J Bus Ethics (2010) 96:7–9
DOI 10.1007/s10551-011-0935-5

Managing for Stakeholders: Trade-offs or Value Creation

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Published online: 28 June 2011

One of the central uses of stakeholder theory, in its original form, was as a counterpoint to the idea that corporations should be managed in the interests of shareholders. As the theory developed the debate was often framed in terms of "shareholders vs. stakeholders." While developing "theories of the firm" is an interesting and useful project, focusing solely on "theory of the firm" obscures a more important contribution of stakeholder theory. The purpose of this brief essay is to set forth what I consider to be the central insight of stakeholder theory: the jointness of stakeholder interests.

The Basic Idea

The basic idea of "managing for stakeholders," as I now see it, is quite simple, and I believe it is closer to the origins of the idea from Eric Rhenman and the Tavistock thinkers. In fact, Juha Nasi was correct in his assessment of the Scandinavian origins of the stakeholder idea that focus on what holds stakeholder interests together. Nasi originally suggested that we focus on "intressent" in Swedish. In Finnish, this term was modified as "intressentti" or "sidosryhma," which could be translated as an "interest group" or even as a "linkage" or "bonding" or "binding" group (Nasi, 1995 at 98). It is this bonding or binding idea that is most interesting to explore. Managing for stakeholders asks us to see stakeholders as "bound together by the jointness of their interests." Hence, the basic idea goes like this.

Business can be understood as a set of relationships among groups which have a stake in the activities that make up the business. Business is about how customers, suppliers, employees, financiers (stockholders, bondholders, banks, etc.), communities and managers interact and create value. To understand a business is to know how these relationships work. And, the executive's or entrepreneur's job is to manage and shape these relationships, hence the title, "managing for stakeholders." Customers, suppliers, employees, financiers, communities, and managers are all key parts of today's business organization. Building and leading a great company has always been about managing for stakeholders. This much is perhaps uncontroversial, and has in fact become a mainstream idea about business all over the world.

However, many would still argue that when push comes to shove, the interests of customers, suppliers, communities and employees, must be traded off against the interests of financiers. However, the idea that one particular group always gets priority is deeply flawed. The very nature of capitalism itself is putting together a deal, or a contract, or a set of relationships among stakeholders so that all can win continuously over a long period of time. As Rhenman, Ackoff and the early stakeholder theorists knew, if you take away the support of any stakeholder you simply do not have a viable business.

In this mindset of "managing for stakeholders," executives play a special role. On the one hand, they have a

The ideas in this article have been developed in a number of publications, foremost of which is R. Edward Freeman, Jeffrey Harrison, and Andrew Wicks, Managing for Stakeholders: Survival, Reputation and Success, Yale University Press, 2007, and R. Edward Freeman, "Managing for Stakeholders," in T. Beauchamp, N. Bowie, and D. Arnold (eds.) Ethical Theory and Business, 8th edition, Pearson, 2008. I am grateful to editors, publishers, and co-authors for their support, and allowing me to further develop these ideas here.

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stake like every other employee in terms of an actual or implied employment contract. And, that stake is linked to the stakes of financiers, customers, suppliers, communities, and other employees. In addition, executives are expected to look after the health of the overall enterprise, to keep the varied stakes moving in roughly the same direction, and to keep them in balance or in harmony, and it is here where I believe there is the greatest confusion.

As stakeholder theory began to be taken seriously by scholars writing primarily in the field of business ethics, it developed as a way to raise questions of justice in corporations. It is easy to see that once we begin to see the corporation as a set of contracts among stakeholders, then it is natural to ask, “What is a fair contract?” Several answers were given to this question, and most relied on an abstract and stylized view of the corporation and economic activity.

While most philosophers rejected the shareholder theory, they saw stakeholder theory as an alternative to bring ethics and justice into business. The rejection of the “financiers first” priority rule gave rise to the search for other priority rules to take its place. This search for justice mimicked the literature on distributive justice and became focused on the way to make trade-offs among stakeholders. Questions such as, how could better benefits and pay for employees be traded off against higher earnings for shareholders, or how could attention to product safety be traded off against jobs for employees, etc. Literally there are thousands of such questions. Well-publicized cases such as the Ford Pinto, where managers used cost–benefit analysis to make such trade-offs, had led to disasters. Indeed Steven Brenner, with Philip Cochran and Jamsheed Hosseini, determined a formal theory for making such trade-offs, and presented it at the stakeholder conference in Finland in 1994.

In the economists’ view of the world, there are always trade-offs. A number of assumptions lead to this way of thinking, especially the idea that the right point of analysis is one of equilibrium or near equilibrium. At equilibrium, the most efficient use of resources is reached, and exactly the right number of apples versus oranges have been produced. Producing more oranges leads to unacceptable and irrational “apple consequences.” These trade-offs are built into the utility functions of both consumers and producers. Indeed, the very existence of real-valued utility functions assures us that rational actors can make the required trade-offs among various goods, as producers and consumers.

However, in the real world managers face multiple demands simultaneously. In fact, the very heart of capitalism and its entrepreneurial spirit is in figuring out how to meet the demands of customers, suppliers, employees, communities, and financiers, so that all win. Venkataraman and others have suggested that there is a natural marriage between stakeholder theory and entrepreneurship theory along the following lines. When a stakeholder group’s interests are not being met, either they leave the firm for another network that will satisfy their interests, or they enter into some entrepreneurial venture to find a better way. Continuously trading off their interests with those of another stakeholder group is simply unacceptable in a relatively free society. From a managerial perspective, if managers look for trade-offs among stakeholders, then they will create trade-offs and they may never find the “sweet spot” that signifies the joint interest of all key stakeholders.

As stakeholder theory evolves to become the mainstream narrative about business, I believe that we need to keep in mind three interconnected ideas:

(1) *No stakeholder stands alone in the process of value creation.* The stakes of each stakeholder group are multi-faceted, and inherently connected to each other. How could a bondholder recognize any returns without management paying attention to the stakes of customers or employees? How could customers get the products and services they need without employees and suppliers? How could employees have a decent place to live without communities? The fact that stakeholders have joint interests is, I believe, the key insight of stakeholder theory, as it has been developed over the last 50 years.

Stakeholder interests are inherently tied together. Seeing stakeholder interests as “joint” rather than opposed is difficult. It is not always easy to find a way to accommodate all stakeholder interests. It is easier to trade off one versus another. Why not delay spending on new products for customers in order to keep earnings a bit higher? Why not cut employee medical benefits in order to invest in a new inventory control system?

However, when there is dissonance, the time is ripe to try and find a reframing of the basic business proposition so that more stakeholders win continuously over time. Stakeholders that are difficult to please, critics, employees who push back, even conflicts of values, all can be sources of value creation, when approached with the “no trade-offs” mindset of managing for stakeholders. Rather than give into trade-offs, executives should first try to reframe the questions. How can we invest in new products and create higher earnings? How can we be sure our employees are healthy and happy and are able to work creatively so that we can capture the benefits of new information technology such as inventory control systems?

In a recent book reflecting on his experience as CEO of Medtronic, Bill George summarized the managing for stakeholders mindset[1]:

[1] Bill George, *Authentic Leadership*, 2006.

Serving all your stakeholders is the best way to produce long term results and create a growing, prosperous company…Let me be very clear about this: there is no conflict between serving all your stakeholders and providing excellent returns for shareholders. In the long term it is impossible to have one without the other. However, serving all these stakeholder groups requires discipline, vision, and committed leadership.

(2) *The primary responsibility of the executive is to create as much value as possible for stakeholders.* Where stakeholder interests conflict, the executive must find a way to rethink the problems so that these interests can go together, so that even more value can be created for each. If trade-offs have to be made, because of a failure of imagination, time pressure, or other reasons, then the obvious next step is to try and figure out how to improve the trade-offs for all sides. Managing for stakeholders is about creating as much value as possible for stakeholders, without resorting to trade-offs.

The key idea that holds this value creation mindset together is the idea that businesses can have a purpose. And, there are few limits on the kinds of purpose that can drive a business. Wal-Mart may stand for "everyday low price." Merck can stand for "alleviating human suffering." The point is that if an entrepreneur or an executive can find a purpose that speaks to the hearts and minds of key stakeholders, it is more likely that there will be sustained success.

Purpose is complex and inspirational. The Grameen Bank wants to eliminate poverty. Fannie Mae wants to make housing affordable to every income level in society. Tastings (a local restaurant) wants to bring the taste of really good food and wine to lots of people in the community. And, all of these organizations have to generate profits, or else they cannot pursue their purposes. We cannot emphasize this idea too much. Capitalism works because we can pursue our purpose with others. When we coalesce around a big idea, or a joint purpose evolves from our day-to-day activities with each other, then great things can happen.

(3) *Stakeholders have names and faces and children.* Executives and academics, especially, must understand that business is fully situated in the realm of humanity. Businesses are human institutions populated by real live complex human beings. They are not mere placeholders for social roles. As such, matters of ethics are routine when one takes a managing for stakeholders approach. Of course, this should go without saying. One CEO put it very succinctly, "the only assets I manage go up and down the elevators everyday."

Most human beings are complicated. Most of us do what we do because we are self-interested and interested in others. Business works in part because of our urge to create things with others and for others. Working on a team, or creating a new product or delivery mechanism that makes customers lives better or happier or more pleasurable all can be contributing factors to why we go to work each day. And, this is not to deny the economic incentive of getting a pay check. However, the assumption of narrow self-interest is extremely limiting, and can be self-reinforcing—people can begin to act in a narrow self-interested way if they believe that is what is expected of them, as some of the scandals such as Enron have shown. We need to be open to a more complex psychology—one any parent finds familiar as they have shepherded the growth and development of their children.

Summary

The last 30 years of research on stakeholder theory has led to a rich and varied literature. The next step is to see stakeholder theory as a way to redefine how we think about value creation and trade. If we can make the twenty-first century the century of value creation for stakeholders, and if we can escape the political and institutional trap of building in trade-offs among stakeholders into public policy, then the sheer audacity of our fellow humans will lead to prosperity and freedom for more and more people.