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THE ETHICAL AND ENVIRONMENTAL LIMITS OF STAKEHOLDER THEORY

Eric W. Orts and Alan Strudler

Abstract: We argue that though stakeholder theory has much to recommend it, particularly as a heuristic for thinking about business firms properly as involving the economic interests of other groups beyond those of the shareholders or other equity owners, the theory is limited by its focus on the interests of human participants in business enterprise. Stakeholder theory runs into intractable philosophical difficulty in providing credible ethical principles for business managers in dealing with some topics, such as the natural environment, that do not directly involve human beings within a business firm or who engage in transactions with a firm. Corporate decision-making must include an appreciation of these ethical values even though they cannot be captured in stakeholder theory.

Stakeholder theory has become a mainstay in business ethics and management theory in the last several decades. This issue of *Business Ethics Quarterly* is one of several collective contributions to the topic in recent years,[1] and other scholars canvass the enormous number of articles and books written on stakeholder theories of business management in the latter part of the twentieth century.[2] Despite the huge academic literature devoted to stakeholder theory, however, leading scholars in the field continue to complain about the "blurred" and "relatively vague" concept of the "stakeholder."[3]

In this article, we contribute our perspective to the important issue of the nature of a "stakeholder" in management theory. In particular, we argue that though stakeholder theory has much to recommend it—particularly as a heuristic for thinking about business firms as involving the economic interests of other groups beyond those of the shareholders or other equity owners—the theory is limited by its focus on the interests of human participants in the business enterprise. Stakeholder theory therefore runs into intractable philosophical difficulty in providing credible ethical principles for business managers in dealing with topics that do not directly involve human beings within a business firm or who engage in transactions with a firm. For example, we do not believe stakeholder theory can adequately account for the ordinarily overriding moral obligation for businesses to obey the law. Stakeholder theory also cannot satisfactorily

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treat the increasingly important problems of managing business enterprise in an environmentally ethical and responsible fashion, despite recent attempts by a few theorists to include the natural environment as a "stakeholder" by definition.[4] However one may redefine stakeholders, and however one may balance their interests, we maintain that stakeholder theory does not provide very much assistance to managers who find themselves faced with deciding how to "do the right thing" with respect to whether to follow the law or how to value the natural environment, which includes non-human species, the physical conditions supporting life on the planet, and aesthetic values of undisturbed landscape and wilderness.[5] Other ethical theories and principles beyond stakeholder theory are required to give guidance to managers in order for them to make appropriate business decisions with respect to these kinds of moral issues.

What is a Stakeholder?

Stakeholder theory is a modern extension of older conceptions of business enterprise that argue that doing business is more than a matter of making money. Many of the most important moral philosophers in the Western tradition, including Jeremy Bentham, David Hume, and Adam Smith, treated ethics and economics as integrated topics,[6] and there are very good arguments that the two should not be divorced in modern times.[7]

Stakeholder theory finds antecedents in ideas of "corporate social responsibility."[8] At the dawn of the twentieth century, John Dewey in the United States and Walther Rathenau in Germany during the Weimar Republic argued that business corporations owed ethical duties to consider social and public interests.[9] In the 1930s, a famous debate between Adolf A. Berle and E. Merrick Dodd recapitulated the argument in legal terms.[10] Like earlier ideas of corporate social responsibility, contemporary stakeholder theory is described aptly as "a powerful heuristic device, intended to broaden management's vision of its roles and responsibilities beyond the profit maximization function to include interests and claims of non-stockholding groups."[11] In essence, stakeholder theory is a rhetorical response to financial theories that assert that firms should focus only on maximizing the economic interests of shareholders, that is, the residual owners of business corporations.[12] Corporations are not the only form of modern business enterprise, however. Many legally recognized types of business firms do not have shareholders, including sole proprietorships, partnerships, and limited liability companies. In addition, many firms, including most corporations, have capital structures that include various creditors (including bondholders, suppliers, employees, or customers) as well as equityholders.[13] But public corporations comprise a large percentage of current business enterprise in modern economies,[14] and the broad-gauged neoclassical economic argument is that the purpose of these large corporate firms should be to maximize shareholder value.[15] Stakeholder theory stands with other ethical theories against this univocal view of shareholders *über alles*. Most versions of stakeholder theory maintain that ethical, non-economic considerations must also be taken into account in the proper management of business enterprises.[16]

Not all theories that describe themselves as "stakeholder theory" agree with our account. As Thomas Donaldson and Lee Preston point out in an important article, three different schools of thought within stakeholder theory may be identified: (1) descriptive, (2) instrumental, and (3) normative.[17] We agree with Donaldson and Preston's conclusion that stakeholder theory requires a normative philosophical foundation.[18] We therefore put aside those theories that consist merely of a purely descriptive, empirical examination of the interests that managers may actually consider in practice without an understanding of the purpose or motivation of these practices.

Instrumental stakeholder theories do not necessarily propose a normative alternative to shareholder-primacy theories of management. Instead, they often argue that considering the interests of other stakeholders (or at least pretending to consider them) may provide an instrumental strategy for achieving the goal of maximizing shareholder value. For example, one recent author has described this kind of approach as "strategic corporate social responsibility."[19] Instrumental theories make the empirically optimistic argument that a consideration of the various interests involved in a business will inevitably serve to maximize the primary interests of the equity owners (in a corporation, the residual shareholders)—or at least the economic interests of the firm considered as a unified whole.[20] If this argument succeeded, it might provide a normative foundation for stakeholder theory. But we believe that to argue that "the best interests of *stake*holders" will inevitably also promote "the best interests of *share*holders" is unreasonably optimistic. Moreover, following "the best interests of stakeholders" even to the extent that they may conflict with the more narrowly defined interests of shareholders does not necessarily lead to ethical results. Instrumental stakeholder theories assume, in the absence of persuasive evidence, that "good" ethical behavior toward stakeholders will have "good" economic consequences. This argument is wrong because the better assumption from common observation is that ethics and economic self-interest sometimes conflict. Simple theft of assets by insiders in a corporation is an obvious case in point. Even if theft can be justified as maximizing shareholder value or the economic value of other stakeholder interests in the firm, it is morally wrong.

The etymology of the word "stakeholder," we believe, reveals something important for normative theories that employ the term. Using "stakeholder" to refer to various interests involved in running a business (including employees, suppliers, customers, and creditors—as well as shareholders) became fashionable in business schools in the 1980s.[21] But William Safire in his *New York Times* column on language traces the theoretical use of the term "stakeholder" at least to 1965.[22] More interestingly, Safire speculates that the origin of the word "stakeholder" lies in the nineteenth-century American Western frontier. A "grub stake" meant an advance of money or food on the job—for example, a cowboy's meals while herding cattle.[23] A stakeholder therefore holds a bet or a wager on the outcome of an enterprise—as well as, perhaps also originally, the result of a gamble or a horse race.[24]

The etymology of the word "stakeholder" lends support to what Max Clarkson calls the "narrow" view of stakeholder theory.[25] Clarkson argues that placing some property or other asset "at risk" in a business firm must be considered a key characteristic of a proper conception of stakeholder.[26] Participants in a business enterprise who may be considered "stakeholders" under this economic risk-based approach include not only shareholders (who risk the loss of their investment, nonpayment of dividends, or bankruptcy), but also creditors (who risk default on their loans or bonds), employees (who risk being dismissed or paid less compensation in return for their work), and suppliers and customers (who have more than an arms-length spot market contractual relationship with a particular business enterprise and thus also risk the loss of some economic interest). All of these participants in a business have some kind of economic stake *directly* at risk in an enterprise. Excluded from this list are interests that broad views of stakeholder theory argue in favor of incorporating within the ambit of managerial consideration, including political states and their governmental subdivisions, third parties who may be harmed by the activities of a business enterprise (i.e., tort victims), and entities that have no literally identifiable "interests," such as the natural environment.

We find Clarkson's narrow version of stakeholder theory far more plausible than broader versions, which seem inevitably to collapse due to a lack of structure. Edward Freeman develops the most well-known version of the broad view of who counts as a stakeholder: "A stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the organization's objectives."[27] As other critics of broad views of the meaning of a stakeholder point out, however, virtually anyone and anything can "affect or be affected" by the decisions and actions of a business enterprise.[28] Expansive views of relevant "stakeholders" tend easily to become so broad as to be meaningless and so complex as to be useless.

The lack of definition plaguing stakeholder theory is a consequence of the fact that the economic (and other) interests recognized in stakeholder theories often conflict, and stakeholder theories offer no convincing way to reconcile or balance conflicting interests. Indeed, nobody recognizes this problem more lucidly than Freeman himself, who argues (in an article coauthored with William Evan) that:

> [M]anagement, especially top management, must look after the health of the corporation, and this involves balancing the multiple claims of conflicting stakeholders. Owners want more financial returns, while customers want more money spent on research and development. Employees want higher wages and better benefits, while local community wants better parks and day-care facilities.[29]

How should management respond to the pervasive conflicts it confronts? Stakeholder theory has not yet produced a helpful answer to this question. As Evan and Freeman explain:

> The task of management in today's corporation is akin to that of King Solomon. The stakeholder theory does not give primacy to one stakeholder group over another, though there will surely be times when one group will benefit at the expense of others. In general, however, management must keep the relationships among stakeholders in balance.[30]

We submit that advising management to "balance" the interests of stakeholders in this fashion and to think like King Solomon hardly constitutes useful practical advice. For stakeholder theory to be useful, it must give some guidance about how to achieve such a "balance." We do not believe any version of stakeholder theory has yet achieved this aim. Even Freeman now declares: "There is no such thing as stakeholder theory."[31] Instead, he suggests that stakeholder theory is better understood as a "genre of stories about how we could live."[32]

Not all stakeholder theorists share Freeman's aspiration to transform stakeholder theory into mere storytelling. But stakeholder theorists who embrace a broad conception of the meaning of "stakeholder" will have trouble stopping the devolution and eventual disintegration of their theories. The broader one conceives stakeholder theory to extend, the deeper the conflicts among stakeholder interests will become; the greater number of different stakeholders one recognizes, the more divergent and irreconcilable their interests. In contrast at least to the broad "kitchen-sink" versions of stakeholder theory, Clarkson's narrow view of stakeholders seems more plausible. A narrow conception of "stakeholder" also comports with the etymological account of the idea as referring to a participant in an enterprise who bears some kind of economic risk. It is conceptually more tractable than the broad view. For example, stakeholder theory may advocate a managerial focus on a goal of overall economic productivity of the enterprise, and the conflicting economic claims of participants in the enterprise may be managed with this overall economic objective in mind—subject to internal and external normative constraints regarding noneconomic moral and legal obligations.

The narrow version of stakeholder theory we propose can be distinguished from the broader version of the theory by the directness it requires of a stakeholder's interests in a firm. Narrow stakeholder theory takes stakeholders to be comprised by the participants in a business enterprise who have significant property rights in the firm or who have significant contractual relations with the firm. It therefore denies that an entity should be regarded as a stakeholder just because its economic interests are affected by the firm; it denies that government and members of the community in which the firm operates must be regarded as stakeholders, even if their economic interests are affected by the firm. The conception of stakeholder we propose avoids the unfortunate consequence of broad stakeholder theories; the narrow conception, unlike the broad conception, does not include everybody and everything that might be affected by, or affect, the firm.

Narrow stakeholder theory is consistent with a theory of the firm that includes direct participants in a business—for example, employees and creditors—as well as shareholders and other equity owners of an enterprise.[33] Business managers thus become the "agents"—both legally and practically—of the economic business enterprise as a whole.[34] Managers have legal authority in business enterprise to advance the economic interests of the firm in general. This authority allows them to consider moral and legal considerations of various kinds, as well as purely economic calculations. Over time, legal concepts have developed, such as "the business judgement rule" and liberally construed fiduciary duties in the United States, which confer considerable discretion to managers in making decisions that are intended to advance the overall interests of the firm.[35] Managers also ordinarily have legal discretion to make various decisions that, in practical effect, "balance" the competing interests within a firm, such as: negotiating contracts with employees, suppliers, and customers; agreeing to terms of loans and other credit instruments; and issuing stock and deciding whether and when to pay dividends.

At the same time, managers have legal and ethical obligations. For example, managers may not make certain kinds of self-dealing transactions that would violate a "duty of loyalty" owed to the firm. Beyond the law, managers also should act ethically in their role as managers, an obligation that the American Law Institute recognizes in its *Principles of Corporate Governance*: "Even if corporate profit and shareholder gain are not thereby enhanced, the corporation in the conduct of its business . . . may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business."[36]

An appreciation of the legal agency authority of business managers acting within the legal boundaries of the firm provides a formal theoretical framework in which a narrow version of stakeholder theory gains structure and conceptual limits. Admittedly, the boundaries of the firm in practice are not strictly delineated, either in law or economic theory, and they shift according to the circumstances and even the perspective one takes on the firm with respect to a particular issue or question.[37] But a legal and economic theory of the firm helps to ground and give shape to a narrow version of stakeholder theory.

To instead expand the idea of a "stakeholder" beyond any formal legal or economic limits or boundaries invites arbitrary definition of relevant interests in business governance limited only by the political or ideological proclivities of a particular theorist. Theorists who do not observe such limits or boundaries and advocate very broad definitions of "stakeholders" risk highjacking theories of economic business enterprise for other political or philosophical purposes. Not surprisingly, such academic highjacking attempts have largely failed to have a practical effect in the everyday business world.

Business Ethics beyond Stakeholders

Entities other than narrowly defined economic stakeholders in a business are no doubt morally relevant to business firms and the managers that run them. Government, for example, is one prominent entity that does not ordinarily claim a direct economic interest in business firms (other than the imposition of taxes) in capitalist societies.[38] Government, therefore, does not fit within Clarkson's narrow definition of a stakeholder, and we agree that it should ordinarily be excluded. To include government on the list of relevant stakeholders is to begin the unwise theoretical expansion of the broad conception of the idea against which we have warned. Yet few would argue with the proposition that business managers should, morally, follow the law. In general terms, business firms and the participants in them are expected to obey the law on the simple and straightforward ground that it has been legitimately enacted though democratic government and therefore carries at least presumptive moral authority, even if particular instances of whether a firm should obey a law may be debated.[39] Ordinarily, a business firm has a moral obligation to obey the law, and this obligation is external to the economic interests of the firm. At least in cases of criminal law, this obligation cannot (or at least should not) be "traded off" against economic interests. In other words, the moral obligation to obey the law is not simply a matter for cost-benefit analysis of compliance versus violation (though some argue that a cost-benefit analysis along these lines may sometimes be justified in civil violations—for example, a delivery firm that decides to incur parking tickets intentionally and pay the costs). To give an obvious example, even if a firm would certainly go bankrupt unless its managers and employees diversify their business to include criminal activities such as fraud, embezzlement, armed robbery, or murder-for-hire, violating these laws cannot be justified through an appeal to the economic interests of the participants. More pedestrian examples of the obligation to comply with the law arise daily in business practice.[40]

A firm's moral obligation to obey the law does not fit easily within a stakeholder account. The narrow version of stakeholder theory does not count the government as a stakeholder, and so it suggests no direct reason that the government's laws should be respected. Some broad versions of stakeholder theory attempt to account for the moral obligation to obey the law by expanding the definition of "stakeholder" to include "the government."[41] But this does not make sense because, as we suggest above, to redefine "stakeholder" as any relevant interest that deserves ethical consideration would rob the notion of a stakeholder of all relevant meaning. Moreover, even if a never-ending process of expanding the list of relevant "stakeholders" was allowed, another problem becomes apparent. Some moral obligations are more important than others, and a problem with simply redefining the government as just another stakeholder is that this analytical step allows the moral obligations owed under the law to be "balanced" against the economic interests of other stakeholders. In fact, the very purpose of criminal law (and many civil laws as well) is often to impose noneconomic, moral obligations on all citizens equally (including those engaged in business) without allowing individuals to have recourse to an economic calculation of benefits and harms.[42] Broad versions of stakeholder theory, as Evan and Freeman explain, advise the manager to balance stakeholder interests, but sometimes the very idea of such balancing is itself morally objectionable.[43] We argue instead that a manager who tries to decide whether to obey a just and legitimate law by asking first whether it is in the interests of the firm's stakeholders to obey it fails to appreciate the moral responsibilities of a manager who is also a political citizen.

The moral obligation to follow the law is not the only moral obligation more fundamental than a presumed "obligation" to balance stakeholder interests. To take a familiar example: In order to know that slavery is wrong, we do not balance the interests of the slave against the interests of his or her owner. Traditions of reasoning about right and wrong are as old as human culture, but stakeholder theory is relatively new. We believe that stakeholder theorists with broad views of the ethical application of their theories have offered no good reason to think that a method of balancing stakeholder interests can, or should, displace the traditional but more difficult normative task of reasoning about right and wrong.[44]

By the same token, the attempt to extend the concept of "stakeholders" to apply to the natural environment—as a substitute for serious consideration about how best to include these kinds of concerns in the processes of business decision-making—is unpersuasive. Taking the broad view of stakeholder theory to this uncharted territory, Mark Starik attempts to expand the meaning of "stakeholder" to include "non-human nature," but the result is to urge managers to take "non-human nature" into account as represented by a "Gaia concept of an all encompassing planetary, living system" or consulting "single non-human species, subspecies, communities, or even individuals."[45] Starik observes accurately that "talking about the environment" in many business organizations often "results in derisive joking and a general ascription of 'flakiness,'" and he apparently aspires to develop a theory that will be credible to practical managers rather than to engage merely in academic theory construction.[46] But encouraging managers to contemplate the mysticism of the Gaia hypothesis or to cavort with non-human species before making business decisions is not likely to improve this hostile climate.

Although we believe that the natural environment possesses moral importance, Starik gives no reason to think that conceiving of nature as a "stakeholder" captures this importance.[47] Furthermore, even if a broad version of stakeholder theory proceeds by balancing the interests of stakeholders, as followers of Evan and Freeman argue, then Starik's theory is in trouble. First, it is doubtful that nature has identifiable "interests." The concept of an interest is ordinarily tied to happiness and well-being.[48] To advance one's own interest is to make one happier or better off on these dimensions. Unless something possesses a mind, it makes no sense to ascribe interests to it, or to ascribe the related characteristics of needs or wants. Only a very strained metaphor would suggest that nature itself could be happy or otherwise enjoy well being.[49] Here we follow the distinguished philosopher of science, Elliot Sober, who argues:

> If one does not require of an object that it has a mind for it to have wants or needs, what is required for the possession of these ethically relevant properties? Suppose one says that an object needs something if the object will cease to exist if it does not get it. Then species, plants, and mountain ranges have needs, but only in the sense that automobiles, garbage dumps, and buildings do too. If everything has needs, the advice to take needs into account in ethical deliberations is empty, unless it is supplemented by some technique to weighting and comparing the needs of different objects.[50]

Sober agrees that the environment is extraordinarily important and worth preserving, even independently of human interests and needs. But he scoffs at the idea that one can justify this treatment of nature in terms of its own (i.e., "nature's") needs or wants. His skepticism applies equally to justifying treatment of nature in terms of its interests: If something has no mind, then it has no needs, wants, or interests.[51]

We believe that Sober's argument is persuasive. At the same time, we appreciate why some environmentalists would wish to reject it. It may seem easy to distinguish between an ecological area that is flourishing and one that suffers environmental degradation, and this distinction may seem to suggest that nature itself has needs and interests. For example, when a piece of prairie has been so smothered with toxic wastes that it can no longer support indigenous flora and fauna, then the land itself seems to "suffer" and to need detoxification. If we can thus distinguish between healthy and ailing land, doesn't that show that nature itself has some interest in being treated properly?[52] Here, following Sober, we answer no. A car may run better with high-octane gas, but that does not show that the car itself has an interest in the gas. A painting may look better after restoration, but that does not show that the painting itself has interests in looking better. Similarly, a piece of prairie may be more beautiful and may more successfully sustain indigenous plants and animals if cleansed of toxic wastes, but that does not demonstrate that nature itself has an interest in being cleansed.

It is important to see that one can coherently deny that nature itself has any interests in being cleansed while at the same time asserting that, as a moral matter, respect for the dignity and beauty of a piece of land requires that it be cleansed. In fact, people regularly make analogous judgments about great works of art and even about whole cities. Consider Venice, Italy, one of the most historically significant and beautiful cities in the world. It is at risk of sinking into the sea. A common and coherent view is that, as a moral matter, Venice should be saved. But this is not because the city itself has an interest in being saved. The rationally defensible attitude toward Venice is analogous to a rationally defensible attitude toward nature: We should save it because of its moral and aesthetic importance, including the rarity of its beauty and cultural value, not because of its own interests or needs. Similarly, we may argue for the preservation of particular ecological systems or prominent landmarks on moral and aesthetic grounds. Endangered species (such as giant pandas or tigers, as well as less commonly appreciated species) may often deserve preservation not only because of possible benefits that may accrue to human interests through future research or consumption in zoos, but also on independent moral and aesthetic grounds akin to the reasons that we care about Venice.[53]

If we are correct, then nature itself has no interests, it cannot be a stakeholder, and Starik's stakeholder approach to the environment cannot get off the ground. But set aside, for the moment, this objection against Starik's theory. Even if the idea that nature could have an "interest" made sense, Starik's theory gives no useful suggestion about how this environmental interest might be balanced against the interests of other stakeholders. In this respect, versions of stakeholder theory that include the natural environment as a legitimate "stakeholder" are no better than other broadly defined versions.

In an ingenious paper responding to Starik and proposing ways to conceive stakeholder theory so that it accommodates environmental concerns, Robert Phillips and Joel Reichart argue that stakeholder theory may give voice to environmental concerns by virtue of the interests that human stakeholders have in the environment. They argue that even though the natural environment should not be regarded as a stakeholder itself, stakeholder theory provides a moral reason to protect the environment because ordinary human stakeholders care about the environment.[54] Phillips and Reichart also criticize Starik's theory as an example of "the problem of stakeholder identity run amok."[55] Yet they seem to commit the same sin indirectly by arguing that environmental values will be legitimately expressed through the opinions of employees, managers, and perhaps other stakeholders of the business firm.[56] They give a few anecdotal examples of niche businesses that reflect this approach, such as the Body Shop and Tom's of Maine.[57] But these niche businesses succeed precisely because a select (and usually privileged) group of consumers and employees perceive these companies to be more socially or environmentally responsible than their competitors. Not all businesses, however, have such influential, socially, and environmentally responsible customers. There is therefore no reason to think that Phillips and Reichart's stakeholder model will generally produce environmentally responsible management when most of a firm's stakeholders are substantially different from the customers and employees of the Body Shop or Tom's of Maine.

Concerns beyond stakeholder interests should enter into moral managerial deliberations about the natural environment, but Reichart and Phillips do not explain how this can coherently occur. Consider, for example, the moral and environmental disaster that occurred as a result of the infamous crash of the Exxon Valdez.[58] When the ship crashed, millions of barrels of oil were spilled on pristine Alaskan coastline, polluting the sea, soiling the landscape, and killing fish and other wildlife. The crash occurred because Exxon's lax polices and lax enforcement permitted a habitual drunk to pilot its supertanker and wreck it on the fragile Alaska coastline. On Phillips and Reichart's view, how may stakeholder theory help us to understand Exxon's wrong? Exxon's stakeholders, which include, on their own account, stockholders, employees, and customers, have different interests in preserving the Alaskan coastal environment. These interests should, under stakeholder theory, be given weight when deciding the right course of action. By allowing the Valdez to be piloted by an habitual drunk, Phillips and Reichart might argue that Exxon thereby compromised the interests of its stakeholders in preserving nature, and that is therefore wrong.

To be fair to Phillips and Reichart, we must acknowledge that they are clear that stakeholder arguments do not exhaust the relevant moral arguments that managers must take seriously when making environmental decisions.[59] Still, they contend that applying stakeholder theory helps to provide a normative basis for corporate environmental ethics, and we do not believe that they establish even this modest contention. Stakeholder theory determines the right course of action by balancing relevant stakeholder interests. There are at least two reasons why balancing stakeholder interests promises little progress in the environmental area. First, as we have already suggested, broad stakeholder theories offer no concrete proposals about how competing and conflicting interests should be balanced in general, and Phillips and Reichart give no reason to think that such balancing would work any better in environmental cases. (In contrast, narrow versions of stakeholder theory that focus on economic interests only may appeal to the long-term economic advancement of a firm's interests within the normative constraints of external, non-stakeholder legal and moral obligations.) Second, and more importantly, the idea of trying to reach a decision about many environmental issues by balancing stakeholder interests seems, on its face, to be morally repugnant. In the Valdez case, for example, imagine that some stakeholders (including shareholders, employees, and others) want Exxon to maximize its profits, and, moreover, they are happy to take profound risks concerning the natural environment of the Alaskan coast in order to make profits. Other stakeholders within the firm, perhaps a small minority, may be willing to risk less profits (or even an occasional loss!) in order to assure protection of the Alaskan coast (or at least to reduce the environmental risks of Valdez-sized oil spills significantly). How should Exxon's managers respond to this conflict of interests?

Simple notions of balancing might suggest that the managers should poll Exxon's stakeholders and take the course of action embraced by the majority or, alternatively, try to find some compromise between majority and minority stakeholder interests. But we would argue that any manager who reasons in this manner when confronted with situations similar to the one posed in the Valdez case evades his or her ethical responsibilities and invites trouble. If lax corporate policy and enforcement with respect to controlling oil tankers near the Alaskan coast is morally wrong, then managers should not adopt, follow, or allow for such a policy, regardless of whether it advances the interests of the company's stakeholders as a whole. A manager who contemplates deferring to stakeholder interests when doing so runs significant risks of massive oil spills in a fragile environment must face the prospect of ferocious condemnation from the public and from juries who consider their cases. This legal trouble includes economic penalties and damages for liability, but it is also at least in part a public expression of well-founded moral outrage.

Deferring to stakeholder interests in the Valdez case is the moral equivalent of engaging in a simple cost-benefit analysis with respect to the natural environment. It amounts to using a decision procedure that fails to capture the moral complexity of the problem that faces a decision-maker.[60] Recall the infamous Pinto case.[61] The gas tanks in Ford Pinto automobiles exploded too easily in minor rear-end collisions, and jurors in the resulting product liability cases apparently believed that it was morally wrong (as well as legally negligent) for Ford to install such dangerous fuel tanks regardless of calculations of costs and benefits. One reason juries reacted so strongly, we maintain, is that Ford's use of cost-benefit analysis in making its decision to produce the faulty design was inappropriate. The jurors responded by awarding plaintiffs enormous punitive damages against Ford.[62]

The Pinto case is not unique. Decision procedures and thinking patterns must be appropriate for the particular kind of business problem at issue. Often, both economic and ethical considerations are relevant. To recall an easy example, if managers decide whether a firm should obey the law by balancing the interests of shareholders or other stakeholders, they reach a decision on this matter using criteria that are considered inappropriate. As we have argued above, businesses have a moral obligation to respect legitimate law quite independently of how it may affect their stakeholders' interests. More generally, we maintain that managers should not behave wrongly even when doing so would advance the stakeholder interests of the firm taken as a whole. This position has obvious implications for dealing with environmental issues; it means that it will often be morally wrong for managers to make environmental decisions by balancing stakeholder interests.

As we see the problem of environmental management as illustrated in the Exxon Valdez case, then, Exxon's managers took great and foreseeable risks with the natural environment along the Alaskan coast in pursuit of profits, and their policies and actions allowing these risks were morally wrong. But even if one disagrees with us about the right course of action for Exxon in the case of the Valdez spill, our general point remains—just as every firm has a moral responsibility to obey the law, so too every firm, including Exxon, has a moral responsibility to "do the right thing" with respect to the natural environment, regardless of its human stakeholders. Identifying the "right thing" to do in environmental cases is often difficult. We do not mean that Exxon must feel itself morally compelled to transform itself into a nonprofit charitable environmental group to advance the cause of environmental protection. Nor do we argue that Exxon should devote all of its resources to reducing any risk of an oil spill to extremely small probabilities. Instead, Exxon's business purpose must instead include environmentally responsible management. We cannot adequately summarize here exactly how we think managerial reasoning within business enterprises about environmental protection should proceed. Plainly, however, there are important moral questions that any decision-maker in this area must face. For example, one should think about the moral importance of the Alaskan coastline routinely traveled by Exxon's tankers. The ethics of environmental management should include issues regarding the unique value of wilderness, the depth of its beauty, and its cultural and historical importance—as well as a contemplation of the role of the business enterprise in the natural order. Large business corporations like Exxon, and perhaps *especially* such large and powerful corporations, should not judge the value of the natural environment purely in terms of economics. Instead, environmental management must include an appreciation of ethical value of the natural environment, including aesthetic, cultural, and historical value. These dimensions of ethical value are not easily measured, but to try to balance ethical values concerning the natural environment in a framework of human interests cannot be done. Questions about the value of nature cannot be answered purely in terms of human interests any more than can such questions as "Is this a piece of great art?" or "Is this mathematical proposition true?"[63]

Conclusion

In the end, stakeholder theories of the firm cannot supply the necessary perspective on the most difficult moral questions in business, such as the obligation to obey the law and to manage in an environmentally responsible manner. Managers, employees, and others who have responsibility for making business decisions and setting business policy have the ethical duty as moral agents acting within an organization to make the best ethical as well as the best economic decisions that they can.

It is therefore important for those who wish to advance a coherent and respectable ethical position in the business world to recognize the conceptual limits of stakeholder theory. Stakeholder theory provides a useful expansion of the interests that are considered to have economic "stakes" at risk in a business enterprise to include non-equity owners, including employees, various types of creditors, and others. But a pitfall in many broad versions of stakeholder theory lies in what several scholars have called "the maddening variety" of who (and what) may count as a legitimate "stakeholder."[64] Limiting the concept of a "stakeholder" to include only actual economic risk-bearing participants in a firm allows for other important ethical considerations of business behavior to be addressed directly and practically, without the baggage of an unnecessary and unworkable theory. Whether or not to obey legitimate law and how to consider the effects of business practices and decisions on the natural environment are two examples of important ethical questions that cannot be reduced to a balancing exercise of competing interests of participants. Some moral issues are more important than stakeholder theory can accommodate—and we maintain that the general ethical obligation to obey the law and the need to think seriously about how a business affects its natural environment are two of them.

Notes

[1] For a leading example, see two articles and several responses collected in the April 1999 issue of the *Academy of Management Review*. Jeff Frooman, "Stakeholder Influence Strategies," *Academy Management Review* 24 (1999): 191; Thomas M. Jones and Andrew C. Wicks, "Convergent Stakeholder Theory," *Academy Management Review* 24 (1999): 206; Thomas Donaldson, "Making Stakeholder Theory Whole," *Academy Management Review* 24 (1999): 237; Dennis A. Gioia, "Pracitcability, Paradigms, and Problems in Stakeholder Theorizing," *Academy Management Review* 24 (1999): 228; Linda Klebe Trevino and Gary R. Weaver, "The Stakeholder Research Tradition: Converging Theorists—Not a Converging Tradition," *Academy Management Review* 24 (1999): 222. Another example appears in the *festschrift* for Max Clarkson collected in the March 1999 issue of *Business & Society*. E.g., Archie B. Carroll, "Corporate Social Performance and Stakeholder Thinking: The Work and Influence of Max B. E. Clarkson," *Business & Society* 38 (1999): 15; Thomas M. Jones, "Max Clarkson, the Toronto Conferences, and the Development of Stakeholder Theory," *Business & Society* 38 (1999): 19; Robert Phillips, "On Stakeholder Theory Delimitation," *Business & Society* 38 (1999): 32; Deborah Vidaver-Cohen, "Taking a Risk: Max Clarkson's Impact on Stakeholder Theory," *Business & Society* 38 (1999): 39; Donna J. Wood, "Living Stakeholder Theory: A Tribute to the Life and Works of Max Clarkson," *Business & Society* 38 (1999): 6. See also *The Corporation and Its Stakeholders: Classic and Contemporary Readings*, Max B. E. Clarkson, ed. (1998).

[2] According to a leading survey of the literature, at least a dozen books and more than 100 articles had already been written on the subject by 1995. Thomas Donaldson and Lee E. Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications," *Academy Management Review* 20 (1995): 65. Another survey counts another 200 articles in the last few years. Kevin Gibson, "The Moral Basis of Stakeholder Theory," *Journal of Business Ethics* 26 (2000): 245.

[3] Donaldson and Preston, supra note 2, at 66; Jones & Wicks, supra note 1, at 206.

[4] See Mark Starik, "Should Trees Have Managerial Standing? Toward Stakeholder Status for Non-Human Nature," *Journal of Business Ethics* 14 (1995): 207. For criticism, see Robert A. Phillips and Joel Reichart, "The Environment as Stakeholder? A Fairness-Based Approach," *Journal of Business Ethics* 23 (2000): 185. We discuss both of these theories below.

[5] For recent philosophical discussions of the importance of the idea of "nature" beyond instrumental human economic interests, see Elliott Sober, "Philosophical Problems for Environmentalism," in *Environmental Ethics*, Robert Elliot, ed. (1995); David Wiggins, "Nature, Respect for Nature, and the Human Scale of Values," *Proceedings of the Aristotelian Society* 100 (2000): 1.

[6] See Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* (1823); David Hume, *A Treatise of Human Nature* (1738); Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776).

[7] For general discussions of the relationship between ethics and economics, see Daniel M. Hausman and Michael S. Mcpherson, *Economic Analysis and Moral Philosophy* (1996); Amartya Sen, "Does Business Ethics Make Economic Sense?" *Business Ethics Quarterly* 3 (1993): 45. At the same time, it is also true that some economists in recent years have attempted to transform all questions of "value" into terms of monetary "price,"

thus ignoring the traditional "distinction between that which did and that which did not lie within the ambit of their discipline." Wiggins, supra note 5, at 14 n. 15, 16–17.

[8] See Ronald K. Mitchell et al., "Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts?" *Academy Management Review* 22 (1997): 853, 856. See also Archie B. Carroll, "Corporate Social Responsibility," *Business & Society* 38 (1999): 268 (which gives a history of the development of the concept from the 1950s to the present).

[9] For discussion and sources, see Eric W. Orts, "A North American Legal Perspective on Stakeholder Management Theory," in *Perspectives on Company Law*, Fiona Patfield, ed., 2 (1997): 169–70.

[10] See A. A. Berle, Jr., "Corporate Powers as Powers in Trust," *Harvard Law Review* 44 (1931): 1049; E. Merrick Dodd, Jr., "For Whom Are Corporate Managers Trustees?" *Harvard Law Review* 45 (1932): 1145.

[11] Mitchell et al., supra note 8, at 855. For a textbook discussion of the interests relevant to corporate social responsibility that correspond to "stakeholders" in more recent theories, see Richard N. Farmer and W. Dickerson Hogue, *Corporate Social Responsibility* (1985): 75–202.

[12] For an explicit recognition of this rhetorical "play" on "shareholder" and "stockholder," see R. Edward Freeman, "Stakeholder Theory of the Modern Corporation," in *Ethical Issues in Business: A Philosophical Approach*, Thomas Donaldson and Patricia H. Werhane, eds. (6th ed., 1999), supra note 7, at 247, 250; Kenneth E. Goodpaster, "Business Ethics and Stakeholder Analysis," in *Ethical Issues in Business*, supra at 257, 258.

[13] For a theoretical survey of different types of business firms and their participants, see Eric W. Orts, "Shirking and Sharking: A Legal Theory of the Firm," *Yale Law & Policy Review* 16 (1995): 265, 298–314.

[14] In the United States, the number of sole proprietorships and partnerships greatly exceeds the number of corporations, but corporations account for most business revenues. According to the most recent census data in 1995, business corporations accounted for over ninety percent of business receipts. Jesse H. Choper et al., *Cases and Materials on Corporations* (5th ed., 2000), 1 and n. 1. See also Eric W. Orts, "The Future of Enterprise Organization," *Michigan Law Review* 96 (1998): 1947, 1962–63 (which reviews statistics on the global dominance of the corporate form of business organization).

[15] For a classic expression of this viewpoint, see Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits," *New York Times* (Magazine), Sept. 13, 1970, §6, at 32. For a more recent and influential argument along similar lines, see Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (1991), 1–39.

[16] See R. Edward Freeman and Daniel Gilbert, *Corporate Strategy and the Search for Ethics* (1988); Thomas M. Jones, "Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics," *Academy Management Review* 20 (1995): 404.

[17] Donaldson and Preston, supra note 2, at 66–67, 70–73.

[18] Ibid. at 87–88.

[19] David Baron, "Private Politics, Corporate Social Responsibility, and Integrated Strategy" (unpublished manuscript, August 2000) (presented at a Wharton School conference on Management Strategy and the Business Environment, Sept. 2000).

[20] See, e.g., Jones and Wicks, supra note 1, at 4217–19 (which argues that "normative" and "instrumental" versions of stakeholder theory "converge" because ethical stakeholder management strategies yield instrumental economic "competitive advantage" to firms).

[21] See R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (1984). Freeman's book is often described as a "landmark" in this respect. See, e.g., Max B. E. Clarkson, "A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance," *Academy Management Review* 20 (1995): 92, 105; Donaldson and Preston, supra note 2, at 65.

[22] William Safire, "Stakeholders Naff? I'm Chuffed," *New York Times* (Magazine), May 5, 1996, §6, at 26 (which cites business texts written in 1975 and 1965). Lee Preston finds evidence that successful American corporations began to refer to conceptions of stakeholder management even earlier, in the late 1940s and early 1950s. Lee E. Preston, "Stakeholder Management and Corporate Performance," *Journal of Behavioral Economics* 19 (1990): 361, 362.

[23] Safire, supra note 22.

[24] Ibid. See also *The Concise Oxford English Dictionary of Current English* (8th ed., 1990), 1186 (which defines "stakeholder" as "an independent party with whom each of those who make a wager, deposits the money, etc. wagered"); Goodpaster, supra note 12, at 258 (which notes that "the term 'stakeholder' is associated with a 'player' in a game like poker," and a person with "a 'stake' in the game is one who plays and puts some economic value at risk").

[25] See Mitchell et al., supra note 8, at 857 (contrasting "narrow" and "broad views" in competing versions of stakeholder theory).

[26] See Max B. E. Clarkson, "A Risk Based Model of Stakeholder Theory" (unpublished manuscript) (working paper for The Centre for Corporate Social Performance and Ethics, University of Toronto, presented at the Annual Meeting of the Society for Business Ethics, Vancouver, Canada, August 1995). See also Max B. E. Clarkson, "A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance," *Academy Management Review* 20 (1995): 92, 105–07 (which describes "primary stakeholders" in these terms and argues that a firm may be understood as "a system of primary stakeholder groups, a complex set of relationships between and among interest groups with different rights, objectives, expectations, and responsibilities"). This concept of "stakeholder" as extending only to parties who "have something at risk" in a corporation is also adopted in *Clarkson Centre for Business Ethics, Principles of Stakeholder Management* (1999), 2.

[27] Freeman, *Strategic Management*, supra note 21, at 64.

[28] See, e.g., Mitchell et al., supra note 8, at 854.

[29] William M. Evan and R. Edward Freeman, "A Stakeholder Theory of the Modern Corporation," in *Ethical Issues in Business*, supra note 12, at 314.

[30] Ibid.

[31] R. Edward Freeman, "The Politics of Stakeholder Theory," *Business Ethics Quarterly* 4 (1999): 409, 412.

[32] Ibid.

[33] See Orts, "Shirking and Sharking," supra note 13, at 270–82, 299. For another example in the legal literature that take accounts of economic stakeholder interests in a theory of the firm, see Margaret M. Blair and Lynn A. Stout, "A Team Production Theory of Corporate Law," *Virginia Law Review* 85 (1999): 247.

[34] For an earlier argument along these lines, see Orts, "A North American Perspective on Stakeholder Management Theory," supra note 9, at 174–76.

[35] For an overview of the basic legal principles, see Eric W. Orts, "Beyond Shareholders: Interpreting Corporate Constituency Statutes," *George Washington Law Review* 61 (1992): 14, 41–48.

[36] *American Law Institute, Principles of Corporate Governance: Analysis and Recommendations* (1994) §2.01(b).

[37] For elaboration of this point, see Orts, "Shirking and Sharking," supra note 13, at 313–14.

[38] Exceptions may include state-owned enterprises, such as in China, and public utilities that are run as businesses but in fact amount to subdivisions of the government. On China, see Minkang Gu and Robert C. Art, "Securitization of State Ownership: Chinese Securities Law," *Michigan Journal of International Law* 19 (1996): 115. In addition, "golden shares" are sometimes granted to government entities in large firms in order to ease transition to private ownership or to prevent hostile corporate takeovers, but this kind of government "ownership" interest is probably better conceived as a regulatory mechanism rather than an economic "stake." See, e.g., John C. Coffee, Jr., "The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control," *Yale Law Journal* 111 (2001): 1, 21 n. 59 (which describes golden shares retained by governments in privatizations); Gustavo Visentini, "Compatibility and Competition Between European and American Corporate Governance: Which Model of Capitalism?" *Brooklyn Journal of International Law* 23 (1998): 833, 848 and n. 59 (which describes golden shares issued to some Italian and British companies when large state-owned industries were privatized).

[39] For example, a business firm may commit civil disobedience in response to a law that it deems immoral and pay the legal consequences, just as individual citizens may. We also agree the businesses may make different ethical judgments about following the law (or give following the law less ethical weight) in countries that have illegitimate governments.

[40] For a recent collection of essays on moral reasons for respecting law, see *The Duty to Obey the Law: Selected Philosophical Readings*, William A. Edmundson, ed. (1999). But also see A. John Simmons, *Moral Principles and Political Obligations* (1979), which argues that there is no general moral obligation to obey the law. For an introduction to the jurisprudential debate, see Kent Greenawalt, *Conflicts of Law and Morality* (1987).

[41] See, e.g., Freeman, "Stakeholder Theory of the Modern Corporation," supra note 12, at 252.

[42] The American Law Institute's "Principles of Corporate Governance" specifically applies this principle to business corporations. See *American Law Institute*, supra note 36, §2.01, cmt. g, at 60 (which observes that though cost-benefit economic analysis "may have a place in the state's determination whether a given type of conduct should be deemed legally wrongful," "the resulting legal rule normally represents a community decision that the conduct is wrongful as such, so that cost-benefit analysis whether to obey the rule is out of place").

[43] See Joel Feinberg, "The Rights of Humans and Unborn Generations," in *Rights, Justice, and the Bounds of Liberty,* Joel Feinberg, ed. (1980), 159; Sober, supra note 5.

[44] Dennis Gioia argues that proponents of a normative approach too often amount merely to "shouting from the sidelines that organizational decision-makers should do the right thing." Gioia, supra note 1, at 228. We share Gioia's general aversion to shouting. On the other hand, we think that identifying the morally right course of action in business is often not an easy thing to do, and Gioia's appeal to the social sciences does not offer answers to hard normative questions. There are therefore an abundance of worthwhile topics and activities for non-shouting normative theorists concerned with business ethics.

[45] Starik, supra note 4, at 214.

[46] Ibid.

[47] In this article, we use the words "nature" and "natural environment" interchangeably.

[48] See Feinberg, supra note 43, at 165.

[49] See Sober, supra note 5, at 227 ("[T]rees, mountains, and salt-marshes do not suffer. They do not experience pleasure and pain, because, evidently, they do not have experiences at all.").

[50] Ibid. at 239. Sober claims no originality for this argument, which he attributes to Mark Sagoff, "On Preserving the Natural Environment," *Yale Law Journal* 84 (1974): 205, 220–24.

[51] The normative importance of the continued existence of various endangered species also follows the same logic. Sober, supra note 5, at 239–40. Particular animals or plants may have needs. But the idea of preserving a species of animals or plants cannot be said to be necessary (since evolution is the history of the creation and destruction of species) or to represent interests (other than human interests in using genes, etc. for human uses, including possible future uses).

[52] This is perhaps part of the intuition informing Leopold's recommendation of a "land ethic": "A thing is right when it tends to preserve the integrity, stability, and beauty of the biotic community. It is wrong when it tends otherwise." Aldo Leopold, *A Sand County Almanac* (1966), 262. The problem is that humanity itself and human environments also count as part of "the biotic community."

[53] For an elaboration of the moral and aesthetic argument in favor of the preservation of species as a "whole," see Sober, supra note 5, at 240–47. Of course, human beings (including stakeholders of various firms) also have an interest in preserving the natural environment for their own health and survival (and that of future generations). But our argument here is that the moral obligation to respect the natural environment is not limited to human interests.

[54] Phillips and Reichart, supra note 4, at 193.

[55] Ibid. at 191.

[56] Ibid. at 191–94.

[57] Ibid.

[58] See Alan Strudler, "Valuing Nature: Assessing Damages for Oil Spills," *Report from the Institute for Philosophy and Public Policy* (1995): 6–9. For a useful account of the ensuing litigation and its consequences, see Deborah S. Bardwick, Note, "The American Tort System's Response to Environmental Disaster: The Exxon Valdez Oil Spill as a Case Study," *Stanford Environmental Law Journal* 19 (2000): 259. For an economic analysis, see Victor P. Goldberg, "Recovery for Economic Loss Following the Exxon Valdez Spill," *Journal of Legal Studies* 23 (1994): 1.

[59] Phillips and Reichart, supra note 4, at 190.

[60] See Elizabeth Anderson, *Value in Ethics and Economics* (1993), 190–216.

[61] See Richard T. DeGeorge, "Ethical Responsibilities in Large Organizations: The Pinto Case," *Business & Professional Ethics Journal* 1 (1981): 1.

[62] Against our view, one might say that the problem with Ford was not that it engaged in cost-benefit analysis, but that it did not set a high enough price on the environment in its cost-benefit analysis. For a recent response to this variety of argument, see Anderson, supra note 60, at 190–216. Anderson argues that it is morally repugnant to make certain choices in terms of price, and that this aversion inheres in the very idea of using price as a standard of decision-making, rather than the price chosen. It is easy to see the sense in her analysis when one thinks about a personal decision, such as the choice of spouse: Anybody who chooses a spouse based on the expected financial advantages is morally strange in unattractive ways. We agree with Anderson that an anti-pricing or anti-commodification argument is plausibly applied to environmental cases. Of course,

Anderson is not the first person to make broad arguments against using cost-benefit economic analysis alone to inform decision-making. For important predecessors, see Michael Walzer, *Spheres of Justice* (1984) (which argues that qualitatively different choice criteria are relevant in different normative realms); Mark Sagoff, *The Economy of the Earth* (1988) (which argues that cost-benefit analysis cannot suffice to answer environmental questions that have important moral and aesthetic dimensions). These authors do not argue that economic considerations are irrelevant to environmental decision-making. Instead they argue simply that not all considerations relevant to decisions about the environment can be translated into economic terms. We agree.

[63] As David Wiggins argues, human values are necessarily developed on "a human scale," but they are not necessarily "human centred." Wiggins, supra note 5, at 7–8. For a classic work on the idea that the natural environment is morally and aesthetically valuable independent of human interests, see Leopold, supra note 52. Leopold's arguments are embraced and developed in Sagoff, *The Economy of the Earth*, supra note 62. For an excellent anthology discussing related issues, see *Environmental Ethics*, supra note 5. For a philosophical discussion that more closely resembles Starik's position, see Holmes Rolston, III, *Environmental Ethics: Duties to and Values in the Natural World* (1988).

[64] Mitchell et al., supra note 8, at 853. These scholars attempt to clarify stakeholder theory through the following "attributes" for identification: (1) the "power" of an interest group to influence a business firm's behavior, (2) the "legitimacy" of an interest group's relationship to the firm, and (3) the "urgency" of a interest group's claim on the firm. Ibid. at 854. We fail to see, however, how these attributes provide a solution to the identification problem. If anything, these attributes seem to illustrate the conceptual problems of broad versions of stakeholder theory.