

# Stakeholder Capitalism

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**ABSTRACT.** In this article, we will outline the principles of stakeholder capitalism and describe how this view rejects problematic assumptions in the current narratives of capitalism. Traditional narratives of capitalism rely upon the assumptions of competition, limited resources, and a winner-take-all mentality as fundamental to business and economic activity. These approaches leave little room for ethical analysis, have a simplistic view of human beings, and focus on value-capture rather than value-creation. We argue these assumptions about capitalism are inadequate and leave four problems in their wake. We wish to reframe the narrative of capitalism around the reinforcing concepts of stakeholders coupled with value creation and trade. If we think about how a society can sustain a system of voluntary value creation and trade, then capitalism can once more become a useful concept.

**KEY WORDS:** capitalism, stakeholder, ethics, economics, free market

## Introduction<sup>1</sup>

We live in the age of markets. While markets have been around for thousands of years, we are just beginning to understand their power for organizing society and creating value. In the last 200 years markets have unleashed a tremendous amount of innovation and progress in the West. The industrial revolution, the rise of consumerism, and the dawn of the global marketplace have each in their own way made life better for millions of people. Many of us now know comforts, skills, and technologies that our ancestors could only dream of.

Along side these great strides forward, are a set of deeply troubling issues. Capitalism and markets have also notoriously increased the divide between the rich and the poor, both within and across nations. In the pursuit of innovation, we have become blind to some of the harmful consequences of our actions on others, such as environmental degradation, dominance of less privileged groups, and the inequitable distribution of opportunities. The seeds of these deeply troubling issues are beginning to germinate. Global warming, global financial crises, and global terrorism threaten to destabilize our world. It is more imperative than ever to carefully study and understand the power of markets and capitalism.

In this article, we present five contemporary narratives of capitalism and show that each privileges the rights of one group over the others. In addition all five narratives make a set of assumptions about markets and capitalism that we believe to be

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counterproductive. Each assumes that market participants have naïve self interest, that morality is separate from (or even antithetical to) prosperity, and that competition for limited resources (value as a zero-sum game) is the dominant mode of prosperity.

Our claim is that the great strides forward and the deeply concerning issues about markets and capitalism are connected to these assumptions. The majority of current conversations about capitalism are not about these fundamental assumptions, but about designing the best enforcement mechanisms. We have been told that institutions and legal structure can solve the troubling consequences that arise in a market. Are property rights enforced? Transaction costs reduced? A good market design helps to foster good behavior on the part of market participants. We agree. Institutional structure and market design surely go along way in helping markets thrive. We want to add that the way we talk about markets and the assumptions we make about value creation also play a role in creating the outcomes we want and also those we do not. We show how four contemporary problems are connected to the way we talk about capitalism.

In the final section of this article we offer a new narrative of capitalism, one that builds in morality and ethics from the foundations, and acknowledges stakeholders as essential to value creation and trade, rather than trying to put the rights of one group beyond discussion. Stakeholder capitalism is a way to resolve some of the deep tensions within capitalism, and to better foster the powerful innovations that can help us all live better.

### **The narratives of capitalism**

In this section, we will examine five contemporary narratives of capitalism that dominate academic, political, and practitioner discourse and thinking. Each of these current narratives falls short in addressing the concerns of a broad set of stakeholders, and makes a series of assumptions that perpetuate many of the problems of capitalism. We fully acknowledge that our discussion does not represent a complete survey of thought on capitalism. We have chosen these views because they are most prevalent in modern discourse, and we are indebted to their authors for furthering our thinking

and that of countless other academics on the subject. The classic narratives of capitalism – that of labor, government, investor, managerial, and entrepreneurial – retell the story of value creation and trade from the perspective of one stakeholder, whose views become inseparable from and ultimately stand in for the larger story.

#### *Labor capitalism*

Since the revolutionary writings of Marx and Engels, the term capitalism has been tied to class division: specifically the self-aggrandizement of the capitalist at the expense of the proletariat. The division of society into capitalist and labor has always played a central role in Marxist writings, from examinations of the American Civil War to detailed investigations of pricing. Marxism, and its political derivatives socialism and communism, turn on the dialectic between the capitalists (or bourgeoisie) who own property and the means of production and the laborers (or proletariat) who own no property and are obligated to sell their labor to the bourgeoisie to gain subsistence (Marx and Engels, 1847). For Marx and Engels, this labor market is inherently fraught with tension, since the interests of the capitalist and the laborer are diametrically opposed. Within these competing interests, those of the laborer dominate Marx and Engels' view of capitalism. Engels points out in the *Principles of Communism*, which later became the foundation for the *Communist Manifesto*, that:

To say that “the worker has an interest in the rapid growth of capital” means only this: that the more speedily the worker augments the wealth of the capitalist, the larger will be the crumbs which fall to him, the greater will be the number of workers that can be called into existence, the more can the mass of slaves dependant upon capital be increased. (Marx and Engels, 1847)

Ethics and moral language are obscured when viewed through the Marxist lens. Noted Marx scholar David McLellan comments on the apparent paradox in his introduction to *Socialism and Morality*,

Morality has been viewed by Marxists as a form of ideology reflective of class interests and of changing social patterns. Such a stance ruled out appeal to moral

principles by Marxism, which was viewed as a science of society and therefore as indifferent to morality as was, say the science of biology. On the other hand, the works of Marxists from Marx himself onwards have contained bitter condemnations of the injustices of capitalism, and have been shot through with moral terms such as ‘alienation’ and ‘exploitation’. (McLellen and Sayers, 1990)

The Marxist version of capitalism tells a story where the opposing groups of labor and capital, fight over the fixed resources of productive assets. Economic and business activity itself is amoral and the only inevitable solution for labor is to take control of those productive assets by force.

### *Government capitalism*

Born in the same year of Marx’s death, economist John Maynard Keynes was concerned with the vagaries of the labor market, specifically, the stability in national unemployment rates. In his acclaimed *General Theory of Employment, Interest, and Money*, Keynes traced the connections between unemployment, consumption, and investment (Stewart, 1999). Keynes’ revolutionary shift of economic thought from a micro view (pricing and cost mechanisms) to a macro view (national income and employment) has had tremendous policy implications for political economists and theoretical implications for business academics (Romano and Leiman, 1970). To the requisite institutions of capitalism, he added the idea that capitalism could and should be managed by the government.

For Keynes, the world was far too complex for individuals to bring about the necessary changes for a good society. Since Keynes believed that a government that heavily regulated economic affairs could attain optimal levels of wealth and employment, we credit him with the creation of *government capitalism* where the government and its rights dominate the needs of all other stakeholders in the narrative of capitalism.

Although Keynesian economics has become less popular in the post-cold war period, Keynes’ deeper view of capitalism still holds strong among liberals and academics. It is explicit in Keynes’ views that capitalism without interventions by the government would lead society astray from ‘ideal values’. In fact,

capitalism, according to Keynes, fosters a counter-productive love of money:

The love of money as a possession – as distinguished from the love of money as a means to the enjoyments and realities of life—will be recognized for what it is a somewhat disgusting morbidity, one of those semi-criminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease (Hoover, 2003).

The metaphor in this narrative is of a garden, that capitalism left to its own devices would produce chaos and despotism through a love of money. The government is seen as the gardener, who by his skill, knowledge, and wise management keeps the productive powers of capitalism at bay, and creates a utopia by enacting policies that keep growth and weeds in balance.

Keynes’ view of utopia and ideal values were heavily influenced by the moral philosopher, G. E. Moore. Both viewed certain mental states as morally good in and of themselves. It was these states that Keynes hoped to foster in the American public through his economic policies. A closer look at these mental states shows “Keynes’ belief in the rationality of ends and the homogeneity of values;” in short there was a finite moral answer for Keynes, which he believed everyone should attain (Skidelsky 1995). Ethics in this view becomes about one person’s interpretation of the good that is made to stand for everyone and thus becomes unattainable in a diverse and changing world. Furthermore, ethics is imposed by government through the amoral tool of economic policies – to regulate a system that is seen as actively leading society astray from the good.

Keynes view of capitalism is conflicted – the system can do good, but this requires government intervention:

I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life (Romano and Leiman, 1970).

The concept of the welfare state is a later descendant of Keynes’ vision of capitalism. Today many echo

Keynes' distrust of capitalism and reassure their faith in the government to solve the problem created by the market.

### *Investor capitalism*

In direct opposition to many of Keynes' conclusions, Milton Friedman advocates a return to laissez-faire economic policies and a reliance on the market mechanisms to achieve "fair" distributions. Economic freedom – the ability to buy and sell without interference from the government – becomes central to Friedman's vision. It is important to note, that Friedman believes in economic freedom for particular groups, namely shareholders. To facilitate this view, Friedman limits the role and rights of the government in his narrative about how capitalism should function. In Friedman's view government's role should be relegated to eliminating monopolies, reforming the tax laws in favor of corporations, and maintaining civil law and order.

As Friedman shifts focus away from government and its regulation of capital, he focuses the limelight on a new dominant group: investors. In fact the whole of commercial business activity has one specific purpose: "to use its resources and engage in activities designed to increase its profits, so as it stays within the rules of the game, which is to say, engages in free and open competition, without deception or fraud (Friedman, 1962)." This goal is the investor's goal and is assumed to be in competition with alternative stakeholders' goals. In Friedman's view shareholders who are better off will continue to invest in the market and produce better results for all. Friedman and those who give priority to the concerns of investors above and beyond the concerns of other stakeholders, subscribe to *investor capitalism*.

Friedman's writings suggest that he views the inner workings of capitalism as amoral. His analysis and description of capitalism is given in monetary terms and in the language of economics, a grammar that avoids 'non-factual' value distinctions (Romano and Leiman 1970). Nevertheless, ethics and morality play a large role in justifying Friedman's claims about the importance of free enterprise and actions against a centrally mandated economy:

The fundamental threat to freedom is power to coerce, be it in the hands of a monarch, a dictator, an oligarchy, or a momentary majority. The preservation of freedom requires the elimination of such concentration of power to the fullest possible extent and the dispersal and distribution of whatever power cannot be eliminated... (Friedman, 1962).

Friedman offers us a story of capitalism, where values and ethics do not enter into the heart of how we create value and trade it with each other. In his view, ethics is a side constraint, since managers are expected to refrain from fraud and deception. For Friedman, the purpose of the capitalist system is to increase wealth for the investor. In fact, any consideration outside that goal – for example, consideration of the welfare of customers, concern for the community, or charity – is seen as in competition with investor needs and diverting resources away from the primary goal. Friedman goes so far as to say that "social responsibility" is a tax on the investor and that such considerations take money out of the hands of the primary stakeholder. Investor capitalism sees the investor as the primary engine for economic growth; any obstacles to the investor's concerns become obstacles to capitalism's ability to create wealth.

### *Managerial capitalism*

For scholars studying capitalism and the corporation, the owner of the private property is in control. Keynes, Marx, and Friedman assume that the investor (or stockholder) is the owner of the means of production and has responsibility and control over its use. Managerial capitalism, on the other hand, clearly differentiates the managers of the organization from the investors and other stakeholders. Berle and Means in *The Modern Corporation and Private Property* see traditional economic theory as inadequate in handling the newly differentiated roles between ownership and control of assets (Berle and Means, 1932). For Berle and Means, we are now dealing with distinct functions: ownership on the one side, control on the other. This control tends to move further and further away from ownership and ultimately to lie in the hands of the management itself, a management capable of perpetuating its own position. These distinct functions of ownership and

control now lay in the hands of opposing groups with competing interests.

Similarly, Marris in *The Economic Theory of 'Managerial' Capitalism* positions managers as separate and distinct from all other stakeholders including investors (Marris, 1964). Managers, as those who both control and have responsibility for the corporation, are the dominant group of interest for this view of modern capitalism. This line of scholarship is continued through the literature on agency theory where owners of corporations are seen as property holders of the organization and managers are the agents of those stockholders. Managers have a contractual or fiduciary duty to shareholder interests above and beyond any other relationship in managing the shareholder's property (the organization in this case). Continuing within this narrative, agency theory positions the managers' interests to be in competition with other stakeholders.

Managerial capitalism's view on business ethics is more complicated. As Berle and Means state, "Neither the claims of ownership nor those of control can stand against the paramount interests of the community (Berle and Means, 1932)." While acknowledging the community interests as an important consideration to the functioning of the firm, the authors also believe it to be essential for the "control" (or management) of the corporation to develop into a purely neutral technocracy. Similar to Friedman, the process of business is considered amoral with a reconciliation to morality or community interests required.

Marris continues by stating that directors or managers who pay attention to competing social interests to the detriment of profits may be popular. However, he also believes managers to have growth and productivity as primary goals and constraints for their actions. Marris' view of morality and motivation outlines the financial motivations of managers in their role as controllers of the corporation. Marris does, however, find the rules of the game to be open and flexible giving managers the opportunity to pursue alternative goals than those which are financial.

### *Entrepreneurial capitalism*

The entrepreneur is missing from many of the views of capitalism outlined above. Yet, the entrepreneur becomes an important stakeholder to ignore as she

epitomizes the role of value creation in the capitalistic system. Within modern theory, economists such as Schumpeter (1942), Kirzner (1979), and more recently Baumol (1990) emphasize the role of the entrepreneur within capitalism and epitomize what we are calling *entrepreneurial capitalism*. For these authors, the entrepreneur functions as the dominant player within the capitalist system. So dominant is the entrepreneur that she is the lifeblood of capitalism and "thoroughly and profoundly shapes and determines economic phenomenon (Kirzner, 1985)."

Schumpeter (1942) argues that the entrepreneur is in the process of *creative destruction* – necessitating the destruction of the current market to introduce a new market. In doing so, Schumpeter posits the entrepreneur in opposition to the status quo interests of other stakeholders and in competition over resources. Others, within this same narrative, do not take such a view. Kirzner allows for the entrepreneur to be a part of *creative discovery* and focuses on a more positive vision of capitalism within the "Austrian" tradition of modern economic thought. Such a narration of capitalism leaves open the possibility of a strong role for business ethics. However, such a role is not explicitly stated within these scholars.

Each author differentiates the entrepreneur and singles her out from capitalists, property owners, managers, and laborers. Entrepreneurs for these economists are decidedly different – and each has their own interpretation of that difference. One piece that is common to all, however, is the importance of the role of the entrepreneur in the capitalist system as the agitator who leads all others out of the status quo.

### **Problems with the traditional narratives**

All five narratives make a similar set of assumptions about markets and capitalism that we believe to be counterproductive. Each narrative assumes that market participants have a naïve version of self-interest (that one's self-interest is not connected to, or doesn't take into account the self-interests of others), that morality is separate from (or even antithetical to) economic prosperity, and that competition for limited resources (value as a zero-sum game) is the dominant mode of prosperity. These three assumptions combine to create four problems

with the traditional models of capitalism that manifest within theory and practice: the problems of competition, business ethics, the dominant group, and of business in a liberal democracy.

#### *The problem of competition*

By pitting individuals against one another within the survival-of-the-fittest atmosphere, narrators within the traditional approach to capitalism foster the notion of competition as a *prerequisite* to capitalist society. Competition is necessary, it is argued, due to the many individuals fighting over the same resources. Other individuals are seen as a threat to survival rather than as potential partners for value creation, and capitalists are left with the problem of resolving competitor demands and threats.

The focus on competition rather than cooperation is mistaken on two counts. First, focusing on how to beat stakeholders and retain power in any relationship leaves out those many instances where collaboration is necessary to survive. For many entrepreneurial ventures, strong collaborating relationships are necessary to create sustainable organizations. According to Sarasvathy (2001), entrepreneurs rely on non-competitive stakeholder relationships to navigate the perils of extreme uncertainty and to bolster their legitimacy. Those creating markets for future goods and services (Shane and Venkataraman, 2000) simply cannot miss value-creating relationships to create a sustainable competitive advantage. While entrepreneurs are the lifeblood of capitalism, the traditional story of capitalism does not tell their story of collaboration and mutually beneficial relationships for survival.

Second, we do find those instances with limited resources and minimal growth in the form of some commodity markets. According to traditional strategic thinking, this situation leads to intense rivalry and should be avoided. However, value-creation can emerge from joint resolution of issues rather than in determining a single winner. Using imagination to create sustainable collaborative relationships can lead managers to be more effective within even highly competitive markets. Large gains in prosperity throughout history are associated more with mutually beneficial trade (which creates value) than with dominance (which tries to capture value).

The modern descendant of this focus on competition rather than cooperation is exemplified in the much used Porter's Five Forces analysis of industries (Porter, 1985). While strategists were focusing on the bargaining power of organizations versus their customer and suppliers, managers were realizing that a good relationship with their supply chain partners could be a competitive advantage. Using Porter's Five Forces analysis would lead one to assume that a single, strong relationship with a stakeholder would be detrimental as that stakeholder would hold too much power over the firm. In fact, all of the work within the automobile industry in the past two decades in reducing suppliers and creating long-term sustainable relationships would be considered to be to the detriment of each of manufacturers. This analysis relies on the assumption that firms and individuals are in competition with each other.

#### *The problem of business ethics*

If, as is assumed in the current narrative of capitalism, individuals are in a constant survival mode with value being 'taken' rather than 'created,' ethics is assumed to have a limited (and even detrimental) role in capitalism. We are faced with a continual "Ethics Crisis" as we have mistakenly taught managers that business within capitalism is by its very nature amoral. Individuals are in competition with others for limited resources and societal rules are assumed to be of limited value. The traditional models of capitalism needlessly separate capitalism from ethics by making the foundations of capitalism competition and autonomy. This Separation Fallacy is described by Freeman (1994):

The discourse of business and the discourse of ethics can be separated so that sentences like, "x is a business decision" have no moral content, and 'x is a moral decision' have no business content.

The problem of business ethics is that ethics is left out from the story of capitalism. Rather than acknowledging the moral dimensions of every decisions – whether in business or not – academics and practitioners have created a separate sphere of norms, rules, and morals and named it capitalism where competition and winning dictate the rules of the game.

Ironically, the arguments against acknowledging values or morality within a survival of the fittest narrative of capitalism ignores the fact that moral concepts, such as relationships, mutually beneficial agreements, teams, trust, honesty, and care are necessary in those instances when survival of the individual, group, or organization is at stake. As Daniel Dennett (1995) illustrates, evolutionary theory or jungle metaphors do not negate ethics and morality in and of themselves. Mutually beneficial agreements (versus opportunism), group focus (versus individualism), and empathy (versus narcissism) foster surviving and thriving.

The Separation Fallacy is evidenced by the phrase “It’s just business” which runs rampant within society and seeps into the business ethics literature. We see the dominance of investor rights, the diminishment of good, moral decisions at the sight of any profit-taking, and the very question *if* we should consider value-systems when assessing a business decision, leader, or organization. Business ethicists reinforce this separation of moral and capitalist rules with the constant question of if and how to reintegrate the two and the assumption that capitalism is based on competition.

In doing so, this approach guides managers to ignore the ethical implications of their decisions. This, however, does not make their decisions amoral; rather it causes managers to “do ethics badly (Wicks and Freeman, 1996).” Business ethicists are left to add ethics back into the story of capitalism.

#### *The problem of the dominant group*

This competitive framing of capitalism leads to debates over who is the “dominant” group in a market – the ideas of competition tumble over to those intimately involved in the organization. The focus is on the conflicting needs and demands of labor, government, investors, and managers in the hopes of resolving the ‘inherent’ conflicts. As such, one group must dominate in order to win the conflict and thereby prioritizing the demands. The ensuing relationships are “fraught with tension” (Freeman et al., 2006).

The problem of the dominant group is that there must be one group whose rights trump the rights of others. The wishful thinking behind this view goes

something like, “if only we were all to just follow the right leading group and align our interests with theirs, the ills of capitalism would be solved, and we would become more prosperous.”

For Keynes, the government’s rights and responsibilities supersede all others. For Marx, the laborers rights have been ignored for too long. Berle and Means’ major contribution was in securing separate rights for management. Friedman’s focus on investor rights diminished the role of all other stakeholders including government. After securing dominant rights, each narrative positions the organization in existence to serve the needs of the corresponding dominant group. Not only must the goals of the dominant group become the goal of the organization, but all organizational decisions must then take into account the rights of this dominant group.

These narratives do not simply ignore other stakeholders. Rather, each narrative presumes that by focusing on the interests and rights of their dominant group, all other stakeholders will benefit. Friedman is particularly pointed when he argues that in allowing investors to prosper, all others will benefit as a result. We see many benefits in meeting the needs of a dominant group in these narratives including:

- The economy is prevented “from falling into a rut and precludes those who constitute the economy from falling into lethargy” (Baumol).
- Society is lead toward ideal values (Keynes).
- All other stakeholders see better results (Friedman).
- Economic growth rises (Friedman and Schumpeter).
- Income justly distributed to other stakeholders (Berle and Means).
- Alternative, nonproductive interests kept in balance (Marx, Berle and Means).

Such a paternalistic treatment of stakeholders acknowledges stakeholders existence and need to thrive yet subsumes stakeholders’ interests to those of the dominant group.

Each of these views improperly focuses on one group to the detriment of all others. We may encounter specific instances where the needs of one

group – e.g. the investor – trumps those of others. However, by entering into every decision with this type of a priori prioritization leads academics and practitioners to make decisions that can hurt the long-term value creation of the company.

In practice, placing stakeholders in opposition to one another leads to a focus on winning and losing as opposed to working together. Situations are analyzed with an either/or mentality since requirements of the different groups are assumed to be in opposition.

### *The problem of business in a liberal democracy*

When we create the problems of competition, business ethics, and dominant groups, we also generate corresponding roles for government to fix these problems. This Problem of Business in a Liberal Democracy is a problem of creating a larger, more intrusive government in a system that is founded on a liberal democracy.

The state has three primary roles in support of the problems created above. First, the government *resolves conflicts* between stakeholders. With winners, losers, and limited resources (The Problem of Competition) comes the role of the referee to resolve those conflicts. Rather than allowing organizations and individuals to create their own relationships, the state becomes the place to resolve conflicting, because individuals “cannot be trusted to find solutions that will benefit society.”

Second, the state *legislates morality* of capitalism. Amoral capitalists (The Problem of Business Ethics) necessitates the legislation of morality on business, organizations, and individuals. This is most commonly seen through the legal system, where the boundaries of propriety are laid out, clear as night and day. It is assumed that individuals and organizations are allowed to move freely and within moral norms within the bounds set by legislators.

Third, the state *redistributes resources*. When one group is assumed to dominate all others in the acquisition of resources (The Problem of the Dominant Group), the government is called upon to redistribute those resources when they become too unbalanced. One group is assumed to be constantly taking from all others; and the government is in

existence to protect these disadvantaged groups and redistribute the resources through a tax code.

Ironically, these roles for the state are self-perpetuating. When government is assigned roles to solve problems that, as is argued in this paper, were never systemic problems, we are left with a solution in search of a problem and a solution that begets more problems. As government fulfills its role, the consequences are a continuation of a problem rather than a solution:

- If we set up rules governing morality of individuals and organizations, we absolve those agents of their responsibility to conduct business within community norms. That is now the government’s job. Individuals and organizations within a capitalist society are expected to behave poorly and without a personal value-system as long as they stay within the moral code as legislated – Keynes noted that capitalism without government intervention, would lead society astray from ideal values. As Berle and Means state, the role of the organization is “balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity (Berle and Means, 1932).”
- If we rely upon the state to redistribute wealth, they will inevitably make a mistake and create a further need to re-redistribute wealth. Milton Friedman warns, “In fiscal policy as in monetary policy, all political considerations aside, we simply do not know enough to be able to use deliberate changes in taxation or expenditures as a sensitive stabilizing mechanism. In the process of trying to do so, we almost surely make matters worse (Romano and Leiman, 1970).”
- If we rely upon the state to solve stakeholder conflicts, individuals and organizations never develop the imagination required to create different, mutually beneficial relationships. In addition, the parties are not expected to learn how to resolve issues themselves when the court system was created for such a purpose.



Further, the legislative system is gamed by individuals and organizations and manipulated to their advantage. As evidenced by the proliferation of civil court cases, lobbying for favorable legislation, and industry writing their own regulations (later enforced by the state), businesses have not allowed the government to be the dictator of capitalism. However, businesses involvement with government also enlarges and perpetuates the role of government. Collusion and civil law suits become a strategic tool.

This view of government leaves out a role for the state as a part of value creation. Rather than solving disputes and reallocating resources, the state could be a player in the capitalist system in knocking down barriers to value creation and trade. However, as it stands, the government is too busy solving problems that need not exist.

### Stakeholder capitalism

We wish to offer a new vision of capitalism – stakeholder capitalism – founded on libertarian and pragmatist lines. Stakeholder capitalism is not based solely on private property, self-interest, competition, and free markets – such a view requires constant justification based on achieving good outcomes or avoiding authoritarian alternatives. We argue that we do not need to justify capitalistic systems based on the outcome or the alternatives – the principles of capitalism are worthy goals in and of themselves. Rather stakeholder capitalism is “based on freedom, rights, and the creation by consent of positive obligations.”

First, adults have *freedom* to do what they want including making voluntary agreements that are sustainable over time. Rather than focusing on individuals in competition over limited resources as in traditional narratives of capitalism, stakeholder capitalism focuses on individuals voluntarily working together to create sustainable relationships in the pursuit of value creation.

Second, individuals have rights protecting them in those agreements. One group’s rights do not *prima facie* dominate the narrative of capitalism. Rather, each stakeholder should be protected within their voluntary agreements. Finally, those individuals can decide to cooperate and *obligate themselves* to others through those voluntary agreements. These obliga-

tions can take the form of formal written contracts or social contracts with assumed responsibilities. The relationships are sustainable when these obligations and responsibilities are upheld.

We offer six principles that together build a framework for our value creation and trade that infuses ethics at the foundations, respects the complexity of human beings, fosters innovation, and can help us move beyond the problems outlined above.

#### *Principles of stakeholder capitalism*

1. *The Principle of Stakeholder Cooperation* – “Value can be created, traded, and sustained because stakeholders can jointly satisfy their needs and desires by making voluntary agreements with each other that for the most part are kept.”

Rather than assume that we are all first and foremost self-interested and out to maximize our own benefit, this principle highlights the social nature of value creation. Value, any value is a social phenomenon. We must create value in a context, with the help of others and with others who value what we create. This principle acknowledges that business activity is explicitly social and uses that to enhance the process of value creation.

2. *The Principle of Stakeholder Engagement* – To successfully create, trade and sustain value, a business must engage its stakeholders.” Almost every business transaction involves: customers, suppliers, communities, employees, and financiers. Other stakeholders, such as media, additional civil society representatives, NGOs, etc. are often affected or can affect value creation.”

Rather than argue over whose rights trump whose, this principle acknowledges that a large cast of stakeholders are necessary to sustain value creation. As often as possible the needs of multiple stakeholders must be met. There may be specific situations in which privileging the rights of one group can benefit others in the long-term, but this is not clear *prima facie*, and must be decided upon by the effected parties.

3. *The Principle of Stakeholder Responsibility* – Value can be created, traded, and sustained because parties to an agreement are willing to accept responsibility for the consequences of their actions. When third parties are

harmed, they must be compensated, or a new agreement must be negotiated with all of those parties who are affected.”

This principle rejects the view that business is amoral or even immoral. If business is a social process, then morality is at its center. Scandals and selfish behavior are a breach of the trust and transparency that is the normal for business to flourish. Being proactive about effects on others, rather than waiting for government recourse, will help managers build stakeholder trust and loyalty which will help create more sustainable business.

*4. The Principle of Complexity* – Value can be created, traded, and sustained because human beings are complex psychological creatures capable of acting from many different values and points of view.” Individuals are socially situated and their values are connected to their social context.

This principle rejects the cardboard view of human nature at the heart of the current narratives of capitalism. People are complex, they act for a variety of reasons. Their actions benefit themselves and others, and people usually take that into account. It is also important to note, that since we are complex we are able to differentiate consequences based on who is being affected. It is part of human nature to care more about consequences that affect those we are close to, than those that affect others. That is another reason why the Principle of Stakeholder Responsibility is important. It helps to balance our natural tendency to discriminate and reminds us that despite our differences and separation we still can have profound effects on each other.

Based on these principles, capitalism becomes “the voluntary associations of fair, responsible, cooperation, consenting, and complex adults” and does not include competition or self-interest as foundational assumptions.

*5. The Principle of Continuous Creation* – “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.”

Self-interest is not the only source of innovation or progress. Working with others and for others can be

a stronger motivation to enhance the pace of progress.

*6. The Principle of Emergent Competition* – “Competition emerges from a relatively free society so that stakeholders have options.” “Competition is an emergent property rather than a necessary assumption to capitalism.”

This principle also highlights the ways in which our assumption of competition can affect our behavior. Not every interaction is a zero-sum game and not every interaction has a win-win solution. We should do our best to look for the win-win before jumping to other sub-optimal solutions.

Finally, these principles and the stakeholder capitalism view do not claim to be a panacea. There will always be a small minority who are focused on their own self-interest at the expense of others. Our claim is that we should set the bar for capitalism at the best we can achieve not limit it by trying to only avoid the worst. Talking about capitalism this way can foster behavior along these lines. Those that choose to exploit the trust of their stakeholders for their own gain, are doing so at their own peril.

We are not claiming that by adopting these principles we will remove conflict from capitalism and that from then on things will be easy. In some ways explicitly dealing with stakeholders is harder than ignoring them. Participants in the value creation process will have to have a thick skin, patience, and be comfortable with conflict and change. These things are not easy. But creating value necessitates them. They provide the opportunity for real leadership.

## Conclusion

In the social sciences, the way we talk affects what we see and how we live. The theories we create and the stories we tell become self-fulfilling prophecies. We argue that the same process is at work in our discussions of capitalism. The current narratives of capitalism assume naïve self interest, the separation of business and morality, and that valuable resources are limited. These assumptions form the core of four problems that we currently face: the problem of competition, business ethics, dominant groups, and of business in a liberal democracy. If we are to overcome these problems we will have to change the

way we talk about business as well as the way we actually conduct it. The stories we tell and the assumptions we make about business effects how business is actually carried out. By making these assumptions explicit and optional rather than implicit and mandatory, we hope that we can move a step closer to overcoming the deeply troubling issues that surface in our current practice of value creation.

Business should be about the best that we can create together, rather than about avoiding the worst. If we critically embrace a new set of assumptions about how value is created, the practice of business will soon follow. We do not have to sacrifice the great strides forward to solve some of the deeply troubling issues with capitalism. We need to think critically, acknowledge the social nature of value creation, and work with an insatiable passion to create value for our stakeholders.

## Notes

<sup>1</sup> Some of the ideas in this paper appear earlier in: Freeman (2000), Freeman and Philips (2002), and Freeman et al. (2006). We are grateful to the editors and publishers for their permission to recast some of the ideas in these papers here.

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