

STAKEHOLDER AND SHAREHOLDER THEORIES OF THE FIRM

Ethics in Context

Competing Stakeholder Demands at Amazon



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Businesses have a vested interest in managing different stakeholder groups. Similarly, various stakeholders closely monitor what businesses do and how they treat them. While the interests of various stakeholders and businesses may not always align, some view managing stakeholders as an ethical issue. Does a person or a group have the moral right to be treated in a certain way by a company? Later in the chapter, in the Ethics in Context section, we will examine the ethical implications of conflicting stakeholder demands.

Learning Objectives

Upon completion of this chapter, the reader should be able to do the following:

- 1.1 Describe what is a stake and who is a stakeholder.
- 1.2 Explain the difference between shareholder and stakeholder theories of the firm.
- 1.3 Articulate the main issues in the stakeholder and shareholder debate.
- 1.4 Describe stakeholders in terms of issues, powers, and interests.
- 1.5 Assess the issues that may arise when businesses try to manage various stakeholder interests.

INTRODUCTION

The role and influence of a broader set of “stakeholders” of a business organization has become a very common theme in the business and society landscape. Often this perspective is juxtaposed to the “shareholder” perspective. There are many reasons for managers and researchers alike to

think of these two perspectives as if coming from different camps. While there are differences in these two predominant theories of the firm, there are also similarities and overlaps. Each stakeholder has different powers, issues, and interests. And while most stakeholder groups are thought to have certain characteristics, a person can be a part of one or more stakeholder groups simultaneously. Managing multiple stakeholders at one time—something managers are routinely pressured to do—can be a challenge given there are also conflicts between these groups.

DEFINING STAKE AND STAKEHOLDER

LO 1.1 Describe what is a stake and who is a stakeholder.

stake: A kind of interest in or claim on something of value.

claim: A legal entitlement or a right to be treated in a certain way.

To understand the concept of a stakeholder, it helps to start with its root—a **stake**. A stake is a kind of interest in or claim on something of value.¹ For example, a person or a group who is affected by a certain decision has an *interest* in that decision. A **claim** could be a legal entitlement or a right to be treated in a certain way—or even a formal request.² In R. Edward Freeman’s influential book on stakeholder management, “stakes” are multidimensional and represent stakeholders’ issues of concern about the company.³

One additional idea to keep in mind is that multinational corporations (MNCs)—some of the largest of which are Microsoft, Google, FedEx, Diageo, and Marriott—operate in many and varying legal jurisdictions, so they often face additional pressures because the claims made on them may be numerous and therefore difficult to resolve, both for formal reasons, such as differences in legal institutions or competing legal requirements and jurisdictional conflicts, and for informal reasons, such as cultural differences. For example, Google has faced criticism for its practices resulting from differences in the privacy rights of stakeholders in Europe, China, and the United States. We will discuss globalization more in Chapter 16.

stakeholder: Any identifiable group or individual who can affect the achievement of an organization’s objectives or who is affected by the achievement of an organization’s objectives.

The term **stakeholder** was coined by the Stanford Research Institute in the early 1960s, but later, two academic scholars—Edward Freeman and David Reed—proposed a broad definition of stakeholder as “any identifiable group or individual who can affect the achievement of an organization’s objectives or who is affected by the achievement of an organization’s objectives.”⁴ They contrast this definition with a narrow sense of stakeholder as “any identifiable group or individual on which the organization is dependent for its continued survival.”⁵

While the broad sense definition reveals the perception that multiple and varied groups affect and are affected by the firm, termed the *stakeholder perspective* or *theory*, the narrow sense definition can lead to interpretations that shareholders, as a stakeholder group, deserve primacy because they are the foundation of a firm’s survival. Shareholders are directly relevant to the firm’s core economic interest, which represents the *shareholder perspective* or *theory*.⁶ A **shareholder**, or sometimes known as a stockholder or investor, is a person, group, or organization owning one or more shares of stock in a corporation.

shareholder: A person, group, or organization owning one or more shares of stock in a corporation.

Defining Stake and Stakeholder

- A stake is a kind of interest in or claim on something of value.
- A stakeholder is any identifiable group or individual who can affect the achievement of an organization's objectives or who is affected by the achievement of an organization's objectives.
- A shareholder is a person, group, or organization owning one or more shares of stock in a corporation. A shareholder is also stakeholder.

STAKEHOLDER VERSUS SHAREHOLDER THEORIES

LO 1.2 Explain the difference between shareholder and stakeholder theories of the firm.

Theory provides a road map that allows us to make sense of unfamiliar terrain. Even when we think we are just using common sense, there is usually a theory guiding our actions. A **theory** is a set of propositions or concepts that seek to *explain or predict* something.

Stakeholder- and shareholder-oriented theories are both what are called *normative* theories of corporate responsibility—advocating for what a firm *ought* to be—that is, its purpose.⁷ Some theorists have suggested that one perspective should, or will, eventually replace the other⁸ or even that the two are contradictory and incompatible.⁹ Positioning these as distinct theoretical camps has resulted in overlooking the possibility that shareholder and stakeholder perspectives might complement one another.¹⁰

There are two critical questions when talking about theories of the firm. Stakeholder and shareholder theories or perspectives answer these questions differently.

- What is the purpose of the modern corporation?
- To whom, or what, should the firm be responsible?

Stakeholder Theory

There is general consensus that **stakeholder theory** operates when management believes there is a moral obligation for a firm to work toward addressing the needs of customers, employees, suppliers, and the local community as well as shareowners, keeping these needs and interests in “balance” not simply so it will benefit the firm in the long run but because it is the right thing to do.¹¹ It is also generally acknowledged that managers need to engage in making trade-offs but must also be accountable to multiple stakeholder groups.¹²

There is a growing assertion that responsible management, which balances the legitimate stakes of internal and external constituencies, can lead to higher financial return. However, additional research requires a second look at the concern over any real trade-offs between shareholder objectives and social responsibility.¹³

• **theory:** A set of propositions or concepts that seeks to explain or predict something.

• **stakeholder theory:** Creating value for society beyond a pure monetary benefit for shareholders, sometimes referred to as there being a moral obligation to work toward addressing the needs of customers, employees, suppliers, and the local community as well as shareowners, and keeping these needs and interests in balance.

While managers need to focus on generating profits in order to be sustainable, stakeholder theory emphasizes creating value for society beyond a pure monetary benefit for shareholders. Likewise, the obligation of managers extends to consider the interests of all stakeholders even if doing so reduces company profitability.¹⁴

There are three key questions for managers to consider with stakeholder theory:

1. If this decision is made, for whom is value created or destroyed?
2. Whose rights were enabled or not?
3. What kind of person would I be if I make this decision in a particular way?¹⁵

Multinational firms approach stakeholder theory a bit differently. They tend to add local stakeholder obligations as the process of globalization unfolds over time and most often manage these obligations centrally, at the firm's headquarters, but actively allocate responsibilities to subdivisions. This central coordination is most beneficial when it is integrated with already established multinational stakeholder groups which share the firm's goals (e.g., the United Nations Global Compact or the World Wildlife Federation).¹⁶

Shareholder Theory

shareholder theory: A shareholder-oriented view of the firm's responsibilities claims that managers should spend capital, given to them by shareholders initially, in ways that have been authorized by shareholders and act in the shareholders' interests.

fiduciary duty: The trust that *one* party will act in the best interests of another, owing them a duty of loyalty and care.

corporate governance: The rules, processes, and procedures as outlined by an organization's board of directors to ensure accountability, fairness, and transparency among all parties with a claim on the organization.

The **shareholder theory** claims that managers should spend capital, given to them by shareholders initially, in ways that have been authorized by shareholders and act in the shareholders' interests.¹⁷ In fact, some have argued that managers assume what is called a fiduciary duty to use various company resources in ways that have been authorized by the stockholders—regardless of any societal benefits or detriments.¹⁸ **Fiduciary duty** involves trust that *one* party will act in the best interests of another, owing them a duty of loyalty and care.¹⁹ Likewise, there is an underlying belief that shareowners' interests ought to take precedence over the interests of all other groups. In part, the theory and practice of corporate governance relies on this premise. **Corporate governance** is defined as the rules, processes, and procedures as outlined by an organization's board of directors to ensure accountability, fairness, and transparency among all parties with a claim on the organization.

The shareholder theory focuses on the firm's ability to provide long-term market value for shareholders²⁰ regardless of the benefits or detriments to other organizational or societal constituents.²¹ The shareholder view also rests on the belief that a firm is better able to achieve competitive advantage because it allows managers to be unencumbered by other stakeholders' concerns.²² This focus appeals to managers wanting to lower the cost of capital necessary for expansion and consequently gain better access to the capital markets—both of which some argue is the best reasoning for a global convergence of the stockholder form.²³

Generally, this view supports the idea that firms must put shareholders' interests above all others because the firm is the property of its (share)owners. The owners' interests take precedence over the interests of all other groups because of the recognition of a special relationship between the firm and its shareholders.²⁴ Professor Cynthia E. Clark and her colleagues created a table comparing and contrasting some of the key elements of both perspectives, which is adapted in Table 1.1.²⁵

In shareholder theory, managers must ask themselves the following:

1. How do we measure “better” versus “worse” with regard to what we are trying to do?

2. How do we best maximize long-term value?
3. Who should decide value: managers or shareholders?²⁶

Table 1.1 Stakeholder and Shareholder Theories

Characteristic	Stakeholder Theory	Shareholder Theory
Fiduciary relations	Multifiduciary—Obligations of loyalty and care are owed to multiple parties. ⁱ	Single fiduciary—Shareholders have a special role, and these obligations are owed only to them. ⁱⁱ
Moral claim	Shareowner's theory is morally untenable. ⁱⁱⁱ	Stakeholder theory is morally inadequate. ^{iv}
Sources of legitimacy	Stakeholders' relationship with firm; nature of request	Shareholder primacy ^v
Sources of power	Access to resources ^{vi}	Residual risk bearers ^{vii}
Basis of strategy	Stakeholders have intrinsic value; management selects activities and directs resources to obtain benefits for legitimate stakeholders. ^{viii}	Direct resources and capabilities are toward shareholder value; management has free hand to direct externalities to society and even may have obligation to do so.
Governance mechanism	Nonshareholding stakeholders should have board representation.	Manager (agent) works on behalf of principal (owner); only shareowners have representation on board and voting rights; and shareholders ought to have control. ^{ix}
Attitude toward social responsibility or purpose	"The survival and continuing profitability of the corporation depend upon its ability to fulfill its economic and social purpose, which is to create and distribute wealth or value sufficient to ensure that each primary stakeholder group continues as part of the corporation's stakeholder system" (Clarkson, 1995, p. 110). ^x	"What does it mean to say that 'business' has responsibilities? Only people can have responsibilities. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom" (Friedman, 1970). ^{xi}

ⁱFor a discussion of both approaches, see Goodpaster, K. E. (1991). Business ethics and stakeholder analysis. *Business Ethics Quarterly*, 1, 53–73.

ⁱⁱSee Marcoux, A. M. (2003). A fiduciary argument against stakeholder theory. *Business Ethics Quarterly*, 13, 1–24.

ⁱⁱⁱThis is mainly based on an article by Donaldson, T., & Preston, L. E. (1995). The stakeholder theory of the corporation: Concepts, evidence, and implications. *Academy of Management Review*, 20, 65–91; it is also based on related citations.

^{iv}This is mainly based on an article by Marcoux (2003) and related citations.

^vShareholder primacy tends to regularly render legitimate all corporate efforts on behalf of shareholders and to render irregular those efforts on behalf of other constituents and, further, that such efforts need of some type of justification—cf. Boatright, J. R. (1994). Fiduciary duties and the shareholder-management relation: Or, what's so special about shareholders. *Business Ethics Quarterly*, 4, 393–407.

^{vi}See Frooman, J. (1999). Stakeholder influence strategies. *Academy of Management Review*, 24, 191–205; Eesley, C., & Lenox, M. J. (2006). Firm responses to secondary stakeholder action. *Strategic Management Journal*, 27, 765–781.

^{vii}See Boatright (1994).

^{viii}See Donaldson & Preston (1995).

^{ix}See Boatright, J. R. (2006). What's wrong—and what's right—with stakeholder management. *Journal of Private Enterprise*, 21, 106–130.

^xClarkson, M. B. E. (1995). A stakeholder framework for analyzing and evaluating corporate social performance. *Academy of Management Review* 20, 92–127.

^{xi}Friedman, M. (1970, September 13). The social responsibility of business is to increase its profits. *The New York Times Magazine*, 32–33, 122, 124, 126.

Source: Adapted from Clark, C. E., Steckler, E. L., & Newell, S. (2016). Managing contradiction: Stockholder and stakeholder views of the firm as paradoxical opportunity. *Business and Society Review*, 121, 123–159.

Stakeholder Versus Shareholder Theories

- Both theories are *normative* theories, and both advocate for what a firm *ought* to be: the purpose the firm plays in society.
- The *shareholder theory* supports the idea that firms must put shareholders' interests above all others because the firm is the property of its (share) owners. The owners' interests take precedence over the interests of all other groups because of the recognition of this special relationship.
- The *stakeholder theory* supports the idea that there is a moral obligation for a firm to work toward addressing the needs of customers, employees, suppliers, and the local community as well as shareowners not simply so it will benefit the firm in the long run but because it is the right thing to do.

THE STAKEHOLDER AND SHAREHOLDER DEBATE

LO 1.3 Articulate the main issues in the stakeholder and shareholder debate.

There is considerable debate about which theory is better at describing how a company should operate. This debate is ongoing and complex. There are descriptive, instrumental, normative, moral, and legal arguments in this debate.

The Stakeholder Arguments

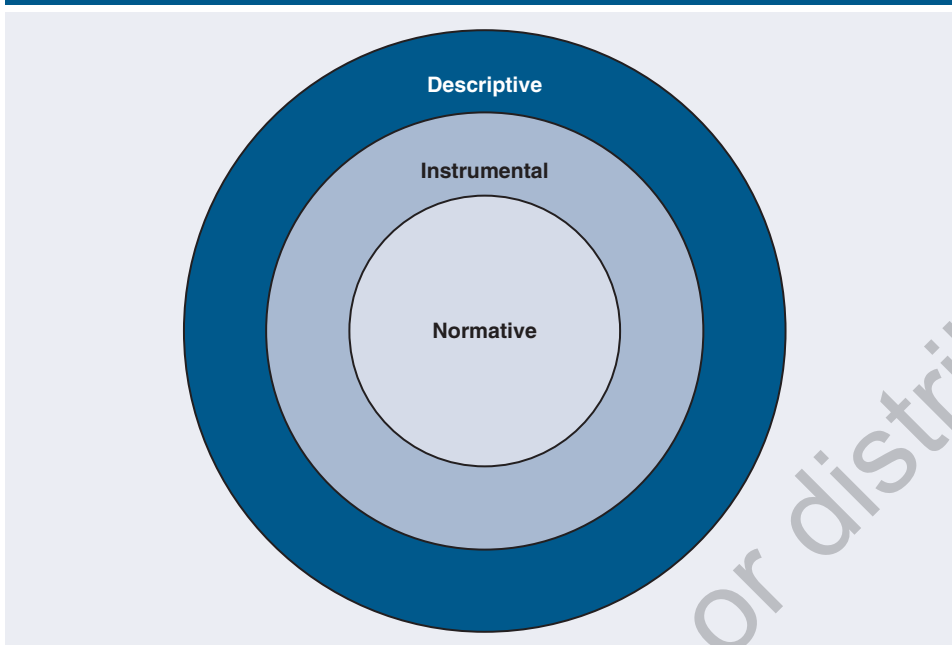
In an attempt to clarify and justify the stakeholder theory over the shareholder theory, researchers Tom Donaldson and Lee Preston conceptualized the descriptive, instrumental, and normative arguments. These authors model these three aspects of the theory in a bull's-eye fashion, with normative at the core and descriptive at the outer edge (see Figure 1.1).

Stakeholder theory defined in a descriptive manner literally describes how firms operate, arguing that the stakeholder approach is more representative of how firms truly operate. There is little doubt that stakeholder language is very common; for example, corporate websites, brochures, and Instagram posts are filled with firm's using the word *stakeholder* or expressing their concern for stakeholders.

Stakeholder theory defined from an instrumental perspective is characterized by attempts to find evidence of connections between stakeholder management and positive financial performance. Stakeholders are a means to an end in that they contribute to achieving better performance overall. Here, firms are more likely to work toward the goal of better financial performance and see stakeholders as secondary.

Defining *stakeholder theory* from a normative perspective, stakeholders have value regardless of their instrumental use to managers or the firm. Adopting this view requires managers to endorse the attitude that all stakeholders have a legitimate stake in the firm, that they have *intrinsic* value. Here, firms work directly with stakeholders because they are a primary concern. In fact, Donaldson and Preston argue that stakeholder theory is fundamentally normative because of its guidance about what are right and wrong behaviors. In other words, a stakeholder approach should be adopted simply because it is the right thing

Figure 1.1 Stakeholder Theory Bull's-Eye



to do. What's more is they maintain that a shareholder approach to the firm, which treats one group as superior, is therefore not morally supportable.

The Shareholder Arguments

Some shareholder theorists, in turn, claim a lack of a moral foundation in stakeholder theory. The main criticism of stakeholder theory by shareholder theorists is that it appears morally and practically unworkable to orient firms' decisions that bear on the fiduciary duties of managers to anyone but stockholders. Because shareholders hold a special moral status in their relationship with managers, a stakeholder approach is morally inadequate.²⁷ This description of fiduciary duties refers to a prioritization, a commitment to advancing the interests of that special group over those of another party—very much like a doctor has to a patient. From this perspective, a firm simply cannot have multiple fiduciary duties (as stakeholder theory asserts) because if it did it would require trade-offs, compromises, and multiple loyalties that it cannot sustain because of the very meaning of the word *fiduciary*.²⁸

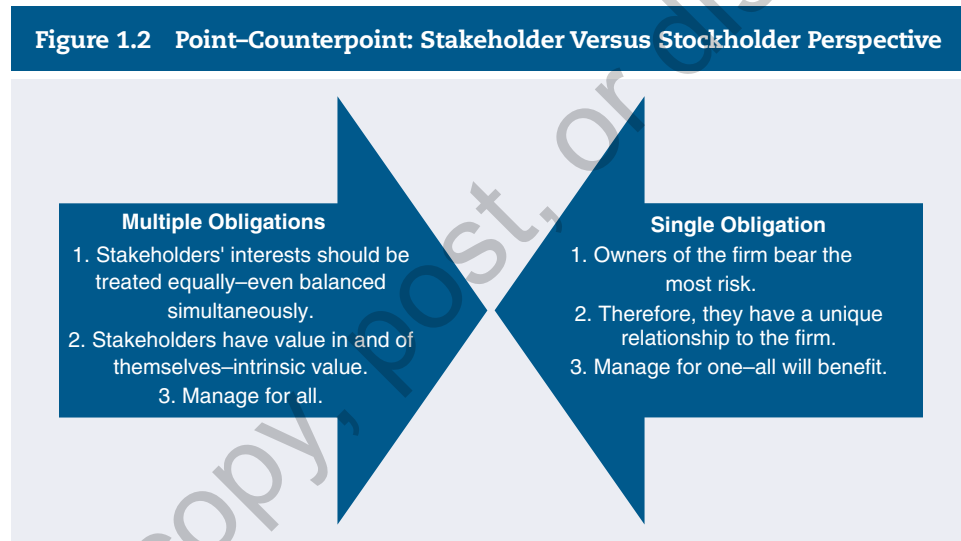
Finally, a legal perspective on the debate is provided by Professor Lynn Stout, who observes that shareholder primacy is often granted as a result of ownership, which she noted is not quite accurate legally.²⁹ From a legal standpoint, she contends, stockholders do not own the corporation but merely a stock. This stock provides the stockholder with certain rights, which are limited. For example, Stout highlights that stockholders do not have the right to control the firm's assets or to decide on the distribution of the firm's earnings. Stout also notes that shareholder primacy is often granted on the premise that stockholders are the sole residual claimants of the firm, which, from a legal position, stockholders are only residual claimants in the case of bankruptcy. But even if the law cannot be counted on to enforce the

shareholder theory, economic forces might drive the board of directors and thus the managers they oversee to embrace it.³⁰ Figure 1.2 is illustrative of each side of the debate.

Is One Right and One Wrong?

Given these contradictory arguments, some suggest the stakeholder and stockholder debate is based on a series of misrepresentations about what they stand for (see Table 1.2) and that they are not mutually exclusive.³¹

For one, numerous stakeholders can benefit from managers prioritizing the interests of shareholders. For example, some argue that all constituents are better off when the firm is run for shareholders because it forces an accountable management of the firm’s assets and creates greater overall wealth.³² Professor John Boatright thinks that “any successful corporation must manage its relations with all stakeholder groups, if for no other reason than to benefit the shareholders” by not necessarily serving each group’s interest but by considering their interests “sufficiently to gain their cooperation.”³³



Source: Adapted from Clark, C., Steckler, E., & Newell, S. (2016). Managing contradiction: Stockholder and stakeholder views of the firm as paradoxical opportunity. *Business and Society Review*, 121(1): 123–159.

Table 1.2 Misrepresentations of Each Theory

Shareholder Theory Misrepresentations
<ul style="list-style-type: none"> • Firms do anything to make a profit. • Firms focus on short-term profits. • Firms are prohibited from giving to charity or nonprofits.
Stakeholder Theory Misrepresentations
<ul style="list-style-type: none"> • There is no demand that firms make a profit. • The theory can't be practically implemented.

Two, since most firms today have evolved from the traditional family-operated business to corporations with dispersed ownership, there are several subsets of specific interest groups even within the shareholder group. For example, shareholders can be long-term investors interested in a retirement income, short-term investors seeking to make a noticeable profit every quarter, or activists who acquired a share of the firm in order to press interests as varied as environmental preservation to women's rights or animal protection.³⁴

Three, academics argue that a basis for both the shareholder and the stakeholder theories of the firm exists in the law through the concept of fiduciary duties. But while traditional American law posits firms as fiduciaries of their owners (the shareholders), many states have amended the law to allow managers to take into consideration a wider range of other stakeholders' interests, reflecting the increasing pressure by multiple stakeholders for firms to endorse responsibility and accountability for social issues as well as economic issues. Still, H. Jeff Smith believes managers and firms that do not achieve profitability, operating either under a stakeholder or stockholder framework, will likely be penalized for underperformance by being removed by the board of directors or taken over by a competitor.³⁵ In fact, recently the Business Roundtable, a group of large company CEOs and a powerful voice in Washington for U.S. business interests, called for a new purpose for corporations: to view each stakeholder as essential and deliver value for all of them. This departs from its former statement of purpose, which focused on an obligation to provide value for shareholders alone.^{xii}

Lastly, others suggest that despite the persistence of these opposing theories, there are two key aspects where they complement one another: accountability and value.³⁶

Shareholder theories argue managers should be held accountable for a single goal, such as shareholder value, and thus held accountable to shareholders for increasing the wealth of the firm's shareholders to the extent possible.³⁷ On the other hand, normative stakeholder theory suggests firms should manage with multiple and competing stakeholder interests in mind while not holding shareholder interests above others. And those adopting a stakeholder perspective would tend to argue that managers are accountable to all legitimate interests or to legitimate groups.³⁸

As we mentioned previously, a fundamental question asked by both shareholder and stakeholder theory is this: For whose primary benefit is this firm managed? If we were to say the shareholders, we could equally say that we are all shareholders given the contemporary dependence on the financial markets for anything from retirement to routine banking to college savings. Likewise, we could say the firm is managed for stakeholders and recognize that employees, consumers, and suppliers can also be shareholders.

As you might guess, the term *value* has also been defined by both stakeholder and shareholder theorists. Recently, academics from the shareholder perspective have moved toward saying "maximizing total firm value" instead of "maximizing the value of the firm's equity" in recent years.³⁹ Further to the point, "total value created is the value created for all business model stakeholders (focal firm, customers, suppliers, and other exchange partners)".⁴⁰ This premise is complementary to the central idea of stakeholder theory: "focusing on stakeholders, specifically treating them well and managing for their interests, helps a firm create value along a number of dimensions and is therefore good for firm performance."⁴¹ It is also complementary to the principle of shared value, which involves creating

^{xii} Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans' Business Roundtable. (2019, August 19). Retrieved from <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>

economic value in a way that also creates value for society by addressing its needs and challenges.⁴²

So do you think there is some overlap in these two perspectives?

KEY TAKEAWAYS

The Stakeholder and Shareholder Debate

- Stakeholder theory is described in normative, instrumental, legal, and descriptive ways. The instrumental version is very similar to shareholder theory. The debate centers on whether the purpose of the firm is to put stakeholders or stockholders first.
- Both theories emphasize the need for value and accountability by firms.
- The stakeholder versus stockholder debate is really based on a series of misrepresentations about what each stands for.

STAKEHOLDER TYPES: INTERESTS, ISSUES, LEGITIMACY, AND POWER

LO 1.4 Describe stakeholders in terms of issues, powers, and interests.

While the debate continues, managers are often faced with limited resources to allocate as well as multiple and competing demands from stakeholders—sometimes every day. So the question becomes who and what should managers pay attention to and in what priority? That is, which stakeholder groups or issues should take precedence over others?

Market and Nonmarket Stakeholders

While stakeholders can be *any* identifiable group or individual—public interest groups, protest groups, government agencies, trade associations, competitors, and unions, as well as employees, customer segments, shareowners, and other stakeholders⁴³—they have increasingly been divided into two categories based on their value to the firm.⁴⁴

While traditionally thought of as primary and secondary stakeholders, they have increasingly been categorized as market based and nonmarket based with the following characteristics:⁴⁵

- Market stakeholders—Engage in economic transactions with the company as it carries out its primary purpose (see Figure 1.3).
- Nonmarket stakeholders—Do not engage in direct economic exchange with the firm but are affected by the firm or can affect the firm (see Figure 1.4).

From a firm-centric viewpoint as depicted in Figures 1.3 and 1.4, these sets of stakeholders can seem very separate from one another because of the categories they are placed in. However, researchers and managers alike have emphasized that they are interrelated

Figure 1.3 Market Stakeholders

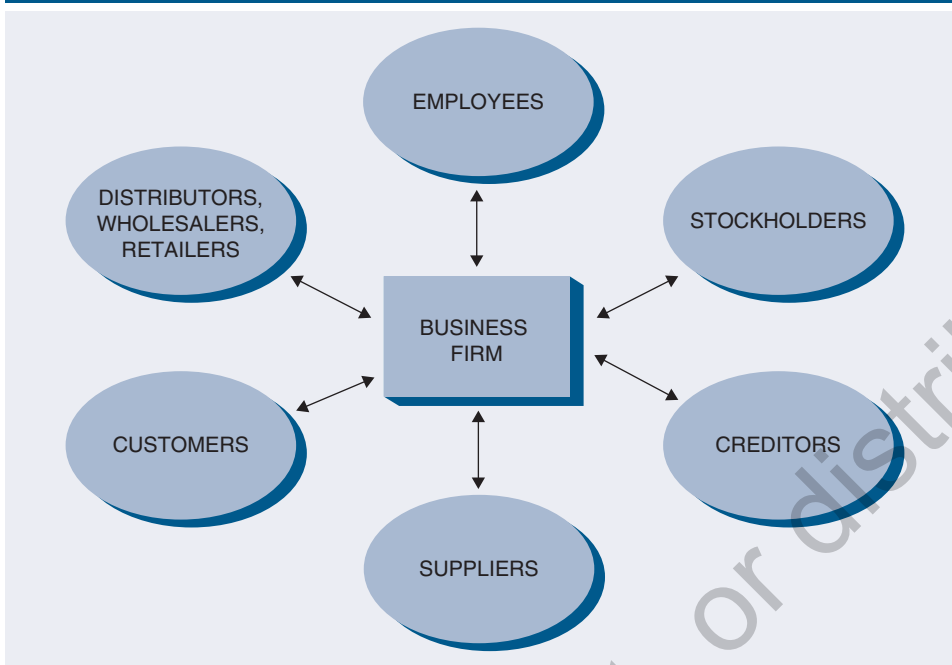
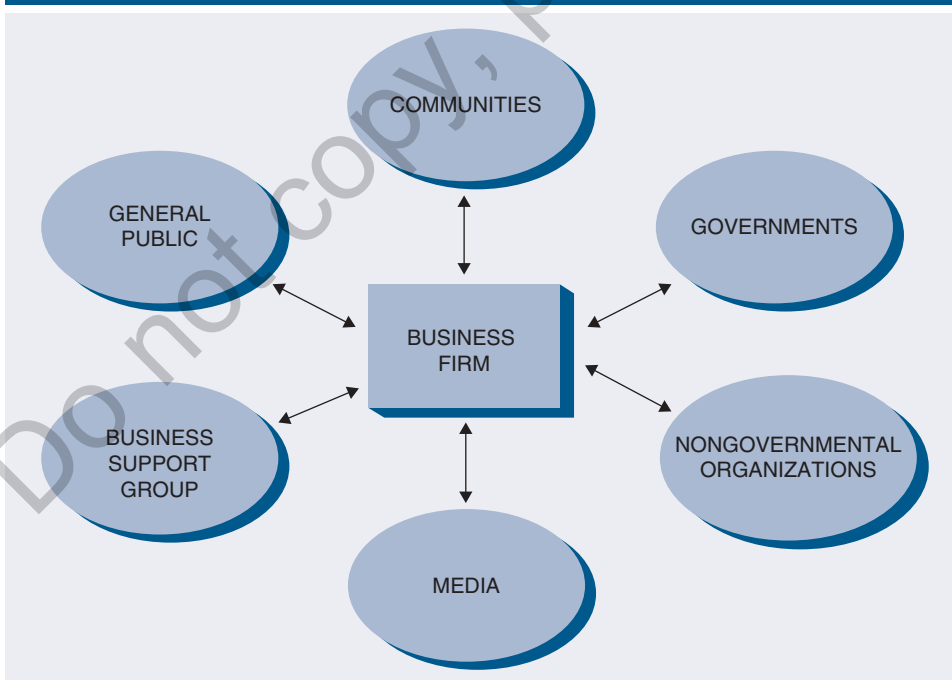


Figure 1.4 Nonmarket Stakeholders



and not always voluntary. For example, engaging with the nonmarket environment may be voluntary, such as when the firm adopts a policy of developing relationships with government officials, or involuntary when government regulates an activity or activist groups organize a boycott of a firm's product.⁴⁶

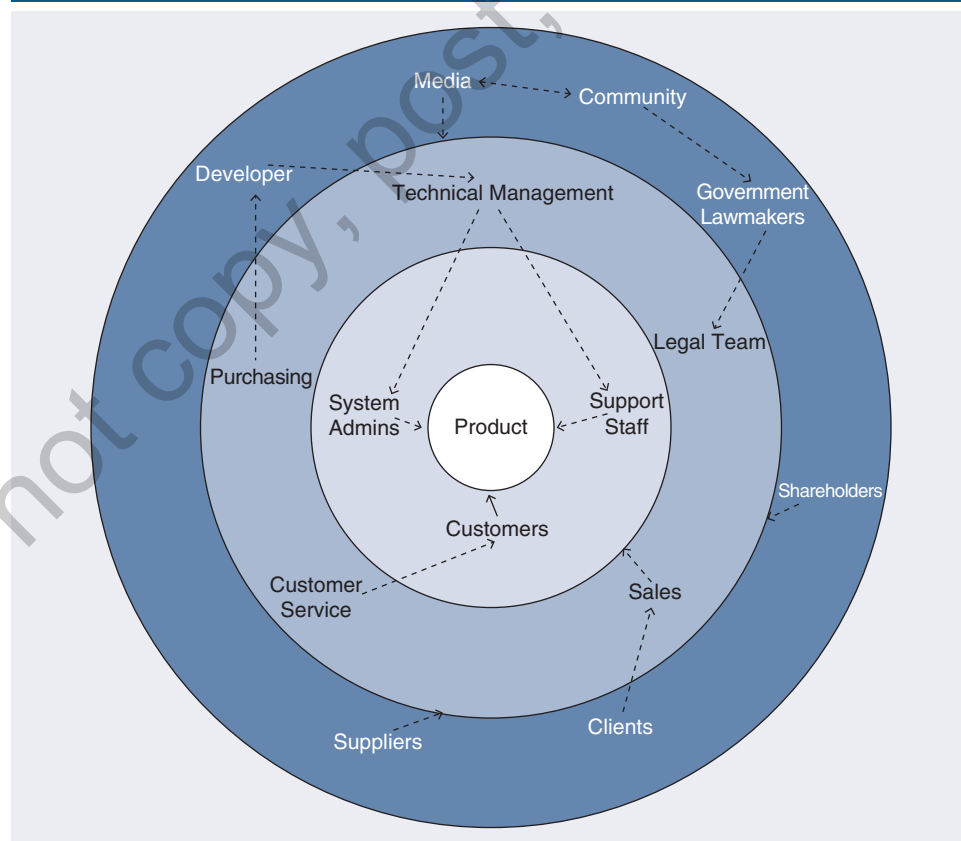
Some managers advocate for products, services, or certain stakeholder groups to be placed at the center (see Figure 1.5); otherwise, this firm-centric approach tends to marginalize other stakeholders even if that is not the explicit intent.⁴⁷ Novo Nordisk, headquartered in Denmark and the leading developer of diabetes medication, places patients in the center of its activities.

Stakeholder Interests and Power

While there are different ways to categorize stakeholders, most firms find the challenge lies in how to prioritize and engage them. Determining what their interests are, what their power base is, and how salient to the firm they are is a common starting point.

Because stakeholders are dynamic by nature, they do not have the same characteristics, especially in terms of their power, legitimacy, issues, and interests. Stakeholder groups often have common interests and will form temporary alliances to pursue these

Figure 1.5 Stakeholder Map With Product at Center



Source: BAwiki | A Reference and Blog for Business Analysts. David Olson.

common interests. Analyzing stakeholder interests typically includes addressing two key questions.

1. What are the groups' issues or concerns?
2. What does each group want or expect from their relationship with the firm?

Issues are the basic unit of analysis when thinking about stakeholder identification and engagement and often result when there is a discrepancy between what is expected from a firm in terms of responsible management and what is actually provided—its performance on those expectations. It is important to differentiate between stakeholder issues, which are defined as the concerns that stakeholder groups nurture in regard to the firm's activities, and social issues, which pertain to the social context in which the firm exists, addressing economic, social, political, or technological concerns.

Both market and nonmarket stakeholders have issues they are concerned about. For example, with Juul Labs, Inc., the largest e-cigarette company, parents, physicians, and regulators have become increasingly concerned about underage use of its vaping products. All three are nonmarket stakeholders. However, they may be part of its adult customer base or they may not use the product. Its current adult customers who are not underage, versus its youth customers, are concerned about a potential shutdown of a company whose products are far less deadly than cigarettes and may offer them a way to eventually quit smoking. As the Juul example indicates, it can be challenging to put stakeholders in clearly defined groups because many overlap. In Case Study 1.1, we discuss these overlapping and conflicting stakeholder challenges in more detail.

Juul's E-Cigarettes and Teens

Juul Labs, Inc. is a San Francisco-based e-cigarette company started by two Stanford University graduate students in 2015. Adam Bowen and Adam Monsees set out to make a replacement for cigarettes that was both appealing and less risky to use. In fact, they thought of it as a sort of off-ramp for adult smokers, wanting “cigarettes to become obsolete,” according to Monsees.⁴⁸ From that simple wish, Juul has become a high-growth enterprise in just a few short years. Today, the company mission is to improve the lives of the world's 1 billion smoking adults.⁴⁹ Juul's products are estimated to be 75% of a \$2.5 billion e-cigarette marketing in the United States alone. According to the National Youth Tobacco Survey, reported in the *Wall Street Journal*, one out of every five of high school students use e-cigarettes, up 78% between 2017 and 2018, and 5% of all middle schoolers use them, up 48%.⁵⁰ In the summer of 2018, the company was valued at \$16 billion and raised \$1.25 billion from investors wanting

to back the future success of this venture.⁵¹ The company is not publicly traded. Altria Group owns a 35% stake in the e-cigarette maker.

In the fall of 2018, the company ran into intense pressure from parents, physicians, and regulators who had become increasingly concerned about underage use of its vaping products. The Food and Drug Administration (FDA) sought to curb this underage use while parents and physicians were concerned about the effects of vaping on young people whose brains are still developing into their 20s and are vulnerable to addiction, according to scientific research.⁵² In mid-November 2018, in response to mounting pressure, Juul Labs shut down its Facebook and Instagram accounts, which were a large part of its growth.⁵³ It also stopped sales of most of its flavored e-cigarettes, particularly popular among teens, in retail stores earlier that month.⁵⁴ The FDA imposed restrictions on the sale of sweet-flavored

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options like mango and cucumber, limiting them to stores that minors can't access or to online sales with age verifications. Mint-flavored e-cigarettes remained on shelves and made up about 35% of Juul's sales in 2018.⁵⁵

In early September 2019, citing the surge in underage vaping, President Trump's administration said it planned to ban all e-cigarettes except those formulated to taste like tobacco.

On its website, Juul CEO Kevin Burns outlined the company's action plan and emphasized their common goal with the FDA. The CEO stated, "We don't want youth using the product," and it is an unintended consequence and serious problem. FDA commissioner Scott Gottlieb said, "I will not allow a generation of children to become addicted to nicotine through e-cigarettes." If sales of mint do not decline, he will "revisit this aspect." In September 2019, the Centers for Disease Control and Prevention (CDC) urged people to stop using electronic cigarettes and other vaping products while they investigate several deaths from a mysterious lung illness; it did not identify a certain brand of vaporizer.⁵⁶

How Does It Work?

A Juulpod is the cartridge that clicks onto the top of the device, and it contains a proprietary nicotine

e-liquid formula that creates the actual vapor. The vapor is created when the e-liquid is heated.

Source: <https://www.juul.com/our-technology>

Discussion Questions

1. Given Juul Lab's reaction to regulatory concern by the FDA, which theory of the firm is the company following to help resolve the widespread concern? Explain.
2. Adult consumers are one set of stakeholders impacted by Juul's decision. Are its consumers one group with the same interests? Who might also be a consumer of these products?
3. What other stakeholders might have been involved, and what were their interests? Did all stakeholders have the same interests?

Critical Thinking

Given that the company's mission is to improve the lives of the world's 1 billion smoking adults, it plans to prevent youth from using its products while at the same time marketing to adult consumers—especially its mint product popular among both groups. How can it strike that balance? Are you convinced? Explain.

It is very common to identify which stakeholders deserve attention based on three specific attributes making them salient to firms:

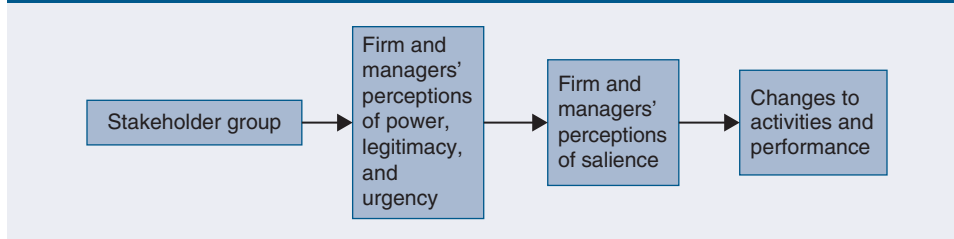
1. The power of the stakeholder to influence the corporation
2. The legitimacy of the stakeholder's relationship with the corporation
3. The urgency of the stakeholder's claim on the corporation

stakeholder salience: A stakeholder group's ability to stand out or apart from something else by possessing power, legitimacy, and urgency.

Possessing these three attributes is thought to result in higher perceptions of **stakeholder salience**, the ability to stand out or apart from something else—and ultimately bring about changes in the firm's performance or current activities (see Figure 1.6).

But not everyone is convinced that power, legitimacy, and urgency are the best ways to describe who and what matters to managers and that there is a need to better understand how legitimacy, power, and urgency are different.⁵⁷ Others have noted this focus essentially argues for a shareholder primacy model—that is, a shareholder has each of these qualities through the simple quality of owning a share.⁵⁸ Still, others argue that the very definition of stakeholders—those with the ability to affect or be affected by the firm's activities—means

Figure 1.6 Theory of Stakeholder Salience



Source: Adapted from Mitchell, R. K., Agle, B. R., & Wood, D. J. (1997). Toward a theory of stakeholder identification and salience: Defining the principle of who and what really counts. *Academy of Management Review*, 22(4), 853–886.

they are legitimate and worthy of managerial attention.⁵⁹ And, finally, that urgency may not be as relevant for identifying stakeholders and instead the salience of stakeholders will vary as the degree of these attributes vary.⁶⁰ Still, it provides a useful tool to initially identify how important a stakeholder claim might be to a firm.

As we discussed earlier, the idea of a claim is central to the stakeholder perspective. Building on this idea, there are additional and interrelated concepts important to a stakeholder claim, such as its issue, its requested action, and the tactic used to make its issue and action known to management.

Some experts have argued that certain types of requested actions may be more successful than others as they provide less risk in terms of the costs and benefits associated with fulfilling the request. One example of a low-cost request is when a firm is asked to disclose information.⁶¹ Also, certain stakeholder tactics are likely to receive more managerial attention—like those that impose greater risk to the continued survival of the firm, such as civil lawsuits rather than tactics that have little bearing on the firm’s continued activities, such as letter-writing campaigns—because the latter fail to impose an economic burden on the firm while the former may create a sense of urgency.⁶²

For these reasons, let’s focus on stakeholder power and legitimacy and how they might interact.

What Is Stakeholder Power and Legitimacy?

Power is the ability or potential of a group to influence another and to secure a desired outcome. Power commands managerial attention in and of itself through the potential threat that it carries.⁶³ Power is context specific, meaning someone is not powerful or powerless alone but rather within the context of relationships with others. That is, power cannot be attributed to an issue, a request, or a tactic. **Legitimacy** represents some form of acceptance of a stakeholder’s claim or of the group itself. Mark Suchman identified three primary forms of legitimacy: *pragmatic* occurs when the audience’s self-interest is satisfied, *moral* is when the concerns over what ought to be are satisfied, and *cognitive* is based on whether something is taken for granted and well known or accepted (see Table 1.3).⁶⁴

Many researchers have discussed the relationship between legitimacy and power. For example, Thomas Jones, Will Felps, and Gregory Bigley explored the dynamics between power and legitimacy by integrating an ethical perspective in the stakeholder salience debate. Using two types of values—other-regarding or self-regarding—the authors predict

• **power:** The ability or potential of a group to influence another and to secure a desired outcome.

• **legitimacy:** Some form of acceptance of a stakeholder’s claim or of the group itself.

Table 1.3 Examples of Forms of Legitimacy

Type of Legitimacy	Example of Type
Pragmatic	Support for a new human resources (HR) policy based on its expected value for a particular group
Moral	Support for a new HR policy because it is the right thing to do
Cognitive	Support for a new HR policy because it would be unthinkable not to have it or because it is inevitable to do so

that firms will prioritize either the interests of stakeholders or their own because firm–stakeholder power relationships are determined by these two value orientations. They find that while self-regarding firms are more prone to exercise power over stakeholders to maintain their interests, they are also more responsive to stakeholders’ power stemming from resources that are essential to their firm’s operational performance. By contrast, firms that are other-regarding are more responsive to stakeholders with legitimacy as they respond more readily to moral appeals.⁶⁵

KEY TAKEAWAYS

Stakeholder Types: Interests, Issues, Legitimacy, and Power

- Stakeholders are commonly categorized as market based and nonmarket based. The basis for these categorizations is whether or not they engage in economic transactions vital to the firm or not.
- A firm’s perception of a stakeholder group’s salience is based on the group’s legitimacy, urgency, and power. These three attributes have different meanings, and these are important for managers to understand.

MANAGING STAKEHOLDERS

LO 1.5 Assess the issues that may arise when businesses try to manage various stakeholder interests.

Stakeholder management involves constantly monitoring and redesigning processes to better serve multiple and conflicting stakeholders. Companies may employ different strategies in terms of the degree of engagement with their stakeholders. Typically, engagement is most likely when (1) both the firm and the stakeholder recognize and share the same goal, (2) they are motivated to participate, and (3) the firm or the stakeholder have the knowledge and resources to effectively engage.⁶⁶ Given that many companies you’ve heard the names of are global, it’s probably no surprise that stakeholder engagement has a global focus. For example, at Coca-Cola, an MNC, stakeholder engagement is carried out in a variety of formal

and informal settings across the entire Coca-Cola system, including local, regional, and international stakeholders. At an international level, the company is involved in multistakeholder initiatives, such as the United Nations Global Compact and the World Economic Forum (WEF), so that it can address pressing global challenges.⁶⁷ In 2017, the company conducted workshops with more than 180 experts around the world to identify potential “impacts to people” associated with the company’s activities and business relationships.

Firms can think of this in terms of four levels of commitment to practicing stakeholder management (see Table 1.4). Managers need to understand how the firm can make various stakeholders’ benefit—making customers better off and simultaneously offering an attractive value proposition to employees, suppliers, communities, and shareholders (Level 1).⁶⁸ Today’s competitive, economic, regulatory, and political environments are so dynamic they require firms to constantly revise their stakeholder perceptions—often upsetting the delicate balance in the basic value proposition to various stakeholders.

Managers must have a deep understanding of how these trade-offs affect each stakeholder, and they may wish to take positions on issues that are not always directly business related (Levels 2 and 3). Recent research points to a strong connection between ethical values and positive firm outcomes like long-term profitability and high innovation and motivation among employees.⁶⁹ Ethical leadership is possible when there is a deep understanding of the power, legitimacy, interests, and issues of concern of the stakeholders (Level 4).⁷⁰

Table 1.4 Levels of Commitment to Managing Stakeholders

Level 1	Basic value proposition	How do we make our stakeholders better off? What do we stand for?
Level 2	Sustained stakeholder cooperation	What are the principles or values on which we base our everyday engagement with stakeholders?
Level 3	An understanding of broader societal issues	Do we understand how our basic value proposition and principles fit or contradict key trends and opinions in society?
Level 4	Ethical leadership	What are the values and principles that inform my leadership? What is my sense of purpose?

Managing Stakeholders

- Stakeholders have issues of concern that they bring to firms with the expectation that the firm will respond to them.
- Firms need to engage with stakeholders to know what their

interests and issues are and to better manage conflicts among stakeholder groups. There are four levels of commitment to managing tensions.

KEY TAKEAWAYS

Competing Stakeholder Demands at Amazon



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Amazon, the publicly traded online retailer with extraordinary success and name recognition, announced in September 2017 a search for a second, equal headquarters to its home base in Seattle, Washington, known as the HQ2 decision. It stated the new location would house roughly 50,000 jobs and represent billions in investments. Amazon factored a number of qualifications for the selection of HQ2, including access to mass transit, proximity to an airport with direct flights to and from Seattle, and a pool of available tech talent nearby. In November 2018, Amazon decided to split HQ2 into two additional headquarters between New York's Long Island City and the Crystal City community in Arlington, Virginia—both located directly across from the major city centers. The company planned to evenly split the operations with as many as 25,000 employees in each location. Amazon intended to begin hiring employees for the new headquarters in 2019 and claimed the average salary for new employees would be \$150,000 per year.

The Pros and Cons

There are a number of potential benefits and harms to a decision to locate a substantial headquarter in these two cities. For example, according to published reports,

Amazon's move to New York pits it against Google, its largest competitor, which is gearing up for its own expansion in the city. And it gives Amazon a major presence in three coastal hubs that politically lean left at a time when tech companies are under scrutiny for their perceived elitism and liberal social views.

On the other hand, Arlington, Virginia, could be a good fit for Amazon politically, as an important purple swing state that promises political clout no matter which party is in power. The company has faced critics ranging from President Donald Trump to Vermont senator Bernie Sanders, who have called out the company over issues like wages. In September 2018, Amazon raised its minimum wage to \$15 per hour compared to the federally mandated minimum of \$7.25 per hour at that time.

The Request for Proposal

Amazon's 2017 request for proposal for HQ2 was sent out to over 200 cities and mentioned incentives as part of its key preferences and decision drivers. For these communities, the announcement of a deal between local government and Amazon includes the promise of jobs but also \$5 billion in new investments. In exchange, these communities offered tax breaks and other incentives. According to MarketWatch, Amazon was to receive \$1.525 billion in performance-based incentives for creating jobs in Long Island City. In return, Amazon was to donate space for a tech incubator for artists and industrial businesses alike, and for a primary public school. In Arlington, Virginia, Amazon is to receive \$573 million in performance-based incentives and a cash grant from the community of \$23 million over 15 years based on incremental growth of a tax on hotel rooms. Virginia will invest \$195 million in infrastructure in return.

After one large company receives a tax deal like this one, a state legislator or city council member will often need to make decisions about where to draw the line. For example, JPMorgan Chase CEO Jamie Dimon told investors that he would work to get HQ2 in New York in order to lobby legislators to give his company the same benefits as Amazon. This puts elected officials in the position of determining whether JPMorgan Chase and other companies should receive subsidies on par with Amazon.

Amazon's stock rose 2% after the HQ2 announcement. And analysts who rate the stock's performance estimated the stock price would soon reach \$2,100 per share. It would seem, then, that Amazon's shareholders were pleased.

In February 2019, Amazon canceled its plans to build its headquarters in Long Island City due to "growing political opposition" in the area. The decision will cost the New York City borough an estimated 25,000 jobs for its community. Public protesters called it corporate welfare and felt the money could be used elsewhere in the community. According to the *Wall Street Journal*, Amazon's decision caught the deal's biggest government backers—Governor Andrew Cuomo and Mayor Bill de Blasio, both Democrats—by surprise. Lastly, Amazon's reputation more broadly took a hit, affecting consumers and employees. In August 2019, reports surfaced of a "burn book" where the company kept a list of negative statements and who said them, including tweets from the hashtag #scamazon.⁷¹

Discussion Questions

1. *Stakeholder–shareholder theories*: Who are the stakeholders affected by Amazon's HQ2

decision? How might its decision impact these stakeholders? Are there advantages and/or disadvantages for them by winning the bid? Do some stakeholders—like employees who are also shareholders—have conflicts by being a member of both groups?

2. *Ethical decision-making*: Why do some businesses receive incentives from communities and others do not? Do companies have a moral responsibility to treat stakeholders equally? Using a principles-based approach and a consequences-based approach, answer this question: How does Amazon choose benefits and harms to various stakeholder groups (including shareholders) in its HQ2 decision-making?

Take a Position

Issue: Should the community offer tax breaks to Amazon, or should it pay the same tax as other businesses? How does the cancellation of the Long Island City site change your view, if at all?

SUMMARY

As every manager eventually realizes, the interests of a firm's stakeholders do not always align with each other or with the business's goals. Effective stakeholder management remains a challenge for both business and society. We've discussed in this chapter how shareholders are one type of stakeholder and how shareholders

sometimes stand on their own as a different class of stakeholder. We've also discussed that both share a concern for firm accountability and value creation. It's vital that managers understand each stakeholders' interests, power, and claim on the firm as a starting point for stakeholder management and engagement.

KEY TERMS

claim 4
corporate governance 6
fiduciary duty 6
legitimacy 17

power 17
shareholder 4
shareholder theory 6
stake 4

stakeholder 4
stakeholder salience 16
stakeholder theory 5
theory 5

REVIEW QUESTIONS

1. What are the differences and similarities of stakeholder and shareholder theories of the firm?
2. What are the primary arguments for managing the firm from either a stakeholder or shareholder perspective? What are the common misrepresentations of each?
3. What is stakeholder salience? Why does it matter to managers of firms?
4. What types of power and legitimacy do stakeholders have?
5. Do stakeholder interests conflict? Can a stakeholder be part of more than one stakeholder group?
6. What are the ways in which firms can manage conflicts among stakeholders?

MANAGER'S CHALLENGE

1.1: Stakeholder–Shareholder Debate

You are a mid-level manager at a company that is considering changing the focus of its annual report. In the past, the report has consisted of regulatory- and shareholder-focused information because annual reports are required by a regulatory body in most countries across the globe, like the U.S. Securities and Exchange Commission (SEC) in the United States, but attitudes about these reports are changing. Now, most are glossy stakeholder-oriented brochures that serve a broader purpose.

Framing Questions

1. How do managers go about integrating both stakeholder and shareholder perspectives?
2. What nonmarket and market stakeholders might read an annual report?

Assignment

Write a memo addressing how stakeholder and shareholder perspectives can be complementary and thus both used in the report. What arguments would you include? How would this dual-purpose benefit the company? Its shareholders? Its stakeholders?

1.2: Stakeholder or Shareholder Perspective?

Your company's products improve consumers' lives. Suppliers want to do business with your company because they benefit from this relationship. Employees really want to work for your company and are satisfied with their remuneration and professional development. And the company is a good citizen in the communities where you are located; among other things, you pay taxes on the profits you make. You compete hard but fairly. You also make an attractive return on capital for shareholders and other financiers.

Framing Questions

1. What are the hallmarks of running a firm using the stakeholder perspective? The shareholder perspective?
2. What are the misconceptions about each perspective?

Assignment

Prepare a one-page memo answering this question: Do you manage your firm from a shareholder or a stakeholder perspective?

Adapted from Freeman, R. E., Velamuri, S. R., & Moriarty, B. (2006). Company stakeholder responsibility: A new approach to CSR. *Business Roundtable Institute for Corporate Ethics*, 19.