STAKEHOLDER THEORY: A LIBERTARIAN DEFENSE

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Abstract: The purpose of this paper is to suggest that at least one strain of what has come to be called "stakeholder theory" has roots that are deeply libertarian We begin by explicating both "stakeholder theory" and "libertarian arguments " We show how there are libertarian arguments for both instrumental and normative stakeholder theory, and we construct a version of capitalism, called "stakeholder capitalism," that builds on these libertarian ideas We argue throughout that strong notions of "freedom" and "voluntary action" are the best possible underpinnings for stakeholder theory, and in doing so, seek to return "stakeholder theory" to its managerial and libertarian roots found in Freeman (1984).

I. Introduction

Quine (1960) once wrote that "sentences do not confront the tribunal of experience alone." And, he might have added, "nor do arguments and theories." Sentences, as well as arguments and theories, always import their background conditions and related theories with them. Context plays a crucial role in social phenomena, and sometimes we need to resist the efforts of greedy reductionists (Dennett, 1995)[1] to set context aside and focus on the precision of hypotheses, the collection of data, and the rituals of method. Sometimes it is important to point out a feature of the everyday landscape which is often taken for granted, because in doing so, we can come to see new relationships and new features that previously were hidden (Wisdom, 1970).[2] Such is the role of what has come to be called "stakeholder theory," and its relationship to our understanding of business activity.

The interpretation of business activity can be approached in several ways. One way is to take for granted the usefulness (others might say "truth" or "moral legitimacy" here) of a way of understanding value creation and trade (or business activity), whereby individuals are presumed to be nakedly greedy, responsible to others for the effects of their action only in so far as they are caught doing harm, and the legitimacy of a state that pervasively regulates all aspects of value-creation and trade, from rules governing the height of ladders to thousands of pages of the tax code. Let us call this way of understanding value

 Business Ethics Quarterly. Volume 12. Issue 3. ISSN 1052-150X pp 331–349

creation and trade, or business activity, "the Standard Story" or "Shareholder Capitalism," or "Cowboy Capitalism," and let us make the requisite academic changes and disclaimers to include sophisticated agency relationships, transaction costs, and other assorted modifications of the standard story so as not to be accused of the Straw Man Fallacy.

Within business ethics it is fairly well accepted that the standard story is the main way that we understand business and capitalism. A great deal of interesting work has emerged that tries to point out various places where the standard story fails a variety of ethical tests.[3] These ethical tests are, for the most part, developed outside of the standard story, and indeed, outside of much consideration for value creation and trade, or business activity, at all.

Yet another group of scholars has developed a critique of the standard story that goes like this. The standard story is fine as far as it goes, but it doesn't go far enough. We need to add the idea that the collections of individuals that we call "corporations" need to understand the *social* effects of their actions. And, we need to link the social effects of corporate action to the economic effects. The background conditions and theories of the standard story simply need to be broadened to include a set of ideas about "social" and its link to "economic."[4]

Yet another way to understand business activity would be to change the background conditions of the standard story itself. Such a method might ask how value creation and trade takes place in a world in which individuals have a complex psychology, where individuals and groups of individuals desire to be, and mostly are, responsible for the effects of their actions on others (good and bad), and where many are, or certainly ought to be, deeply skeptical of the view that the state looks out for their interests. Rather, individuals see the state as mostly pervasive and intrusive without particular insights into either the best height for ladders or the most effective means for building a just society. The standard story would have to be reformed to take account of these questions, and such reform would have to go well beyond the external critique of business ethicists, and the broadening of "economic" proposed by business and society scholars. It would have to include specific appeals to practice and a notion of "best practice" from the real world of value creation and trade. It would necessarily include examples of businesses that voluntarily manage key relationships and thrive. In short such a revisionist account of the background conditions of the standard story should be firmly enmeshed in business, i.e., in the practice of value creation and trade.

However haltingly it has been presented, this latter narrative has been at work in the background (some might say "deep background") in the development of what has come to be called "stakeholder theory." In the following sections we want to refocus "stakeholder theory" toward its "Libertarian" background conditions. In section II we briefly summarize what has come to be called "stakeholder theory." In section III we set out what makes a particular theory "libertarian," and what kinds of arguments could roughly be called "libertarian arguments." In section IV we construct some libertarian arguments for a variety of forms of stakeholder theory. These arguments seek to change the background conditions of the standard story and they lead to a revised understanding of capitalism called "stakeholder capitalism." Finally, in section V we generalize the ideas in the previous sections and construct an argument for understanding capitalism in both stakeholder and libertarian terms, a view which we call "stakeholder capitalism."

II. Stakeholder Theory

Stakeholder theory is a managerial conception of organizational strategy and ethics (Donaldson and Preston, 1995; Evan and Freeman, 1993; Freeman, 1984, 1994, 1996; Freeman and Evan, 1990; Hill and Jones, 1992; Jones, 1995; Mitchell, Agle, and Wood, 1997; Orts, 1992, 1997; Phillips, 1997; Rowley, 1997). The central idea is that an organization's success is dependent on how well it manages the relationships with key groups such as customers, employees, suppliers, communities, financiers, and others that can affect the realization of its purpose. The manager's job is to keep the support of all of these groups, balancing their interests, while making the organization a place where stakeholder interests can be maximized over time. The identification of stakeholder groups is currently among the central debates in the scholarly and popular literature (Mitchell, et al., 1997; Phillips, 1997), but most scholars would include employees, customers, suppliers, financiers, and local communities, at a minimum.

Contributions to stakeholder theory have come from, among others, such disciplines as:

- Ethics (Boatright, 1994; Burton and Dunn, 1996; Donaldson and Dunfee, 1999; Goodpaster, 1991; Phillips, 1997; Phillips and Reichart, 2000; Starik, 1995; Wicks, Gilbert and Freeman, 1994; Van Buren, 2001);
- Strategy (Berman, Wicks, Kotha, and Jones, 1999; Carroll, 1993; Clarkson, 1994, 1995; Freeman, 1984; Frooman, 1999; Mitchell, Agle, and Wood, 1997);
- Law (Lampe, 2001; Orts, 1992, 1997);
- Economics (Alkhafaji, 1989; Barton, Hill and Sundaram, 1989; Freeman and Evan, 1990); and
- Organization theory (Donaldson and Preston, 1995; Freeman 1994, 1996; Evan and Freeman, 1993; Hill and Jones, 1992; Jones, 1995; Rowley, 1997; Williamson and Bercovitz, 1996).[5]

Stakeholder theory has also received significant attention in the discourse of political economy, particularly in the U.K. (e.g., Hutton, 1995; Kelly, Kelly, and Gamble, 1997; Plender, 1997). These authors propose a "stakeholder economy" that features a large-scale role for government in the process of value creation and trade. They argue that, while the stakeholder concept was originally applied to the private sector as a theory of organizational ethics (Phillips and Margolis, 1999), expanding the concept to include public institutions and the entire national or world economy is a conceptual advance (Rustin, 1997; Barnett 1997). This has led some to claim that the stakeholder approach comes from a socialist worldview. One goal of this paper is to clearly differentiate this brand of stakeholder theory from stakeholder theory in general, and our own conception in particular.

We do note, however, that even though we disagree with this "stakeholder economy" approach, the strategy of these thinkers is a central one to the stakeholder project similar to that employed by Freeman and others. Change the background conditions of the standard story. Revise our understanding of capitalism accordingly. See what works. On the "stakeholding" account, these background conditions revolve around the articulation of "liberal" principles instead of libertarian ones, and therefore encourage a large role of the state. The disagreement between liberal and libertarian versions of stakeholder capitalism may turn out to be less over fundamental ethical principles and more over what actually works in the world of value creation and trade.

Finally, it is a mistake to tar all stakeholder theory with the same broad brush. Freeman (1994) suggests that the theory is better understood not as a monolithic theory, but rather as a genre of stakeholder "theories." While the very nature and definition of "stakeholder theory" is itself a contentious issue, the idea is quite simple. A "stakeholder theory" is one that puts as a primary managerial task the charge to influence, or manage, or balance the set of relationships that can affect the achievement of an organization's purpose.

III. Libertarian Arguments

What makes an argument a "libertarian" one?[6] This is a question that is quite controversial, even among libertarians. While they come in many colors and shapes, most libertarians agree that "liberty" or "personal freedom" or "freedom" has intrinsic value. Some might say that such an idea is definitional of humans, or shows us at our best. Others might say that developing "an attitude of liberty" is the only hope for human society.[7] Other libertarians put the matter in terms of "rights" or "natural rights" and concentrate on "negative rights." They claim that one human being has the right not to be interfered with by others, where "interfered with" is parsed in terms of physical harm. Most libertarians argue from freedom and liberty as primary to suggest that a strong system of individual property rights is the best means to preserve freedom and liberty. Property rights become an extension of the right to one's own physical body and its movements, so long as these movements don't interfere with others (Locke, 1690/1952). After all, the argument goes, if one can't have the right to use one's body the way one wants to, it is difficult to see how one can be free, in any meaningful sense of "free."

Typically, libertarians do not want to trade off "equality" with "freedom," especially when "equality" is understood in terms of the distribution of wealth in society. And, they believe that the existence of a "more than minimal nightwatchman state" that redistributes wealth cannot be justified (Nozick, 1974).

Rawls's first principle of justice is a paradigm case of a libertarian principle. He claims that "each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others" (Rawls, 1971: 60). "Basic liberty" here refers to "political liberty, freedom of speech and assembly; liberty of conscience and freedom of thought; freedom of the person along with the right to hold personal property, and the freedom from arbitrary arrest and seizure as defined by the concept of the rule of law" (Rawls, 1971: 61).

However, Rawls is no libertarian, given his extensive arguments for a redistributive state or his second principle of justice.[8] (Some libertarians like John Hospers would quarrel with Rawls's list of basic liberties and argue that most are actually reducible to property rights.) Indeed Robert Nozick takes Rawls's first principle as a starting point for a libertarian theory. Jean Hampton (1997: 145) argues that:

> In a sense he [Nozick] agrees with the importance and priority of Rawls's first principle of justice, but in Nozick's view that first principle, requiring equal liberty for all, has implications for the kind of conception of justice that can be endorsed by a liberty-loving society. It must be one that allows people maximal (and equal) freedom to do with their property what they choose to do, without being subjected to interference by the state.

Nozick's argument is roughly: pick any redistribution that you want. No matter how perfect, people would undertake trade to improve their lot, thereby necessitating more redistribution, negating the effects of the voluntary trades. It is a hallmark of libertarian views that voluntary acts among consenting adults ought to count as morally permissible, provided that they impose no substantial costs on any third party.

So, libertarian theories are often contrasted with liberal theories.[9] According to Alan Ryan (1995: 296) the line is not an easy one to draw.

> Both are committed to the promotion of individual liberty; both rest most happily on a theory of human rights according to which individuals enter the world with a right to the free disposal of themselves and their resources. The line of cleavage lies between the libertarian view that government is not a necessary evil but a largely (and for so called "anarchocapitalists" a wholly) unnecessary evil and the liberal view that government power is to be treated with caution, but like any other instrument may be used to achieve good ends.

It is interesting to note here that the difference between libertarian theories and liberal theories may well be a difference in what actually happens in the real world. Libertarians may believe that the best means to promote liberty, etc., are markets and limited, at most, governments, while liberals may believe that the best means to promote liberty include the welfare state. While the differences in theory are not always so obvious, political philosophers have done a good job of actually ignoring what we might call "differences of fact."[10]

Alternatively, libertarianism can be contrasted with utilitarianism. Jean Hampton has put the point quite contentiously: "Whereas utilitarianism might be said to allow individuals to be held hostage to the well-being of the community, libertarianism might be said to allow the community's well being to be held hostage to the rights, and in particular the property rights, of individuals" (Hampton, 1997).

While the focus of libertarian theory has been on some form of freedom/liberty, some analysis of rights, property rights in particular, and some arguments for the limited role of government, there is also another less obvious tenet of most libertarian thought. Most libertarians must have strong beliefs about personal responsibility.

First of all, on any libertarian account, persons are responsible for themselves. The equal liberty principle makes no sense if A may do whatever she likes to B. The "compatible with a like liberty for all" clause is crucial. The libertarian must assume that people are capable of controlling their actions so that they do not harm others. Second, when such boundary crossings or harms occur, the offending party must make some attempt at reparation. The alternative to this strong notion of individual responsibility is making some collective like the state responsible for repairing any damage that is done, but the whole point of the minimal state is that such "collective responsibility" carries severe "freedom denying" penalties. So, libertarians do or ought to accept some variant of a principle about responsibility. The Responsibility Thesis says:

> The basis for ethics or the moral point of view is that most people, most of the time, take or want to take responsibility for the effects of their actions on others. And, if they did not, then what we call "ethics" and "morality" would be meaningless.[11]

Now there may well be a particular libertarian version of such a principle which specifies the necessary and sufficient conditions under which a person must make someone that she has harmed "whole." But it is hard to conceive of a libertarian theory that doesn't have some version of the responsibility principle.

We claim that an argument is a libertarian argument if it (1) relies on freedom, liberty, the equal liberty principle, or some kindred notion; (2) relies on basic negative rights, like those defined by Rawls's first principle, and including individual property rights; (3) allows for the creation of positive obligations through various voluntary actions (e.g., contracting and promising); (4) countenances at most a minimal state, as defined by Nozick and others; and, (5) assumes that human beings are largely responsible for the effects of their actions on others.

IV. Some Libertarian Arguments for Stakeholder Theory

Now, we want to suggest that in the background of stakeholder theory are libertarian arguments that draw on these five ideas. There are at least two branches of "stakeholder theory" or "managing for stakeholders" that we need to take into account. The first branch is based on what Freeman (1999) has called "the Instrumental Thesis." This thesis suggests:

> To maximize shareholder value over an uncertain time frame, managers ought to pay attention to key stakeholder relationships.

It is easy to see libertarian assumptions running in the background here. We might assume that the corporation is the private property of the shareholders, and that managers have been hired by the shareholders to do what's best for the shareholders. Shareholders must be responsible for the uses of their property, even by their agents, according to the responsibility part of libertarian theory (*respondeat superior*). So, managers who are boundedly rational and acting under real uncertainty, must take the interests of stakeholders into account, else they might misuse shareholders' property to harm others and violate their right to freedom. This argument says nothing about treating all stakeholders equally,[12] nor does it suggest, even remotely, that managers should take from one stakeholder group and give to another. Rather, the argument recognizes that the stakeholder framework is largely managerial, in the sense that Donaldson and Preston (1995) have pointed out (cf. Freeman, 2000).

Why is it important to point out the libertarian roots of the argument for the instrumental thesis? In *Strategic Management: A Stakeholder Approach*, Freeman suggested, in a section entitled "A Plea for Voluntarism," that a growing tendency to look outside the firm for the causes of decline masked the fact that managers had it within their power to influence the external environment (cf. Pfeffer and Salancik, 1978). Only by seeing stakeholder relationships subject to managerial influence could managers actually begin to do their jobs of leading the corporation toward its purpose, whatever that purpose may be. He suggests:

> Such a philosophy of management [the stakeholder one, as interpreted as the instrumental thesis] must be based on the idea of voluntarism, if it is to be implemented in U.S. based companies. Not only is voluntarism the only philosophy which is consistent with our social fabric, but the costs of other approaches are simply too high. Voluntarism means that an organization must on its own will undertake to satisfy its key stakeholders. A situation where a solution to a stakeholder problem is imposed by a government agency or the courts must be seen as a managerial failure (Freeman, 1984: 74).

Today we might add that it is because of bounded rationality and uncertainty that we cannot trust that a governmental solution will continue to be optimal, even though it might look more favorable than one that deals directly with key stakeholders. Give the state power over a particular area, and it rarely relinquishes control. Again, we appeal to libertarian principles to get this voluntarism argument off the ground. The prominence of responsibility in libertarian thought is reflected in this early discussion of the motivational structure of managing for stakeholders. So, we conclude that the Instrumental Thesis can have a decidedly libertarian flavor, even though it need not, i.e., there are certainly non-libertarian arguments for the instrumental thesis. for it does not depend on the idea of exclusive private property rights or the limited state.

The second branch of stakeholder theory is based on what we might call the "Normative Thesis." It claims:

> Managers ought to pay attention to key stakeholder relationships.

There is no starting point of property rights of shareholders here. In fact some have claimed that the normative thesis must be defended from the pure starting point of ethical theory. While we are skeptical of such claims, we do believe that such a defense can be offered on libertarian grounds.

The first defense argues that in fact we do live in a world of property rights. If shareholders are in fact the owners of the corporation in some sense, then managers must respect the property rights of shareholders, unless they are trumped by more important liberty rights of other stakeholders (or shareholders themselves). Most libertarians would argue that property rights are fairly basic, and rarely trumped by other considerations, indeed that most other considerations can be reduced to property rights. Therefore, if we add the ingredients of bounded rationality, uncertainty and responsibility, the argument for the normative thesis looks a lot like the argument for the instrumental thesis even where we have not assumed that managers are the explicit agents for the shareholders.

A variant of this argument suggests that each stakeholder has property rights. Consumers have the property right to their wealth. Suppliers have the property right to the supplies that they sell to the corporation. Employees have a property right to their labor. Communities have a property right to public goods.[13] In order to respect these property rights, managers must pay attention to stakeholders.[14]

Yet another variant of this argument relies on the notion of voluntary action. On one interpretation, the firm is a nexus of contracts or the centerpiece of an ongoing multilateral agreement, based on voluntary consent. As indicated above, libertarian theory is not antithetical to the notion of positive obligations among actors. Rather, the argument is that no such duties exist apart from the voluntary actions of actors. There is no natural right to a job, for example, though actors can create reciprocal obligations based on the voluntary action of entering into an employment contract. If there is a weak presumption that the agreement is ongoing, managers must take the interests of all parties to the contract, or the nexus, into account.

In addition to consent- or contract-based obligations, Phillips (1997) has argued for obligations of stakeholder fairness derived from the voluntary acceptance of the benefits of a mutually beneficial cooperative scheme. Such obligations are also consistent with libertarianism inasmuch as they countenance neither a natural nor a hypothetical basis for organizational obligations to stakeholders, but rather one based on voluntary actions of the organization (or its management). Relying, then, on the responsibility principle, we would expect managers to try to keep the joint interests of stakeholders in balance in any instance where positive obligations have been created through consent, contract, voluntary acceptance of benefits, or any other voluntary action.

In a series of papers, Evan and Freeman made such a libertarian argument in which they went further and tried to set forth conditions under which it would be in the interests of each stakeholder group to conceptualize the firm as such a voluntary agreement. A little-noticed condition in that paper was that such an agreement ought to be enforceable without depending on a specific state regime. Hence, the agreements were to be self-enforcing in order to limit the role of the state.

The classical role of the state to solve coordination problems (*a la* Prisoner's Dilemma), provide or regulate public goods, and serve as a court of last resort, was to be usurped by these voluntary agreements, precisely to limit the involvement of the state in the affairs of the corporation. Evan and Freeman relied on a Rawlsian-like veil of ignorance to make the argument, but it was one with strong libertarian, instead of liberal, background assumptions. Evan and Freeman stipulated (by tacit appeal to libertarian background conditions) that the agreements which came out of the veil must work in any set of conditions, and could not depend on particular kinds of state regimes. Indeed, if Evan and Freeman had perhaps more carefully set out who these hypothetical stakeholders were who were trying to set forth ideal conditions for fair agreements, perhaps they would have explicitly made them (1) holders of the equal liberty principle; (2) committed to negative rights, especially property rights; (3) able to create and accrue positive commitments and obligations among members of private associations; (4) distrustful of the state in any guise; and (5) committed to being responsible for the effects of their actions on others. In short they would have been libertarians.

Despite the libertarian arguments that can be adduced for both the instrumental and normative branches of stakeholder theory, ultimately we have to come to see stakeholder theory as managerial. According to Donaldson and Preston (1995), stakeholder theory is managerial in the sense that it recommends courses of action for managers and deals *at once* with normative, instrumental, and descriptive claims. They write,

> The stakeholder theory is managerial in the broad sense of that term. It does not simply describe existing situations or predict cause-effect relationships: it also recommends attitudes, structures, and practices that, taken together, constitute stakeholder management. Stakeholder management requires, as its key attribute, simultaneous attention to the legitimate interests of all appropriate stakeholders, both in the establishment of organizational structures and general policies and in case-by-case decision making. This requirement holds for anyone managing or affecting corporate policies, including not only professional managers, but shareowners, the government, and others. Stakeholder theory does not necessarily presume that managers are the only rightful locus of corporate control and governance. Nor does the requirement of simultaneous attention to stakeholder interests resolve the

> longstanding problem of identifying stakeholders and evaluating their legitimate "stakes" in the corporation. The theory does not imply that all stakeholders (however they may be identified) should be equally involved in all processes and decisions (1995: 75–76).

To further fill out the conception of stakeholder theory as managerial, we would add that to see stakeholder theory as managerial is to see it as intimately connected with the practice of business. First and foremost, stakeholder theory is about business and capitalism. And it is here that the libertarian background assumptions of stakeholder theory come out the strongest.

Business is that human institution that is about value creation and trade. Libertarian theorists point out that value creation and trade are older than the idea of governments, and that both have gone on independently and in spite of specific state regimes. Note that this is not the claim that the state has no impact on value creation and trade, but the claim that it need not. Value creation and trade take place across state regimes, and among actors who live in a multiplicity of different state regimes. Indeed, as trade becomes increasingly global in scope, the regulatory power of any single government is diminished.

Like Follett (1994) and Barnard (1938) before, Freeman (2000) has argued that the engine of value creation and trade is the human desire to create. It comes from the many values that we hold that drive us to take a stand and do something with our lives. It comes from what Harold Bloom calls the "strong poet," the person who shows us how to live differently. Freeman also argues that the desire for solidarity fuels capitalism, the desire to come together and build something which no single person can accomplish. Now both of these desires emerge in theory when we admit a complex psychology of human beings. There is no reason for libertarians to deny such a complex psychology, though often one finds libertarian analyses which assume that most people are narrowly economic, or self-interested, etc.

If we come to see stakeholder theory as concerned with the practice of value creation and trade, we are led back to "the plea for voluntarism." Regardless of the purpose of the firm, since managers are boundedly rational, and since the world is uncertain, they must pay attention to the consequences of their actions on others. To ignore these others is to put oneself and one's company beyond the pale of morality and ethics, conceived of as liberal, Kantian, Utilitarian, or libertarian.[15]

V. From "Stakeholder Theory" To A Libertarian Stakeholder Capitalism

The arguments of the previous two sections give rise to the question of whether there can be a systematic way to understand business activity that is both libertarian in spirit and attends to the managerial interests inherent in the stakeholder approach. We want to argue that there are a number of principles that any such stakeholder capitalism would have to satisfy.

The hallmark of libertarian theory is one of consent and agreement. Free people have the right to make agreements with others, even if some of these agreements limit their own freedom.[16] The first three criteria for what makes a theory a libertarian one are freedom, rights, and the creation by consent of positive obligations. Our underlying notion of why capitalism works is ultimately due to these three ideas and how they interact. Business is founded (and businesses are created) on this idea of making agreements with each other. And we are free to make these agreements because others are not permitted to interfere (so long as they are not substantially affected).[17] Entrepreneurs see the possibility of creating value where others do not. They contract with suppliers, employees, suppliers of finance, and customers, as well as others, to start and build firms. In other words they create a set of positive obligations among those parties that are affected. We might capture these intuitions in the following principle:

> *The Principle of Stakeholder Cooperation* says that value is created because stakeholders can jointly satisfy their needs and desires by making voluntary agreements with each other.[18]

Value creation and trade is not a zero-sum game. Capitalism works because entrepreneurs and managers put together and sustain deals or relationships among customers, suppliers, employees, financiers, and communities. The support of each group is vital to the success of the endeavor and the outcomes are synergistic. This is the cooperative common-sense part of business that every executive knows. It is deeply libertarian since it is rooted in the notion that voluntary action is the well-spring of capitalism. When stakeholders pool their resources to create something, no one has the right to prevent their actions, provided they do not impose substantial harms on innocent third parties.

Having the freedom to make agreements is as important for customers who purchase products as it is for employees who agree to take direction and work for some corporate objectives in return for money, satisfaction, knowledge, or whatever the particular agreement authorizes. More subtly, communities are also a part of the agreement structure of business, since they provide air, water, schools, roads, protection from harm, and other so-called "public goods."[19]

Whether these agreements among stakeholders are to be understood as bilateral agreements or multilateral agreements is an interesting question. However, if these agreements are to be sustainable over time, they must include some element of fairness, as Freeman (1994) has argued. There are many different conceptions of fairness that may be applied here. And there are many kinds of agreements that can be termed "fair." Freeman (1994) suggests one method based on Rawls's theory of justice (cf. Phillips and Margolis, 1999), called "the doctrine of fair contracts," but there are others that would work equally well (Deutsch, 1975). In a relatively free and open society, if agreements are not fair, parties to the agreement will seek alternatives, and may well seek state intervention and recompense.

In addition to basic fairness, and prior to it from a libertarian perspective is the question of whether parties to an agreement must be responsible for the outcomes of that agreement. We have suggested above that a strong notion of responsibility is necessary for libertarian theories to be tractable, and if parties to an agreement are responsible, the question of fairness may well become subsidiary. Again, the failure of a notion of responsibility to find a place at the center of our understanding of business is perhaps the reason for the large regulatory role played by government and the courts in our current economy. If liberty is to be preserved, then stakeholder capitalism must include a principle that ensures that parties to the agreements will be responsible for the effects of their actions.

> *The Principle of Stakeholder Responsibility* claims that parties to an agreement must accept responsibility for the consequences of their action. When third parties are harmed, they must be compensated, or a new agreement must be negotiated with all of those parties who are affected.[20]

Responsibility is a tricky concept. It is easy to find simple counterexamples using vague terms like harm (suppose I am "harmed" when you wear pink shirts, for example.). Such examples (see Marcoux and Child, for instance) are a function of the vagueness of "harm" or "responsibility" and count no more against our use of these central moral ideas than against anyone else's use of them. So, regardless of the weaknesses of our best current theory of "responsibility," our claim is that some notion of responsibility is central to the development of stakeholder capitalism.

A second feature of this principle is that it applies reciprocally to all stakeholders. If an entrepreneur, manager, or firm has responsibility for the effects of its actions, so too, do customers, communities, suppliers, financiers, and employees. Firms are not the sole carriers of responsibility in today's world. Customers have a duty to use products as they were intended, or else take reasonable care, including the burden of responsibility, when they do not. Employees have a responsibility to support their employers within reason. Suppliers have the duty to do their best to make the supply chain work properly and be efficient.[21] And shareholders have a responsibility to elect responsible directors who will take seriously their "duty of care" to manage "the affairs of the corporation."

The first two principles of stakeholder capitalism ground business in the freedom of individuals to make agreements, and in the concomitant responsibility that comes with exercising such freedom. The alternative to these two principles is a view that capitalism rests on the idea that "anything goes" and "let the buyer beware." Long a part of the common parlance of capitalism, it is high time to put these ideas to rest. The only possible outcome of these principles is a belief by people that "in business what you do is what you can get away with" and that we need the state to protect citizens from the naked self-interest of business. The resulting "bad public relations" for capitalism and the growth of the modern state are both a testament for our argument that we need to return to the basics of how business can and should operate.[22]

Out of this bad reputation for capitalism comes the idea that in business people act solely in their own self interest, and often they go further and act narrowly in a selfish manner. Thus, the popular and scholarly press is filled with "horror stories" about yet another egregious infelicity involving some large multinational. Recently, Werhane (2000) has suggested that most of these cases look like the story of Rashomon, where the description of what happened depends on the point of view that you have. While there are some undoubtedly real "horror stories," it is the assumption that business people must be narrowly self-interested that is really doing the damage. After all, one response to the "horror story" scenario is that in fairness, if business is tarred with the bad, it must at least be feathered with the good consequences. But even this response misses the point. What is missing is a complex psychology of the actors in business. Surely, some are self-interested, and, just as surely, some are other-regarding. Managers, entrepreneurs, and stakeholders must have as complex a psychology as ordinary human beings, for the simple fact that they are ordinary human beings. Once we remove the narrow view of business required by the non-stakeholder story, we can open up the complex entities that are involved.

People have many and varied values. These values cause them to pursue their hopes and dreams in a number of ways. At least some of these pursuits (what Freeman and Gilbert [1988] called "personal projects") involve collaborating and contracting with others to create something of value. Stakeholder capitalism must rest on something like the following principle:

> *The Principle of Complexity* claims that human beings are complex psychological creatures capable of acting from many different values and points of view.

This principle may well seem trivial. But, we argue that the current backdrop of business makes it necessary to spell it out. We are not just self-interested narrowly economic maximizers. The discussions of self-interest vs. altruism, which seem embedded in literatures such as corporate social responsibility, as well as finance, simply miss the mark. Sometimes we are selfish and sometimes we act for others. Many of our values are jointly determined and shared. Capitalism works because of this complexity, rather than in spite of it. A central task of managers and entrepreneurs is to determine an answer to fundamental values questions that may bind together a business entity. There are no obvious "right" answers here. There are many different ways to engage in value creation and trade and also be "an ethical person."[23] Such a principle might rely on the background assumption that free and responsible people who respect each other's freedom will develop complex interests and values, which will lead to many options for themselves and those with whom they form relationships. Capitalism, on this view, becomes the voluntary associations of free, responsible, cooperating, consenting, and complex adults.

The final two principles are subsidiary to the first three. They are necessary to correct the mistaken impressions left by the standard story of capitalism. Perhaps it is possible to construct a stakeholder capitalism without these principles, but let them serve as explanatory of the kinds of behaviors that will result from such a new story.

> *The Principle of Continuous Creation* says that business as an institution is a source of the creation of value. Cooperating with stakeholders and motivated by values, businesspeople continuously create new sources of value.

Schumpeter's old saw is "the principle of creative destruction." It claims that at the center of capitalism is the emergence of new value that necessarily destroys old value. We believe that this principle focuses too much attention on capitalism as a closed system. While value destruction does in fact take place, the genius of the corporate form, combined with the genius of entrepreneurship is that such destruction need not destroy businesses. Corporations can (some would say have the duty to) continuously create value. Obviously, continuous creation is possible because of the three principles outlined above, sharing the libertarian roots of these ideas.

In short, the principle of continuous creation claims that the creative force of humans is the real engine of capitalism. One creation doesn't have to destroy another, rather there is a continuous cycle of value creation which raises the well-being of everyone. People come together to create something, be it a new computer program, a new level of service, a way to heal the sick, or simply to work together. It is the creative spirit that results from freedom-loving people that makes capitalism work.

> Finally, *The Principle of Emergent Competition* says that competition emerges from a relatively free society so that stakeholders have options. Competition emerges out of the cooperation among stakeholders, rather than being based on the primal urge to "get the other guy."

This principle seeks a corrective measure in the now largely dominant idea that capitalism is first and foremost about "anything-goes competition." In a relatively free and open society, people are "free to compete," or "free to offer alternatives." The entrepreneurial process ensures that there is an outside "equilibrating force" that adds pressure for managers to manage for stakeholders. When they don't, yet another stakeholder network is capable of forming (Venkataraman, 2002). Competition is important in Stakeholder Capitalism, but it is an emergent property. The psychological connection between the desire to create and achieve and the desire to compete—to beat others—is an interesting question. Perhaps in the end, both are necessary, or connected in important ways. Suffice it for our purposes to call attention, once again, to the creative force and the complex human psychology that is necessary to combine libertarian ideas of freedom with managerial ideas of stakeholder theory.

Stakeholder capitalism invokes a focus at the level of how value is created, rather than at the societal level of value distribution, or the accrual of large amounts of capital and control over it. Capitalism in this sense has little to do with nineteenth-century robber barons, the emergence of institutions for trading stocks, or the ability to accumulate and make available to entrepreneurs large supplies of capital. All of these issues are important, but they are subsidiary to the value-creation process. Our five principles form a basis for assessing the most basic nature of business, or value creation and trade. How far the enactment of our current story is from these principles is a matter for further debate for academics and policymakers at both the corporate and societal levels. Our suggestion is that, by focusing on these principles, we can reorient capitalism toward an ethics of freedom and responsibility—one that inherently marries business and ethics.

Stakeholder Capitalism requires that freedom-loving human beings be at the center of any process of value creation and trade. It underscores the responsibility thesis that common decency and fairness are not to be set aside in the name of playing the game of business. It suggests that we should demand the best behavior of business, and that we should enact a story about business that celebrates its triumphs, admonishes its failures, and fully partakes of the moral discourse in society as a routine matter. Yet, Stakeholder Capitalism is no panacea. It simply allows the possibility that business becomes a fully human institution. There will always be businesspeople who try to take advantage of others, just as there are corrupt government officials, clergy, and professors. Stakeholder Capitalism bases our understanding and expectations of business not on the worst that we can do, but on the best. It sets a high standard, recognizes the common sense practical world of global business today, and asks managers to get on with the task of creating value for all stakeholders.

Notes

[1] Dennett (1995) distinguishes between "reductionism" and "greedy reductionism."

[2] Wisdom (1970) argues that philosophy's unique contribution to intellectual life is to illuminate such hidden features.

[3] See for instance the work of Bowie, Brenkert, Donaldson and Dunfee, Solomon, Werhane to name but a few

[4] See for instance the work of Carroll, Cochran, Post, Wood, Waddock and others

[5] Many of the works exemplifying the various categories are cross-disciplinary, so neither the works cited nor the categories themselves should be construed as mutually exclusive.

[6] We owe a great debt to Gordon Sollars in the following paragraphs, though this interpretation of what counts as libertarian is our own

[7] See the work of James Buchanan. Buchanan argued that developing an "attitude of liberty" was the central hope for democratic societies at a Liberty Fund Conference at George Mason University in 1986.

[8] There have been many thousands of journal pages devoted to Rawls's second principle, The Difference Principle, but relatively little attention paid to the Equal Liberty Principle, the first principle This is quite odd given that the first principle is supposed to be lexically ordered with the second, i.e., there is an absolute priority of equal liberty over the difference principle. It is interesting to speculate that if one fully works out the best mechanisms for assuring equal liberty, those same mechanisms may also promote equality as far as possible. Get the first principle right, in the details, and one may not need the second principle. This is the spirit of the argument of Lomasky (1987).

[9] Some libertarians take issue with the distinction between liberalism and libertarianism claiming that the term "liberal" originally applied to what is today termed libertarianism and the advocates of current "liberalism" co-opted the term from "classical liberals" (i.e., libertarians) like Locke. See Lomasky, (1987). For the sake of clarity we will employ the more common contemporary usage.

[10] To say there are differences of "fact" is not to countenance the fact-value distinction. More carefully we might say that libertarians and liberals tell different stories about our relationship to our history, and indeed, even write quite different histories.

[11] We need appeal to nothing more here than a standard Darwinian account, *a la* Daniel Dennet, (1995) that the "responsibility meme" is evolutionarily stable. However there is a deeper connection worth exploring among libertarians. existentialists, and pragmatists.

[12] Cf. Marcoux (2000) and Sternberg (2000).

[13] Now any libertarian would severely constrain the interpretations of this statement, but however it turns out, even if it is analyzed away as public goods are turned into private goods the point still stands, as some system of property rights will hold sway.

[14] This seems to be the general approach of Donaldson and Preston, 1995.

[15] That business is in fact "beyond the pale" at least in its perception is precisely the claim that the Separation Thesis is at the heart of this debate about the proper role of stakeholder theory.

[16] The limiting case of whether or not a libertarian theory countenances "selling oneself into slavery" is beyond our scope here, and is probably uninteresting.

[17] We use "substantially" here because we note that counterexamples are easy to come by, but as Rawls cautions us, we shouldn't always give in to them.

[18] The following sections contain some paragraphs from R. Edward Freeman, "Stakeholder Capitalism." *Financial Times*, July 26, 1996. We are grateful to the editors and publisher for permission to use this material here

[19] Whether these goods could be provided by private means. as some libertarians argue, is not at stake here.

[20] We are grateful to an anonymous referee for the suggestion of this principle.

[21] Recent attention to "sweat-shop" working conditions in the developing world has raised questions regarding the responsibility of corporations for the actions of their sub-contractors as well those farther removed in the supply chain (sub-sub-contractors) both "upstream" and "downstream." This is an interesting stakeholder question, but one outside the scope of the present inquiry.

[22] Some might argue that we have committed the naturalistic fallacy here—that we have mistaken how businesses do act with how they should. To begin, we pragmatists will have none of the prescriptive-descriptive, or fact-value distinction Wicks and Freeman (1998) tries to outline how such a pragmatist view of management theory would work. The story of business that is deeply embedded in our society is not the story of stakeholder capitalism. Thus, it is important to clearly set forth the underlying principles on which this new story, the story of stakeholder capitalism. rests.

[23] That there are many ways to run a business is the insight behind the often ignored idea of "enterprise strategy" and its theoretical analog "normative core " It is a separate story whether or not "being an ethical person" makes any sense in isolation from the ideas of value creation and trade. If value creation and trade are fundamental to the human experience, then separating out "ethical person" as the above sentence does. is also illegitimate. Another way to say this is that our analysis points out the need for a political philosophy or a conception of ethics where value creation and trade. rather than the state. play a central role

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