affected by" part:

> The point of strategic management is in some sense to chart a direction for the firm. Groups which can affect that direction and its implementation must be considered in the strategic management process. However, it is less obvious why "those groups who are affected by the corporation" are stakeholders as well... I make the definition symmetric because of the changes which the firm has undergone in the past few years. Groups which 20 years ago had no effect on the actions of the firm, can affect it today, largely because of the actions of the firm which ignored the effects on these groups. Thus, by calling those affected groups "stakeholders," the ensuing strategic management model will be sensitive to future change... (46)

Freeman might have said "who can actually or potentially affect" the company, for the mind-set appears to be one in which attention to stakeholders is justified in terms of actual or potential impact on the company's achievement of its strategic purposes. Stakeholders (other than stockholders) are actual or potential means/obstacles to corporate objectives. A few pages later, Freeman writes:

> From the standpoint of strategic management, or the achievement of organizational purpose, we need an inclusive definition. We must not leave out any group or individual who can affect or is affected by organizational purpose, *because that group may prevent our accomplishments*. (52) [Emphasis added.]

The essence of a strategic view of stakeholders is not that stakeholders are ignored, but that all but a special group (stockholders) are considered on the basis of their actual or potential influence on management's central mission. The basic normative principle is fiduciary responsibility (organizational prudence), supplemented by legal compliance.

Is the Substance Ethical?

The question we must ask in thinking about a strategic approach to stakeholder synthesis is this: Is it really an adequate rendering of the *ethical* component in managerial judgment? Unlike mere stakeholder *analysis*, this kind of synthesis does go beyond simply *identifying* stakeholders. It integrates the stakeholder information by using a single interest group (stockholders) as its basic normative touchstone. If this were formulated as an explicit rule or principle, it would have two parts and would read something like this: (1) Maximize the benefits and minimize the costs to the stockholder group, short- and long-term, and (2) Pay close attention to the interests of other stakeholder groups that might potentially influence the achievement of (1). But while expanding the list of stakeholders may be a way of "enlightening" self-interest for the organization, is it really a way of introducing ethical values into business decision-making?

There are really two possible replies here. The first is that as an account of how ethics enters the managerial mind-set, the strategic stakeholder approach fails not because it is *im*moral; but because it is *non*moral. By most accounts of the nature of ethics, a strategic stakeholder synthesis would not qualify as an ethical synthesis, even though it does represent a substantive view. The point is simply that while there is nothing necessarily *wrong* with strategic reasoning about the consequences of one's actions for others, the kind of concern exhibited should not be confused with what most people regard as *moral* concern. Moral concern would avoid injury or unfairness to those affected by one's actions because it is wrong, regardless of the retaliatory potential of the aggrieved parties.[7]

The second reply does question the morality (*vs.* immorality) of strategic reasoning as the ultimate principle behind stakeholder analysis. It acknowledges that strategy, when placed in a highly effective legal and regulatory environment and given a time-horizon that is relatively long-term, may well avoid significant forms of anti-social behavior. But it asserts that as an operating principle for managers under time pressure in an imperfect legal and regulatory environment, strategic analysis is insufficient. In the Poletown case, certain stakeholders (e.g., the citizens of Detroit or the residents of Poletown) may have merited more *ethical* consideration than the strategic approach would have allowed. Some critics charged that GM only considered these stakeholders *to the extent that* serving their interests also served GM's interests, and that as a result, their interests were undermined.

Many, most notably Nobel Laureate Milton Friedman, believe that market and legal forces are adequate to translate or transmute ethical concerns into straightforward strategic concerns for management. He believes that in our economic and political system (democratic capitalism), direct concern for stakeholders (what Kant might have called "categorical" concern) is unnecessary, redundant, and inefficient, not to mention dishonest:

> In many cases, there is a strong temptation to rationalize actions as an exercise of "social responsibility." In the present climate of opinion, with its widespread aversion to "capitalism," "profits," the "soulless corporation" and so on, this is one way for a corporation to generate good will as a by-product of expenditures that are entirely justified in its own self-interest. If our institutions, and the attitudes of the public make it in their self-interest to cloak their actions in this way, I cannot summon much indignation to denounce them. At the same time, I can express admiration for those individual proprietors or owners of closely held corporations or stockholders of more broadly held corporations who disdain such tactics as approaching fraud.

Critics respond, however, that absent a pre-established harmony or linkage between organizational success and ethical success, some stakeholders, some of the time, will be affected a lot but will be able to affect in only a minor way the interests of the corporation. They add that in an increasingly global business environment, even the protections of law are fragmented by multiple jurisdictions.

At issue then is (1) defining ethical behavior partly in terms of the (nonstrategic) decision-making values *behind* it, and (2) recognizing that too much optimism about the correlation between strategic success and virtue runs the risk of tailoring the latter to suit the former.

Thus the move toward substance (from analysis to synthesis) in discussions of the stakeholder concept is not necessarily a move toward ethics. And it is natural to think that the reason has to do with the instrumental status accorded to stakeholder groups other than stockholders. If we were to treat all stakeholders by strict analogy with stockholders, would we have arrived at a more ethically satisfactory form of stakeholder synthesis? Let us now look at this alternative, what I shall call a "multi-fiduciary" approach.

Multi-Fiduciary Stakeholder Synthesis

In contrast to a strategic view of stakeholders, one can imagine a management team processing stakeholder information by giving the same care to the interests of, say, employees, customers, and local communities as to the economic interests of stockholders. This kind of substantive commitment to stakeholders might involve trading off the economic advantages of one group against those of another, e.g., in a plant closing decision. I shall refer to this way of integrating stakeholder analysis with decision-making as "multi-fiduciary" since all stakeholders are treated by management as having equally important interests, deserving joint "maximization" (or what Herbert Simon might call "satisficing").

Professor Freeman, quoted earlier, contemplates what I am calling the multi-fiduciary view at the end of his 1984 book under the heading *The Manager As Fiduciary To Stakeholders*:

> Perhaps the most important area of future research is the issue of whether or not a theory of management can be constructed that uses the stakeholder concept to enrich "managerial capitalism," that is, can the notion that managers bear a fiduciary relationship to stockholders or the owners of the firm, be replaced by a concept of management whereby the manager *must* act in the interests of the stakeholders in the organization? (249)

As we have seen, the strategic approach pays attention to stakeholders as to factors that might affect economic interests, so many market forces to which companies must pay attention for competitive reasons. They become actual or potential legal challenges to the company's exercise of economic rationality. The multi-fiduciary approach, on the other hand, views stakeholders apart from their instrumental, economic, or legal clout. It does not see them merely as what philosopher John Ladd once called "limiting operating conditions" on management attention.[8] On this view, the word "stakeholder" carries with it, by the deliberate modification of a single phoneme, a dramatic shift in managerial outlook.

In 1954, famed management theorist Adolf Berle conceded a long-standing debate with Harvard law professor E. Merrick Dodd that looks in retrospect very much like a debate between what we are calling strategic and multi-fiduciary interpretations of stakeholder synthesis. Berle wrote:

> Twenty years ago, [I held] that corporate powers were powers in trust for shareholders while Professor Dodd argued that these powers were held in trust for the entire community. The argument has been settled (at least for the time being) squarely in favor of Professor Dodd's contention. (Quoted in Ruder, see below.)

The intuitive idea behind Dodd's view, and behind more recent formulations of it in terms of "multiple constituencies" and "stakeholders, not just stockholders" is that by expanding the list of those in whose trust corporate management must manage, we thereby introduce ethical responsibility into business decision-making.

In the context of the Poletown case, a multi-fiduciary approach by GM management might have identified the same stakeholders. But it would have considered the interests of employees, the city of Detroit, and the

Poletown residents *alongside* stockholder interests, not solely in terms of how they might *influence* stockholder interests. This may or may not have entailed a different outcome. But it probably would have meant a different approach to the decision-making process in relation to the residents of Poletown (talking with them, for example).

We must now ask, as we did of the strategic approach: How satisfactory is multi-fiduciary stakeholder synthesis as a way of giving ethical substance to management decision-making? On the face of it, and in stark contrast to the strategic approach, it may seem that we have at last arrived at a truly moral view. But we should be cautious. For no sooner do we think we have found the proper interpretation of ethics in management than a major objection presents itself. And, yes, it appears to be a *moral* objection!

It can be argued that multi-fiduciary stakeholder analysis is simply incompatible with widely-held moral convictions about the special fiduciary obligations owed by management to stockholders. At the center of the objection is the belief that the obligations of agents to principals are stronger or different in kind from those of agents to third parties.

The Stakeholder Paradox

Managers who would pursue a multi-fiduciary stakeholder orientation for their companies must face resistance from those who believe that a strategic orientation is the only *legitimate* one for business to adopt, given the economic mission and legal constitution of the modern corporation. This may be disorienting since the word "illegitimate" has clear negative ethical connotations, and yet the multi-fiduciary approach is often defended on ethical grounds. I will refer to this anomalous situation as the *Stakeholder Paradox*:

> It seems essential, yet in some ways illegitimate, to orient corporate decisions by ethical values that go beyond strategic stakeholder considerations to multi-fiduciary ones.

I call this a paradox because it says there is an ethical problem whichever approach management takes. Ethics seems both to forbid and to demand a strategic, profit-maximizing mind-set. The argument behind the paradox focuses on management's *fiduciary* duty to the stockholder, essentially the duty to keep a profit-maximizing promise, and a concern that the "impartiality" of the multi-fiduciary approach simply cuts management loose from certain well-defined bonds of stockholder accountability. On this view, impartiality is thought to be a *betrayal of trust.*

Professor David S. Ruder, a former chairman of the Securities and Exchange Commission, once summarized the matter this way:

> Traditional fiduciary obligation theory insists that a corporate manager owes an obligation of care and loyalty to shareholders. If a public obligation theory unrelated to profit maximization becomes the law, the corporate manager who is not able to act in his own self interest without violating his fiduciary obligation, may nevertheless act in the public interest without violating that obligation.[9] (226).

Ruder continued:

> Whether induced by government legislation, government pressure, or merely by enlightened attitudes of the corporation regarding its long range potential as a unit in society, corporate activities carried on in satisfaction of public obligations can be consistent with profit maximization objectives. In contrast, justification of public obligations upon bold concepts of public need without corporate benefit will merely serve to reduce further the owner's influence on his corporation and to create additional demands for public participation in corporate management. (228-9)

Ruder's view appears to be that (a) multi-fiduciary stakeholder synthesis *need not* be used by management because the strategic approach is more accommodating than meets the eye; and (b) multi-fiduciary stakeholder synthesis should not be invoked by management because such a "bold" concept could threaten the private (*vs.* public) status of the corporation.

In response to (a), we saw earlier that there were reasonable questions about the tidy convergence of ethics and economic success. Respecting the interests and rights of the Poletown residents might really have meant incurring higher costs for GM (short-term as well as long-term).

Appeals to corporate self-interest, even long-term, might not always support ethical decisions. But even on those occasions where they will, we must wonder about the disposition to favor economic and legal reasoning "for the record." If Ruder means to suggest that business leaders can often *reformulate* or *re-present* their reasons for certain morally-grounded decisions in strategic terms having to do with profit maximization and obedience to law, he is perhaps correct. In the spirit of our earlier quote from Milton Friedman, we might not summon much indignation to denounce them. But why the fiction? Why not call a moral reason a moral reason?

This issue is not simply of academic interest. Managers must confront it in practice. In one major public company, the C.E.O. put significant resources behind an affirmative action program and included the following explanation in a memo to middle management:

> I am often asked why this is such a high priority at our company. There is, of course, the obvious answer that it is in our best interest to seek out and employ good people in all sectors of our society. And there is the answer that enlightened self-interest tells us that more and more of the younger people, whom we must attract as future employees, choose companies by their social records as much as by their business prospects. *But the one overriding reason for this emphasis is because it is right.* Because this company has always set for itself the objective of assuming social as well as business obligations. Because that's the kind of company we have been. And with your participation, that's the kind of company we'll continue to be.[10]

In this connection, Ruder reminds us of what Professor Berle observed over twenty-five years ago:

> The fact is that boards of directors or corporation executives are often faced with situations in which they quite humanly and simply consider that such and such is the decent thing to do and ought to be done... They apply the potential profits or public relations tests later on, a sort of left-handed justification in this curious free-market world where an obviously moral or decent or humane action has to be apologized for on the ground that, conceivably, you may somehow make money by it. (*Ibid.*)

The Problem of Boldness

What appears to lie at the foundation of Ruder's cautious view is a concern about the "boldness" of the multi-fiduciary concept [(b) above].[11] It is not that he thinks the strategic approach is always satisfactory; it is that the multi-fiduciary approach is, in his eyes, much worse. For it questions the special relationship between the manager as agent and the stockholder as principal.

Ruder suggests that what he calls a "public obligation" theory threatens the private status of the corporation. He believes that what we are calling multi-fiduciary stakeholder synthesis *dilutes* the fiduciary obligation to stockholders (by extending it to customers, employees, suppliers, etc.) and he sees this as a threat to the "privacy" of the private sector organization. If public obligations are understood on the model of public sector institutions with their multiple constituencies, Ruder thinks, the stockholders loses status.

There is something profoundly *right* about Ruder's line of argument here, I believe, and something profoundly *wrong*. What is right is his intuition that if we treat other stakeholders on the model of the fiduciary relationship between management and the stockholder, we will, in effect, make them into quasi-stockholders. We can do this, of course, if we choose to as a society. But we should be aware that it is a radical step indeed. For it blurs traditional goals in terms of entrepreneurial risk-taking, pushes decision-making towards paralysis because of the dilemmas posed by divided loyalties and, in the final analysis, represents nothing less than the conversion of the modern private corporation into a public institution and probably calls for a corresponding restructuring of corporate governance (e.g., representatives of each stakeholder group on the board of directors). Unless we believe that the social utility of a private sector has disappeared, not to mention its value for individual liberty and enterprise, we will be cautious about an interpretation of stakeholder synthesis that transforms the private sector into the public sector.

On the other hand, I believe Ruder is mistaken if he thinks that business ethics requires this kind of either/or: either a private sector with a strategic stakeholder synthesis (business without ethics) or the effective loss of the private sector with a multi-fiduciary stakeholder synthesis (ethics without business).

Recent debates over state laws protecting companies against hostile takeovers may illustrate Ruder's concern as well as the new challenge. According to one journalist, a recent Pennsylvania anti-takeover law

> does no less than redefine the fiduciary duty of corporate directors, enabling them to base decisions not merely on the interests of shareholders, but on the interests of customers, suppliers, employees and the community at large. Pennsylvania is saying that it is the corporation that directors are responsible to. Shareholders say they always thought they themselves were the corporation.

Echoing Ruder, one legal observer quoted by Elias (*ibid.*) commented with reference to this law that it "undermines and erodes free makets and property rights. From this perspective, this is an anticapitalist law. The management can take away property from the real owners."

In our terms, the state of Pennsylvania is charged with adopting a multifiduciary stakeholder approach in an effort to rectify deficiencies of the strategic approach which (presumably) corporate raiders hold.

The challenge that we are thus presented with is to develop an account of the moral responsibilities of management that (i) avoids surrendering the moral relationship between management and stakeholders as the strategic view does, while (ii) not transforming stakeholder obligations into fiduciary obligations (thus protecting the uniqueness of the principal-agent relationship between management and stockholder).

II. Toward a New Stakeholder Synthesis

We all remember the story of the well-intentioned Doctor Frankenstein. He sought to improve the human condition by designing a powerful, intelligent force for good in the community. Alas, when he flipped the switch, his creation turned out to be a monster rather than a marvel! Is the concept of the ethical corporation like a Frankenstein monster?

Taking business ethics seriously need not mean that management bears *additional* fiduciary relationships to third parties (nonstockholder constituencies) as multi-fiduciary stakeholder synthesis suggests. It may mean that there are morally significant *nonfiduciary* obligations to third parties surrounding any fiduciary relationship (See *Figure 1.*) Such moral obligations may be owed by private individuals as well as private-sector organizations to those whose freedom and well-being is affected by their economic behavior. It is these very obligations in fact (the duty not to harm or coerce and duties not to lie, cheat, or steal) that are cited in regulatory, legislative, and judicial arguments for constraining profit-driven business activities. These obligations are not "hypothetical" or contingent or indirect, as they would be on the strategic model, wherein they are only subject to the corporation's interests being met. They are "categorical" or direct. They are not rooted in the *fiduciary* relationship, but in other relationships at least as deep.

	Fiduciary	Non-fiduciary
Stockholders	●	
Other Stakeholders		●

Figure 1. *Direct Managerial Obligations*

It must be admitted in fairness to Ruder's argument that the jargon of "stakeholders" in discussions of business ethics can seem to threaten the notion of what corporate law refers to as the "undivided and unselfish loyalty" owed by managers and directors to stockholders. For this way of speaking can suggest a multiplication of management duties *of the* *same kind* as the duty to stockholders. What we must understand is that the responsibilities of management toward stockholders are of a piece with the obligations that *stockholders themselves* would be expected to honor in their own right. As an old Latin proverb has it, *nemo dat quod non habet*, which literally means "nobody gives what he doesn't have." Freely translating in this context we can say: No one can expect of an *agent* behavior that is ethically less responsible than what he would expect of himself. I cannot (ethically) *hire* done on my behalf what I would not (ethically) *do* myself. We might refer to this as the "Nemo Dat Principle" (NDP) and consider it a formal requirement of consistency in business ethics (and professional ethics generally):

> (NDP) Investors cannot expect of managers (more generally, principals cannot expect of their agents) behavior that would be inconsistent with the reasonable ethical expectations of the community.[13]

The NDP does not, of course, resolve in advance the many ethical challenges that managers must face. It only indicates that these challenges are of a piece with those that face us all. It offers a different kind of test (and so a different kind of stakeholder synthesis) that management (and institutional investors) might apply to policies and decisions.

The foundation of ethics in management—and the way out of the stakeholder paradox—lies in understanding that the conscience of the corporation is a logical and moral extension of the consciences of its principals. It is *not* an expansion of the *list* of principals, but a gloss on the principal-agent relationship itself. Whatever the structure of the principal-agent relationship, neither principal nor agent can ever claim that an agent has "moral immunity" from the basic obligations that would apply to any human being toward other members of the community.

Indeed, consistent with Ruder's belief, the introduction of moral reasoning (distinguished from multi-fiduciary stakeholder reasoning) into the framework of management thinking may *protect* rather than threaten private sector legitimacy. The conscientious corporation can maintain its private economic mission, but in the context of fundamental moral obligations owed by any member of society to others affected by that member's actions. Recognizing such obligations does *not* mean that an institution is a public institution. Private institutions, like private individuals, can be and are bound to respect moral obligations in the pursuit of private purposes.

Conceptually, then, we can make room for a moral posture toward stakeholders that is both *partial* (respecting the fiduciary relationship between managers and stockholders) and *impartial* (respecting the equally important non-fiduciary relationships between management and other stakeholders). As philosopher Thomas Nagel has said, "In the conduct of life, of all places, the rivalry between the view from within and the view from without must be taken seriously."[14]

Whether this conceptual room can be used *effectively* in the face of enormous pressures on contemporary managers and directors is another story, of course. For it is one thing to say that "giving standing to stakeholders" in managerial reasoning is conceptually coherent. It is something else to say that it is practically coherent.

Yet most of us, I submit, believe it. Most of us believe that management at General Motors *owed* it to the people of Detroit and to the people of Poletown to take their (nonfiduciary) interests very seriously, to seek creative solutions to the conflict, to do more than use or manipulate them in accordance with GM's needs only. We understand that managers and directors have a special obligation to provide a financial return to the stockholders, but we also understand that the word "special" in this context needs to be tempered by an appreciation of certain fundamental community norms that go beyond the demands of both laws and markets. There are certain class-action suits that stockholders ought not to win. For there is sometimes a moral defense.

Conclusion

The relationship between management and stockholders is ethically different in kind from the relationship between management and other parties (like employees, suppliers, customers, etc.), a fact that seems to go unnoticed by the multi-fiduciary approach. If it were not, the corporation would cease to be a private sector institution—and what is now called business ethics would become a more radical critique of our economic system than is typically thought. On this point, Milton Friedman must be given a fair and serious hearing.

This does not mean, however, that "stakeholders" lack a morally significant relationship to management, as the strategic approach implies. It means only that the relationship in question is different from a fiduciary one. Management may never have promised customers, employees, suppliers, etc. a "return on investment," but management is nevertheless obliged to take seriously its extra-legal obligations not to injure, lie to or cheat these stakeholders *quite apart from* whether it is in the stockholders' interests.

As we think through the *proper* relationship of management to stakeholders, fundamental features of business life must undoubtedly be recognized: that corporations have a principally economic mission and competence; that fiduciary obligations to investors and general obligations to comply with the law cannot be set aside; and that abuses of economic power and disregard of corporate stewardship in the name of business ethics are possible.

But these things must be recognized as well: that corporations are not solely financial institutions; that fiduciary obligations go beyond short-term profit and are in any case subject to moral criteria in their execution; and that mere compliance with the law can be unduly limited and even unjust.

The *Stakeholder Paradox* can be avoided by a more thoughtful understanding of the nature of moral obligation and the limits it imposes on the principal-agent relationship. Once we understand that there is a practical "space" for identifying the ethical values shared by a corporation and its stockholders—a space that goes beyond strategic self-interest but stops short of impartially—the hard work of filling that space can proceed.

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Notes

This paper derives from a conference in Applied Ethics, *Moral Philosophy in the Public Domain*, held at the University of British Columbia, in June 1990. It will also appear in an anthology currently in preparation at the UBC Centre of Applied Ethics.

[1]Strictly speaking the historical meaning of "stakeholder" in this context is someone who literally *holds* the stakes during play.

[2]See Goodpaster and Piper, *Managerial Decision Making and Ethical Values*, Harvard Business School Publishing Division, 1989.

[3]See Goodpaster, PASCAL: A Framework For Conscientious Decision Making (1989).

[4]Actually, there are subtle ways in which even the stakeholder identification or inventory process might have *some* ethical content. The very process of *identifying* affected parties involves the use of the imagination in a way that can lead to a natural empathetic or caring response to those parties in the synthesis, choice and action phases of decision-making. This is a contingent connection, however, not a necessary one.

[5]Note that including powerless stakeholders in the analysis phase may indicate whether the decision-maker cares about "affecting" them or "being affected by" them.

Also, the inclusion of what might be called secondary stakeholders as advocates for primary stakeholders (e.g., local governments on behalf of certain citizen groups) may signal the values that will come into play in any synthesis.

[6]It should be mentioned that some authors, most notably Kenneth R. Andrews in *The Concept of Corporate Strategy* (Irwin, Third Edition, 1987) employ a broader and more social definition of "strategic" decision-making than the one implied here.

[7]Freeman writes: "Theoretically, 'stakeholder' must be able to capture a broad range of groups and individuals, even though when we put the concept to practical tests we must be willing to ignore certain groups who will have little or no impact on the corporation at this point in time." (52-3)

[8]Ladd observed in a now-famous essay entitled "Morality and the Ideal of Rationality in Formal Organizations" (*The Monist*, 54, 1970) that organizational "rationality" was defined solely in terms of economic objectives: "The interests and needs of the individuals concerned, as individuals, must be considered only insofar as they establish limiting operating conditions. Organizational rationality dictates that these interests and needs must not be considered in their own right or on their own merits. If we think of an organization as a machine, it is easy to see why we cannot reasonably expect it to have any moral obligations to people or for them to have any to it." (507)

[9]"Public Obligations of Private Corporations," *U. of Pennsylvania Law Review*, 114 (1965). Ruder recently (1989) reaffirmed the views in his 1965 article.

[10]Business Products Corporation—Part 1," HBS Case Services 9-377-077.

[11]"The Business Judgement Rule" gives broad latitude to officers and directors of corporations, but calls for reasoning on the basis of the long-term economic interest of the company. And corporate case law ordinarily allows exceptions to profit-maximization criteria only when there are actual or potential *legal* barriers, and limits charitable and humanitarian gifts by the logic of long term self-interest. The underlying rationale is accountability to investors. Recent work by the American Law Institute, however, suggests a rethinking of these matters. See *Exhibit 2*.

[12](Christopher Elias, "Turning Up the Heat on the Top," *Insight*, July 23, 1990).

[13]We might consider the NDP in broader terms that would include the relationship between "client" and "professional" in other contexts, such as law, medicine, education, government, and religion, where normally the community's expectations are embodied in ethical standards.

[14]T. Nagel, *The View from Nowhere*, Oxford U. Press (1986), p. 163.

Exhibit 1

BUSINESS DECISION-MAKING AND ETHICAL VALUES

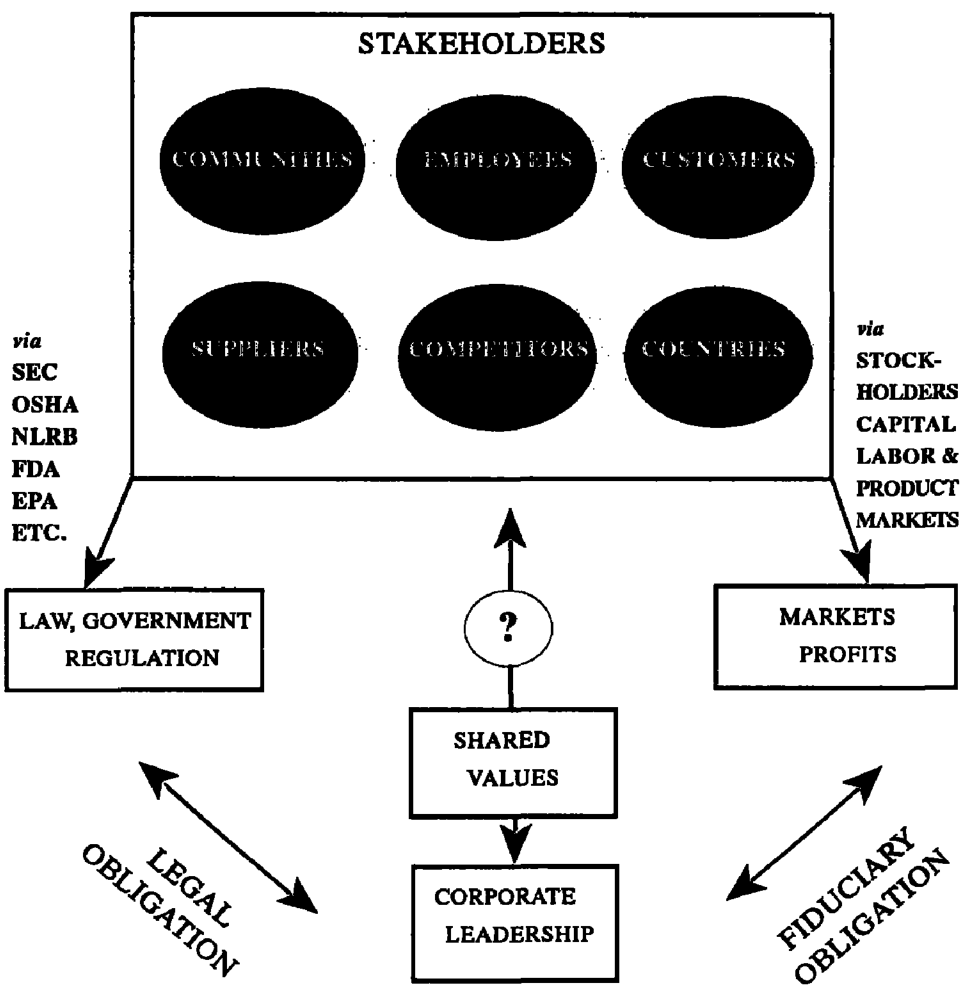

Exhibit 2

The American Law Institute

PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS

Tentative Draft No. 2
(April 13, 1984)

Part II

THE OBJECTIVE AND CONDUCT OF THE BUSINESS CORPORATION

ANALYSIS AND RECOMMENDATION

§201. The Objective and Conduct of the Business Corporation

A business corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain, except that, whether or not corporate profit and shareholder gain are thereby enhanced, the corporation, in the conduct of its business

(a) is obliged, to the same extent as a natural person, to act within the boundaries set by law,

(b) may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business, and

(c) may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.