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## BUSINESS ETHICS AND STAKEHOLDERS

*“Ethical business decisions enable, rather than constrain, the sources of good that flow to stakeholders; namely, to individuals and their society.”*

Ronald K. Mitchell | December 21, 2016 | [PDF](#) | [Facebook](#) | [Google+](#) | [Twitter](#) | [LinkedIn](#) | [Email](#)



Ethics scholar Rob Phillips has suggested that in Western society the movement of social power across time is demonstrated physically by buildings and conceptually by moral philosophy. [\[1\]](#) The oldest buildings are churches. Next oldest: government. Now: business. He argues that, like buildings, moral philosophy also has marked this movement: from scholasticism, to secular moral philosophy, and now to business ethics. In other words, as corporations amassed power over the centuries, ethicists increasingly turned attention to the potential of corporations to help or hinder societal good.

Business ethics is a two-part notion. Part 1 defines *business*—the combination of stakeholders organized to seek some objective. Part 2 adds in *ethics*—the set of moral principles that guide decisions

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about what is good for individuals and their society. Business ethics, Phillips argues, gains legitimacy through furthering norms of reciprocity, or two-way fairness. He reasons that whenever persons or groups of persons voluntarily accept the benefits of a mutually beneficial scheme of cooperation requiring sacrifice or contribution on the parts of the participants, and there exists the possibility of free-riding, then obligations of fairness are created among the participants in proportion to the benefits accepted.

Cynics argue that the term “business ethics” is an oxymoron. Optimists rejoin that business and ethics are inseparable for the long term good of society. In either case, both the business side (stakeholders), and the ethics side (“good”), are implicated. But as things stand presently, neither are especially well served. In this Note I address some of the reasons that reciprocity for stakeholders and reciprocal good are both at risk in their current conceptions. Through better addressing the issues that presently surround the stakeholder idea, it is my hope that as a society we can better manage the power of business for good.

### **Defining Business: The Stakeholder Idea**

A little over 30 years ago, another ethics scholar, Ed Freeman, defined a stakeholder as any group or individual who can affect or is affected by an organization.<sup>[2]</sup> Stakeholder groups include, for example, communities, customers, employees, the environment, financiers (e.g., shareholders), governments, and suppliers. Fundamentally, the stakeholder idea is one of inclusion: essentially that anyone who can affect or is affected by an organization should be treated fairly, and should treat others fairly, in that relationship.

Unfortunately, business relationships often lack such reciprocity. Most issues with the stakeholder idea, in fact, come back to this point. For example, ethicist Donna Wood<sup>[3]</sup> notes reciprocity-related conflicts with the assumptions of economics. Traditionally, economists have assumed, for the sake of simplicity, that economic

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participants are rational actors, that maximizing social welfare occurs by maximizing shareholder wealth, that social welfare equals market efficiency, that monopoly and externalities (unaccountable side effects on other parties) are absent in the economy, that all goods are priced, that a firm's market value reflects its total value, and so on. She argues that these simplifying assumptions not only fail to reflect the real world, but also damage human well-being because they allow and often justify non-reciprocity in stakeholder relationships.

Other issues arise due to non-reciprocal expectations in stakeholder relationships. Philosopher Tom Donaldson suggests that a normative revolution, presently underway requires: (1) a normative justification for economic systems, and (2) that managers consider stakeholders reciprocally – as having intrinsic worth beyond their instrumental usefulness in conducting business.<sup>[4]</sup> Evidence of such normative justification can be seen in the work of Amartya Sen, who has demonstrated a striking compatibility between market systems and normative principles such as freedom.<sup>[5]</sup> Evidence of more-reciprocal treatment of stakeholders, can be seen in the 9,000+ businesses (in 168 countries) that have signed the UN Global Compact, a commitment by businesses to align their strategies and operations with 10 universal principles that concern: human rights, labor, environment, and anti-corruption. But, since there are about 125 million businesses in the world, much more such work remains to be done.

Still other issues surround the time-honored role of shareholders as the possessors of rights to the residual (retained earnings) of the corporation. Strategic management scholar Jay Barney recently has suggested that the very existence of expected economic profits in a corporation necessarily implies that stakeholders, besides shareholders, will be a firm's residual claimants. He recently has argued that those – beyond shareholders – who contribute to the creation of the residual of a corporation should have reciprocity:

distribution rights to the residual, as well. <sup>[6]</sup> However, this is a very early-stage research suggestion—far from implementation.

So as conceived presently, the stakeholder idea—while socially appealing—is plagued by norms of non-reciprocal stakeholder engagement. These norms constitute barriers to its ethical use in corporations. Thus in society at large, the stakeholder idea continues to be at risk of remaining somewhat marginalized: a lip-service mantra, but little more. Conduct toward stakeholders will continue to lack business-ethics legitimacy as long as it lacks built-in reciprocity. Thereby, “good” business will remain underdeveloped.

### **Defining Ethics: The Sources of Good**

How, then, does one assess the goodness of business? I consider there to be multiple pathways in which individuals and groups can produce social “good.” A few years ago, in his innovative dissertation, <sup>[7]</sup> colleague Adam Bailey suggested a simple means whereby one might think about “the good” that is possible in business endeavors. He identified four distinct sources of good (Figure 1).

### Four Distinct Sources of Good<sup>7</sup>

Yes <i>Individual's Efforts Required</i>	(1) Self-Specific	(2) Cooperation-Specific
	(3) Independently Existing	(4) Other-Specific
No	No	Yes
	<i>Others' Efforts Required</i>	

Self-specific good can only be brought about by the individual, such as learning through diligent study; whereas cooperation-specific good requires cooperative effort involving the individual and at least one other, such as a successful team rescue effort. The foregoing two types of good are distinct from independently existing good, such as sunshine, which cannot be brought about by individual or collective effort. A further distinction may be made with other-specific good, which only can be brought about for an individual by another (or others), such as the care of severely disabled persons.

Where does business fall in this typology? While most would agree that the primary source of good in business is cooperation-specific, I maintain that businesses may enable or constrain each of the four sources of good with respect to stakeholders. In our society businesses affect or are affected by each of the four sources of good in the typology, for example by: (1) individual contributions, (2) cooperative endeavor, (3) care of the natural environment, and (4) philanthropy.

How good arises is important ethically, in the sense that a core ethical consideration is human well-being; and constraining any of the four sources of good would harm human well-being in some way. Notably, this is a pluralist conception of good, in which “several goods are viewed as intrinsically...valuable – such as happiness, knowledge, purposeful activity, autonomy, solidarity, respect, and beauty,”<sup>[8]</sup> and these goods figure into the assessment of overall goodness.<sup>[9]</sup> In this respect, then, ethical business decisions enable, rather than constrain, the sources of good that flow to stakeholders; namely, to individuals and their society.

Unfortunately, when considering cooperation-specific good in particular, managers often privilege Milton Friedman’s argument that “it is the social responsibility of business to increase its profits,”<sup>[10]</sup> and its corollary, shareholder wealth maximization. Resulting decisions overemphasizing this single objective function of business tend to be ethically deficient, failing to meet the reciprocity standard for all stakeholders concerned.

### **Business Ethics and Stakeholders**

Thus, when the single-objective function of business—focused on shareholder wealth maximization—excludes other stakeholders who also must assume obligations associated with that business, (and thereby creates an imbalance in benefits received for obligations undertaken), we have a business ethics problem. And, especially over the longer term, when many of these obligations can greatly exceed the benefits, we have a structural business ethics problem. These structural ethics problems persist because the guiding maxim for business, shareholder wealth maximization, endangers reciprocity.

As an example, author Jared Diamond reports<sup>[11]</sup> that in Montana alone there are about 20,000 abandoned mines, many of them a century or more old, that will leak acid and toxic metals essentially forever, with virtually incalculable cleanup costs. He suggests that

early mining companies behaved as they did because society required almost nothing of them. After all, they were businessmen operating according to generally accepted business principles—to send profits to their owners in the Eastern United States or Europe. Other obligations (such as long-term environmental effects) were not considered. And realistically, this short vs. long-term emphasis, its justification by narrow and sometimes self-serving interpretations of the shareholder wealth maximization corporate objective, remains a threat to reciprocity.

But what might happen if, instead, corporate objectives were plural? Plural sources of good *and* plural uses of the corporation. Could a better way forward be envisioned?

Proponents of shareholder wealth maximization as the single objective function for business argue that rational decision making requires a single objective for business: that “any organization must have a single-valued objective as a precursor to purposeful or rational behavior.”<sup>[12]</sup> This is a powerful and persuasive argument; and until recently it has not effectively been rebutted.

However, in a recent publication,<sup>[13]</sup> supported in part by the Wheatley Institution, Wheatley Fellow Brad Agle and I, along with three other colleagues, made the philosophical argument for a pluralist conception of the corporation. In this paper we developed “an account of a multi-objective corporation as a means for enabling a greater range of management decisions, so as to permit more direct corporate engagement in the diverse goals of various stakeholders. In the course of doing this, we critique[d] aspects of single objective theories of corporate function and argue[d] that [the rational-decision-making] objection to multi-objective views can be avoided. Our analysis is built on a stakeholder agency framework wherein corporate actions reflect the outcome of an intra-corporate ‘marketplace,’ where corporate constituencies bargain together to balance multiple purposes. We suggest[ed] that improvements in social welfare are more likely when intra-corporate markets among

stakeholders can operate unconstrained by some single-valued objective.”

Does this rebuttal render reciprocity more likely? We think it does. My hope is that organizations will enhance their ethical contributions to human well-being more broadly, by better enabling the four sources of good, and by more-fully embracing plural business objectives. This “built-in reciprocity,” in turn, will allow stakeholders, including society, to better harness the power of business for good.

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[1] Phillips, R. 2003. *Stakeholder Theory and Organizational Ethics*. San Francisco, CA: Berrett-Koehler, pp. 1, 92.

[2] Freeman, R. E. 1984. *Strategic Management: A Stakeholder Approach*. Boston, MA: Pitman.

[3] In Agle, et al., 2008 Toward superior stakeholder theory. *Business Ethics Quarterly* 18(2): pp. 153-190.

[4] Ibid.

[5] Sen, A. 1987. *On Ethics and Economics*. Oxford: B. Blackwell.

[6] Barney, J. B. 2016. Why strategic management scholars must adopt a stakeholder perspective. Unpublished manuscript presented at the 2016 *International Association for Business and Society Annual Meeting*, Park City, UT, June 17, 2016.

[7] Bailey, A. D. 2009. *Refining the principle of who or what really counts (and why): Seeking a rationally coherent ethical theory as a better foundation for a stakeholder theory of the firm*: p. 162. Dissertation. Lubbock, TX: Texas Tech University.

[8] Railton, P. 1984. Alienation, Consequentialism, and the Demands of Morality. *Philosophy and Public Affairs* 13 (2):134-171, p. 149.

[9] Kagan, S. 1988. The Additive Fallacy. *Ethics* 99 (1): 5-31, p. 62. See also Bailey, 2009.

[10] Friedman, Milton. 1970. The Social Responsibility of Business is to Increase Its Profits. *The New York Times Magazine*, September 13, pp. 32-33, 122, 126.

[11] Diamond, J. *Collapse: How Societies Chose to Fail or Succeed*. New York: Penguin, pp. 36, 38.

[12] Jensen, M. C. 2002. Value maximization, stakeholder theory, and the corporate objective function. *Business Ethics Quarterly*, 12: 235-256, p. 237.

[13] Mitchell, R. K., Weaver, G. R., Agle B. R., Bailey, A. D., Carlson, J. 2016. Stakeholder agency and social welfare: Pluralism and decision making in the multi-objective corporation. *Academy of Management Review*, 41(2): 252-275, p. 252.