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Baumfield, Victoria

Published in:
Australian Journal of Corporate Law

Published: 31/08/2016

Document Version:
Peer reviewed version

[Link to publication in Bond University research repository.](#)

Recommended citation(APA):

Baumfield, V. (2016). Stakeholder theory from a management perspective: Bridging the shareholder/stakeholder divide. *Australian Journal of Corporate Law*, 31(1), 187-207.

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Stakeholder Theory from a Management Perspective: Bridging the Shareholder/Stakeholder Divide

Victoria Schnure Baumfield*

The law literature posits a wide chasm between the standard doctrine of shareholder primacy/shareholder wealth maximisation and stakeholder theory. In so doing, the law literature largely ignores the contribution of our colleagues in the fields of management and business ethics, many of whom conceive of stakeholder theory as an essential part of the good management necessary to maximise shareholder wealth. This article reviews major contributions from the management literature and explains how they can help lawyers understand the proper role that consideration of stakeholder interests should play in management decision making. It argues that stakeholder theory as conceived by the management theorists broadly aligns with the legal concept of enlightened shareholder value and does not conflict with the shareholder wealth maximisation objective as currently understood under dominant paradigms of Anglo-Australian corporate law. To the contrary, stakeholder theory supports shareholder wealth maximisation, because shareholder and stakeholder interests are symbiotic. It is impossible to realise shareholder value without taking care of stakeholders. At the extreme, where a company is harmed by a failure to adequately consider and take steps to mitigate the impact of corporate decisions or policies on stakeholders, that failure could potentially attract plausible claims that responsible directors and officers have breached their directors' duties as those duties are currently defined in Australian law. The article concludes that the management literature assists in bridging the divide between shareholder primacy and stakeholder theory because it provides robust support for the contention that considering the impact of corporate decisions on stakeholders and actively seeking mutually beneficial solutions will ultimately enhance shareholder wealth in anything longer than the short term.

I. Introduction

Stakeholder theorists argue that the company has obligations not just to shareholders but to the other groups that are affected by its conduct, and that companies should accordingly be managed in a way that maximises outcomes for all

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stakeholders. This view has been known by names including stakeholder theory,¹ stakeholder capitalism,² stakeholder management³ and the social entity view.⁴

Although its concepts in embryonic form can be traced back to Berle and Means and even Adam Smith, modern stakeholder theory is widely considered to have been born with the publication of business ethicist R. Edward Freeman's seminal 1984 work, *Strategic Management: A Stakeholder Approach*.⁵ Freeman argued that it was not only morally correct for businesses to take into account how their activities would affect their stakeholders, but that it was also strategically in their interest to do so. Since then, academic consideration of stakeholder theory has lured theorists from disciplines as diverse as corporate law, business management, organisational theory, network theory, public administration and business ethics.

Nevertheless, the law literature on stakeholder theory rarely refers to developments from other disciplines. That is unfortunate, because insights from other disciplines, in particular the management literature, suggest that the divide between stakeholder perspectives and shareholder primacy is not as wide as many law theorists seem to assume. In fact, the management literature persuasively makes the case that shareholder and stakeholder interests are so interrelated as to be inseparable, at least over the medium to long term. Theories that posit an irreconcilable conflict between shareholders and stakeholders in the corporate enterprise are based on a flawed premise: a rejection of the essential symbiosis between the two.

This article, therefore, reviews the management literature and considers how its theoretical developments may contribute to law's understanding of the proper consideration to be given to corporate stakeholders. It does so as follows: Part II contains a detailed discussion of key contributions to the management literature (including the sub-disciplines of both strategic management and business ethics) on stakeholder theory. Within Part II, Part II.A examines definitional issues in determining who should be considered a corporate stakeholder and the implications of using a particular definition. Part II.B examines how an understanding of the power relationships arising from the interdependent nature of stakeholder interests may help corporations accomplish their profit objective while simultaneously serving the interests of stakeholders. Part II.C considers stakeholder salience principles,

¹ Thomas Donaldson and Lee E Preston, 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications' (1995) 20(1) *The Academy of Management Review* 65; Michael C Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' (2011) 14(3) *Journal of Applied Corporate Finance* 8.

² R Edward Freeman, Kirsten Martin and Bidhan Parmar, 'Stakeholder Capitalism' (2007) 74 *Journal of Business Ethics* 303.

³ John R Boatright, 'What's Wrong – and What's Right – with Stakeholder Management' in Denis Gordon Arnold, Tom L Beauchamp and Norman E Bowie (Eds), *Ethical Theory and Business*, 9th ed, Pearson, Upper Saddle River, 2013, p 69.

⁴ William T Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 *Cardozo LR* 261 at 265.

⁵ R Edward Freeman, *Strategic Management: A Stakeholder Approach*, Pitman, Boston, 1984 ('*Strategic Management*').

which explain why certain stakeholders receive (or should receive) more corporate attention than others. Part III argues that stakeholder theory as conceived by the management theorists broadly aligns with the legal concept of enlightened shareholder value and does not conflict with the shareholder wealth maximisation objective as currently understood under dominant paradigms of Anglo-Australian corporate law. To the contrary, the accommodation of stakeholder interests is a prerequisite to the maximisation of shareholder wealth over anything longer than the short term. Moreover, Part III argues, where a company is harmed by a failure to adequately consider and take steps to mitigate the impact of corporate decisions or policies on stakeholders, that failure could potentially attract plausible claims that responsible directors and officers have breached their duties to act in good faith in the best interest of the company under general law and s 181(1)(1) of the *Corporations Act 2001* (Cth) ('*Corporations Act*') as well as their duty of care at general law and under s 180(1) of the *Corporations Act*. Part III also considers criticisms of stakeholder theory and responds from a management literature context. Part IV concludes.

II. The Management Literature

A. Stakeholder Identification: Who Is a Stakeholder?

Stakeholders can be defined in a number of different ways, but the classic definition as originally formulated by Freeman holds that an organisation's stakeholders are 'any group or individual who can affect or is affected by the achievement of the organisation's objectives'.⁶ Under a narrow view, stakeholders might be limited to 'those groups without whose support, the business would cease to be viable'.⁷ Such stakeholders, who in many cases will be directly engaged in transactions with the firm, can be referred to as 'primary stakeholders'.⁸ In Freeman's famous 'wheel diagram', for example, he lists customers, employees, suppliers, financiers (encompassing both shareholders and creditors such as bank lenders and bondholders) and communities⁹ as primary stakeholders.¹⁰ A broader view (but still

⁶ Ibid, at p 46. See generally Ronald K Mitchell, Bradley R Agle and Donna J Wood, 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22 *Academy of Management Review* 853 at 858, which contains a helpful table chronologically listing how the definition of 'stakeholder' has evolved.

⁷ Freeman, *Strategic Management*, above n 5, at p 63.

⁸ See, eg, Max E. Clarkson, 'A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance' (1995) 20(1) *Academy of Management Review* 92, at 105-7 ('*Stakeholder Framework*'); Freeman, *Strategic Management*, above n 5, at p 62; Amy J. Hillman and Gerald D. Keim, 'Shareholder Value, Stakeholder Management, and Social Issues: What's the Bottom Line?' (2001) 22(2) *Strategic Management Journal* 125 at 126-7.

⁹ For a discussion of the various ways that 'community' can be defined in the context of stakeholder theory, see Laura Dunham, R Edward Freeman and Jeanne Liedtka, 'Enhancing Stakeholder Practice: A Particularized Exploration of Community' (2006) 16(1) *Business Ethics Quarterly* 23.

not as broad as Freeman's original formulation) 'captures the idea that if a group or individual can affect a business, then the executives must take that group into consideration in thinking about how to create value.'¹¹ Parties other than primary stakeholders who fall into this conception can be referred to as 'secondary stakeholders'. Examples of secondary stakeholders can include consumer advocate groups, special interest groups such as environmentalists, the media, government, competitors, and even unpleasant actors such as terrorists.¹² Such groups might not transact directly with the corporation, but can 'cause significant damage' if not dealt with in one way or another.¹³

In yet another variation, Clarkson has classified stakeholders as those who voluntarily or involuntarily bear risk from the firm's activities.¹⁴ The basis for stakeholder status here is the fact that such entities have a legitimate moral or legal claim on the firm, as opposed to the fact that they might be able to influence the firm's behaviour.¹⁵ Mitchell et al observe that '[t]he use of risk to denote stake appears to be a way to narrow the stakeholder field to those with *legitimate claims*, regardless of their power to influence the firm or the legitimacy of their relationship to the firm'.¹⁶ They warn, however, that focussing on legitimacy can blind one to who really has power and influence.

Hill and Jones define stakeholders as 'groups of constituents who have a legitimate claim on the firm' as established through the existence of an exchange relationship with the firm whereby stakeholders provide the firm with critical resources and in exchange 'expect[] [their] interests to be satisfied (by inducements)'.¹⁷ Under this formulation, even as diffuse a construct as a local community may qualify because they 'provide the firm with locations, a local infrastructure, and perhaps favourable

¹⁰ Freeman, *Strategic Management*, above n 5, at p 62; Clarkson, *Stakeholder Framework*, above n 8, at p 106.

¹¹ Freeman, *Strategic Management*, above n 5, at p 63. Stakeholder effects on the organization can take various forms including social, political, and economic effects.

¹² *Ibid*, at p 62; Clarkson, *Stakeholder Framework*, above n 8, at p 107.

¹³ Clarkson, *Stakeholder Framework*, above n 8, at p 107.

¹⁴ Max Clarkson, 'A Risk Based Model of Stakeholder Theory', in Max B E Clarkson (Ed), *Proceedings of the Second Toronto Conference on the Stakeholder Theory of the Corporation*, Centre for Corporate Social Performance & Ethics, University of Toronto, Toronto, 1994 ('*Risk Based Model of Stakeholder Theory*'); see also Mitchell, Agle and Wood, above n 6, 856-57.

¹⁵ See, eg, Mitchell, Agle and Wood, above n 6, at 859, 861.

¹⁶ *Ibid* 857 (emphasis in original).

¹⁷ Charles WL Hill and Thomas M Jones, 'Stakeholder-Agency Theory' (1992) 29(2) *Journal of Management Studies* 131 at 133. For a narrower version of this concept consistent with the property rights branch of economics, see, eg, Peter G Klein et al, 'Who Is in Charge? A Property Rights Perspective on Stakeholder Governance' (2012) 10(3) *Strategic Organization* 304 ('focussing on stakeholders with property rights arising from co-investment with shareholders under the reasonable expectation of mutual return').

tax treatment' in exchange for the expectation that the firm will 'enhance and/or ... not damage the quality of life'.¹⁸

For strategic planning purposes, Freeman illustrates that it is useful to identify stakeholders with much greater specificity than is seen in most theoretical discussions.¹⁹ For example, in the case of a government-owned water supplier, a stakeholder map could be drawn in which customers could be broken out as residential customers with low water consumption, residential customers with high consumption, residential customers on modest incomes, industrial customers, agricultural customers, etc. The government relationship could be broken down to include governmental owners, the responsible minister, responsible department, relevant regulators, relevant tax offices, etc. The local community can be broken down to include local government officials, local customers, relevant consumer advocates, other local community organisations, relevant special interest groups such as water conservationists, local media, etc.

Further complicating the analysis, a particular person may wear multiple hats. For example, a government official may also be interested as a customer, a political party member, or as an owner of the relevant organisation.²⁰ The 'multi-dimensional' nature that stakes may take makes it all the more important that firms conduct adequate investigations about stakeholders' needs and concerns rather than just assuming that they know the answer based on the obvious. For example, they can 'undertake a validation process using interviews, surveys, the public record, interviews with internal boundary spanners who are stakeholder experts, etc.'²¹

Based on all of the above, the literature suggests that corporate managers should conduct detailed stakeholder audits to understand who their stakeholders are and the contents of their concerns. Doing so is an essential part of strategic management.

B. The Firm-Stakeholder Relationship

Freeman argues that 'stakeholder interests are joint'.²² By this, he means that because the firm cannot survive if its stakeholders' interests are not attended to, it is in *all* stakeholders' interests (including shareholders') that each stakeholder group's interests be accommodated. Greenfield, for example, illustrates why it is in the company's best interests to take employees' interests into account in management decisions.²³ Where stakeholder interests seem to conflict, Freeman suggests that managers should 'rethink the problems so that these interests can go together, so

¹⁸ Hill and Jones, above n 17, at 133.

¹⁹ See, eg, Freeman, *Strategic Management*, above n 5, at p 56 (listing examples of 'Specific Stakeholders in a Very Large Organization').

²⁰ *Ibid*, at p 59.

²¹ *Ibid*, at p 95.

²² Freeman, *Strategic Management*, above n 5, at p 65.

²³ Kent Greenfield, 'Defending Stakeholder Governance' (2008) 58 *Case Western Reserve LR* 1043 at 1057-9. While this source is written from a law perspective, it is a good example of Freeman's point.

that even more value can be created for each' even though there will nevertheless be times where trade-offs are inevitable.²⁴

A useful insight from *Strategic Management* and Freeman's later writings is his identification of how stakeholders interact not just with the company but with each other. Far from being isolated actors in dyadic relationships with the company, stakeholders often create explicit or implicit networks or 'coalitions' with each other to accomplish mutual objectives.²⁵ Such alliances might arise based on the perceived political, economic, or social effects of an organisation's conduct on a stakeholder's interests.²⁶

Frooman similarly explored the notion of stakeholders working in combination and with third parties to influence firms.²⁷ In an article that discussed how stakeholders can gain and use power to achieve their objectives, he identified three ways to exert power: *resource control* (the withdrawal from the firm of critical resources),²⁸ *usage strategies* (where the resource continues to be supplied, but with strings attached), and *influence pathways*, which include either a *direct* application of the relevant strategy by the stakeholder itself (where it is able to do so) or *indirect* action, where more powerful allies are brought in to assist the stakeholder to attain its objective. While stakeholders with control over a critical resource may effectively exert influence by credibly threatening to withhold that resource or only agreeing to supply it if the firm complies with certain conditions, other stakeholders may nevertheless create power and hence influence by developing relationships with others who supply resources to the firm. For example, consumers may gain an influential voice if they gain the attention of the media. As Hill and Jones point out, '[n]ewsworthy publicity comes cheap, yet it can severely damage managerial reputations'.²⁹ This illustrates the point that 'withholding and usage do not have to be performed by a stakeholder but, instead, could be performed by an ally of the stakeholder with whom the focal firm has a dependence relationship.'³⁰

Others have also explored the relationship of power to stakeholder influence. Goodpaster observed that when firms undertake a strategic review of how their stakeholders can affect the firm (what he terms a 'strategic stakeholder synthesis'), certain stakeholders are given priority because of their ability to affect the firm, for example 'through political action or opposition to necessary regulatory clearances'.³¹ In other words, when stakeholders have power, the firm has no choice but to deal

²⁴ Freeman, *Strategic Management*, above n 5, at p 64.

²⁵ See, eg, *ibid*, at pp 58, 135. See also TJ Rowley, 'Moving Beyond Dyadic Ties: A Network Theory of Stakeholder Influence' (1997) 22 *Academy of Management Review* 887.

²⁶ See, eg, Freeman, *Strategic Management*, above n 5, at pp 92-5.

²⁷ Jeff Frooman, 'Stakeholder Influence Strategies' (1999) 24(2) *Academy of Management Review* 191.

²⁸ See also Hill and Jones, above n 17, at 141 (discussing 'exit as a deterrent').

²⁹ Hill and Jones, above n 91 *ibid*, at 142.

³⁰ Frooman, above n 27, at 198.

³¹ Kenneth E Goodpaster, 'Business Ethics and Stakeholder Analysis' (1991) 1(1) *Business Ethics Quarterly* 53 at 57-8; see also Frooman, above n 27, at 192.

with them. Other stakeholders may be affected by the firm's conduct but nevertheless ignored if they have (or, more accurately, are perceived to have) relatively little power to affect the firm.³² Goodpaster notes that arguments to consider these stakeholders' interests would tend to arise on moral or ethical grounds, rather than strategic ones. (Frooman therefore referred to the latter group as 'moral stakeholders'.³³)

Freeman calls this dichotomy that is commonly assumed to exist between strategic and moral concerns the 'Separation Fallacy' or 'Separation Thesis'. He argues that once one realises that stakeholders' interests are joint, it becomes clear that there can be no distinction between strategic and moral concerns; they are interdependent. As such, 'every business decision is an ethical decision' and ought to be treated as such.³⁴ Moreover, ethical decision-making is strategic because it creates value for the firm.³⁵

Goodpaster disagrees that all stakeholder concerns are inherently strategic and thus legitimate bases for corporate decision-making. He posits the following 'Stakeholder Paradox': '*It seems essential, yet in some ways illegitimate, to orient corporate decisions by ethical values that go beyond strategic stakeholder considerations to multi-fiduciary ones.*'³⁶ In other words, while from a normative perspective all stakeholders' interests should be taken into account, so doing would seem to make a mockery of the fiduciary duty to the company as it is currently normally understood in common law countries. The 'multi-fiduciary' model refers to the notion that managers should be required to act in the interests of not only shareholders but of some permutation of the organisation's other stakeholders, in particular its primary stakeholders.³⁷ The origins of this view were expressed in Professor Dodd's famous debate with Adolf Berle³⁸ and picked up by Freeman in his older writings, although in his more recent writings, Freeman has disclaimed the notion that a fiduciary duty to shareholders should be extended to all stakeholders.³⁹ It is clear that in Australia the current duty to act in the best interests of the company does not entail a legal

³² Goodpaster, above n 31, at 57.

³³ Frooman, above n 27.

³⁴ R Edward Freeman et al, *Stakeholder Theory: The State of the Art*, Cambridge University Press, Cambridge, 2010, p 223.

³⁵ See generally *ibid*, at pp 262-4.

³⁶ Goodpaster, above n 31, at 63.

³⁷ See, eg, Allen, above n 3, at 265. Allen refers to a conception under which a board of directors owes 'a duty of loyalty, in some sense, to all those interested in or affected by the corporation'. See also Rosemary Langford, 'Directors' Duties: Stakeholder Interests - Balancing or Considering?' (2014) 32 *C&SLJ* 64 at 67 quoting Paul Redmond, *Corporations and Financial Markets Law, 6th Ed*, Thomson Reuters, Sydney, 2013, at para 2.207.

³⁸ E Merrick Dodd, Jr, 'For Whom Are Corporate Managers Trustees?' (1932) 45 *Harvard L R* 1145.

³⁹ Freeman et al, above n 34, at p 68 n 14. As Freeman now explains, 'We believe that such a move cannot be defended without doing damage to the notion of "fiduciary". The idea of having a special duty to either one or a few stakeholders is not helpful.'

obligation to act in the interests of a company's stakeholders as a whole, even though a voluntary decision by the directors of a solvent company to take stakeholder interests into account will normally be allowed where some benefit to the company can be shown, even if diffuse, indirect, or unquantifiable.⁴⁰

If one assumes, like Goodpaster, that not all ethical decisions are strategically important for the company, perhaps because of the lack of a fiduciary obligation to the impacted stakeholder, Goodpaster argues that there is still a way to justify those decisions. He suggests that there still may be a *moral* obligation to the affected party even if that obligation is not fiduciary. Social obligations embodying community standards 'not rooted in the *fiduciary* relationship, but in other relationships at least as deep'⁴¹ generally expect human beings to act ethically to each other. We do not countenance community members injuring, defrauding, cheating, stealing from or coercing each other. Companies may not be human, but they are run by humans. Indeed, as artificial persons, they can be viewed as community members themselves.⁴² Therefore, even if corporate managers are not bound by corporate law to respect stakeholders' interests, it should be accepted that fiduciary obligations to shareholders 'are subject to moral criteria in their execution.'⁴³

By interposing morals into the calculation, Goodpaster's view creates a theoretical framework for organisations to take stakeholder interests into account without the need for government involvement. So does Freeman's, through his Separation Fallacy. Indeed, Freeman explicitly argues that it is undesirable to 'rely on the state to solve stakeholder conflicts' because: (1) so doing absolves individuals and organisations of their 'responsibility to conduct business within community norms'; (2) government solutions inevitably have unintended consequences that make matters worse, without the ability to easily make small changes to correct course; (3) 'individuals and organisations [will] never develop the imagination required to create

⁴⁰ See, eg, Langford, above n 37; Corporations and Markets Advisory Committee (CAMAC), *The Social Responsibility of Corporations*, December 2006, pp 82, 86, 91-2; Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value*, Parliament of Australia, June 2006, p 53, para 4.40. See also Shelley Marshall and Ian Ramsay, 'Stakeholders and Directors' Duties: Law, Theory and Evidence' (2012) 35(1) *UNSWLJ* 291 at 292 (discussing the 'widely held view . . . that current Australian company law permits directors sufficient freedom to pursue stakeholder interests without requiring that they do so'); ASX Corporate Governance Council, *ASX Corporate Governance Principles and Recommendations*, 3rd ed, ASX, 2014, p 19. See generally the discussion in Part III, below.

⁴¹ Goodpaster, above n 31, at 67 (emphasis in original).

⁴² Indeed, in the United States, they are even entitled to fundamental rights such as freedom of speech and in some circumstances freedom of religion. See *Citizens United v Federal Election Commission*, 558 US 310 (2010) (corporate right to free speech under the First Amendment to the US Constitution); *Burwell v Hobby Lobby Stores Inc*, 573 US ____ (2014) (close corporation's right to religious freedom under relevant statute without considering the existence of such a right under the First Amendment).

⁴³ Goodpaster, above n 31, at 67-70.

different, mutually beneficial relationships' and they will turn to the courts to resolve disputes instead of learning how to do so themselves; and (4) government is already captured by big business, which would manipulate legislative rule-making to their advantage.⁴⁴

Donaldson and Preston, like Goodpaster, reject Freeman's view that strategic and ethical considerations always overlap. In a significant article, they observed that stakeholder theory naturally divides into three strands:

- instrumental stakeholder theory;
- normative stakeholder theory; and
- descriptive/empirical stakeholder theory.⁴⁵

Instrumental stakeholder theory is comparable to Goodpaster's notion of strategic stakeholders and conceptually is the closest to how stakeholders are treated in Australian law today. It is the notion of paying attention to stakeholders when and because it is in the firm's interest to do so. Normative stakeholder theory relates to the identification of ethical, moral or philosophical guidelines for how companies should take their stakeholders' interests into account. Most of the normative arguments in favour of stakeholder theory are based on fundamental notions of fairness and 'a basic equality among stakeholders in terms of their moral rights as these are realised in the firm', although inequality in treatment may be fair in some circumstances.⁴⁶ Descriptive stakeholder theory examines how companies behave towards their stakeholders in practice.

It is useful to understand which approach one is taking because they 'involve very different methodologies, types of evidence, and criteria of appraisal'.⁴⁷ Nevertheless, they are not mutually exclusive and it might be appropriate to construct an argument or analysis using multiple approaches.

C. Stakeholder Salience

Stakeholder salience refers to 'the degree to which managers give priority to competing stakeholder claims'.⁴⁸ Mitchell et al identified three factors that contribute to stakeholder salience: *power* (defined as 'the probability that one actor within a social relationship would be in a position to carry out his own will despite resistance', or the ability of one social actor to get another social actor to do something it would not have otherwise done⁴⁹), *legitimacy* (the perception or assumption that the actions to be taken are desirable, proper or appropriate – ie, the normative basis for acting⁵⁰)

⁴⁴ Freeman, Martin and Parmar, above n 2, at 310-11.

⁴⁵ Donaldson and Preston, above n 1; see also Freeman et al, above n 34, at p 212.

⁴⁶ See, eg, R Edward Freeman, 'The Politics of Stakeholder Theory: Some Future Directions' (1994) 4(4) *Business Ethics Quarterly* 409 at 415-16.

⁴⁷ Donaldson and Preston, above n 1, at 70.

⁴⁸ Mitchell, Agle and Wood, above n 6, at 854.

⁴⁹ Ibid, at 865.

⁵⁰ Ibid, at 866.

and *urgency* (time sensitivity⁵¹). The ‘relative absence or presence’ of one, two, or all three of these factors – which may vary over time – will determine the level of priority that managers will give to a given stakeholder claim.⁵² Furthermore, the possession of a given attribute, eg power, ‘does not necessarily imply its actual or intended use, nor does possession of power imply consciousness of such possession by the possessor or “correct” perception of objective reality by the perceivers.’ This last point is significant because unless an entity ‘is aware of its power and willing to exercise it on the firm, it is not a stakeholder with high salience for managers’.⁵³ The same point can be made where managers do not appreciate the extent of an entity’s power.⁵⁴

Stakeholder salience analysis need not be limited to corporations. In a useful example of how a stakeholder salience analysis works in a different context, De Bussy and Kelly investigated stakeholder salience in the context of politics.⁵⁵ In particular, they examined the principles of stakeholder identification (ie, ‘who politicians say they should pay attention to in principle’) and stakeholder salience (‘who they actually pay attention to in practice’) to see whether politics in Western Australia suffered from a democratic deficit, ie ‘the argument that [governmental bodies] suffer from a lack of democracy and seem inaccessible to the ordinary citizen.’⁵⁶ They determined that while WA politicians believed that they should be paying attention to ‘moral’ stakeholders or ‘claimants’ (ie, those affected by the government), the stakeholders that WA politicians paid attention to in practice were those with the power to affect government (ie, strategic stakeholders), such as the media, lobbyists, NGOs, industry groups and trade unions. The media had power because of its ability to set the public agenda, ‘amplify an issue’ and ‘strongly influence public opinion’.⁵⁷ The remaining groups receive attention because of ‘their professionalism, high quality representatives and ability to present their point of view succinctly’.⁵⁸ It is hard not to observe that all of those groups also have adequate financial resources to press their case, although money, surprisingly, was not specifically mentioned as a reason for these groups’ influence. The ability to make political donations was separately noted as a source of power, however. Conversely, ‘unorganised groups’ with legitimate claims such as ‘[y]oung people, Australian Muslims, Aboriginal people, single parents, stay-at-home mothers, people with disabilities, gay and lesbian people, and people living in remote, rural or regional areas’ were found to lack power because they ‘lack the resources and skills needed to engage consistently in the political process’.⁵⁹ This led de Bussy and Kelly to

⁵¹ Ibid, at 867.

⁵² Ibid, at 864.

⁵³ Ibid, at 868.

⁵⁴ Ibid, at 873 (‘managers’ perceptions of stakeholders form the crucial variable in determining organizational resource allocation in response to stakeholder claims’).

⁵⁵ Nigel M de Bussy and Lorissa Kelly, ‘Stakeholders, Politics and Power: Towards an Understanding of Stakeholder Identification and Salience in Government’ (2010) 14 *Journal of Communication Management* 289.

⁵⁶ Ibid.

⁵⁷ Ibid, at 298.

⁵⁸ Ibid, at 299.

⁵⁹ Ibid.

conclude that 'there are many groups with legitimate interests who are effectively excluded from the consultative process because they are largely unorganised and hence lack the power to command the attention of the political elite.'

III. Bridging the Management/Law Divide

A. Enlightened Shareholder Value

Stakeholder theory as conceived in the management literature complements and overlaps with the legal notion of 'enlightened shareholder value' ('ESV'), also known as 'enlightened self-interest'. ESV holds that it is in the shareholders' best interests for companies to take stakeholders' interests into account as part of corporate decision-making processes. As the Parliamentary Joint Committee on Corporations and Financial Services ('PJC') explained:

The enlightened self-interest interpretation of directors' duties acknowledges that investments in corporate responsibility and corporate philanthropy can contribute to the long term viability of a company even where they do not generate immediate profit. Under this interpretation directors may consider and act upon the legitimate interests of stakeholders to the extent that these interests are relevant to the corporation.⁶⁰

Although taking stakeholder interests into account is not (explicitly) legally required, the PJC endorsed ESV as the preferable course for Australian company directors:

The committee considers that the most appropriate perspective for directors to take is that of enlightened self-interest. Corporations and their directors should act in a socially and environmentally responsible manner at least in part because such conduct is likely to lead to the long term growth of their enterprise.⁶¹

In the United Kingdom and most US states,⁶² ESV has been given legal recognition through the adoption of 'corporate constituency' or 'stakeholder' statutes that either allow or require, depending on the jurisdiction, the board to take the constituencies listed in the statute into account as part of the directors' duty of good faith to act in the best interests of the company, which in the UK is now framed as the duty to promote the 'success' of the company.⁶³ Most stakeholder statutes are merely

⁶⁰ Parliamentary Joint Committee on Corporations and Financial Services, above n 40, at p 52 para 4.32.

⁶¹ Ibid at p 53 para 4.39.

⁶² In the United States, many areas of corporate law are regulated at the state level.

⁶³ See, eg, *Companies Act 2006* (UK) s 172(1) (mandatory); Connecticut Gen Stat § 33-756(d) (2011) (permissive); Nev Rev Stat § 78.138(4) (2010) (permissive); Ohio Rev Code § 1701.59 (2006) (directors 'shall consider' shareholders' interests and 'may consider' the other enumerated factors); NY Bus Corp Law § 717 (2012) (permissive); 15 Pa Cons Stat § 516 (2015) (permissive); Haw Rev Stat § 414-221 (2010) (must consider shareholders and may consider other constituencies). See generally Andrew Keay, 'Stakeholder Theory in Corporate Law: Has It Got What It Takes?' (2010) 9 *Richmond J Global L and Bus* 249 (noting that as of 2012, 'more

permissive, rather than mandatory, and allow directors to consider groups such as employees, suppliers, customers, and local communities but do not require it. Some also specify intangible factors such as the long-term consequences of a decision, the desirability of a business's maintaining a good reputation with regard to standards of business conduct, and 'the need to act fairly as between members of the company'.⁶⁴

One of the rare mandatory statutes, section 172(1) of the *Companies Act 2006* (UK), states in full:

172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,
- (c) the need to foster the company's business relationships with suppliers, customers and others,
- (d) the impact of the company's operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company.

While in the United States constituency statutes have been considered by many mainly to give the directors legal cover to resist takeovers (for example by considering adverse effects on employees or local communities), most constituency statutes are not limited to the takeover context.⁶⁵ On the other hand, it should be noted that these constituency statutes are not a real-life manifestation of the multi-fiduciary model discussed in Part II.B above because of the differing purpose of why stakeholders are to be considered. Under the multi-fiduciary model, stakeholders are considered because it is ethically correct to do so. Under the ESV model, stakeholders are considered because it is in the *company's* best interests to do so. ESV thus can be viewed as an example of instrumental stakeholderism, as that term is defined by Donaldson and Preston.

Conversely, the management literature supports the contention that it is impossible for directors to be confident that they are acting in the best interests of the company

than 40' of the 50 US states had constituency statutes); Lawrence E Mitchell, 'A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes' (1992) 70 *Texas LR* 579.

⁶⁴ See, eg, *Companies Act 2006* (UK) sub-ss 172(1)(a), (e), and (f).

⁶⁵ See, eg, Mitchell, above n 63, at 588-9.

where they have *not* performed an adequate stakeholder analysis and factored the results into their management decisions. If it is no less than a minimally competent standard of management for directors to factor stakeholders' interests into their decision making, as the management literature indicates, then directors have *at the minimum* an implicit obligation to do so as part of their duty to act in the best interests of the company or perhaps even their duty of care,⁶⁶ regardless of whether that duty is spelled out explicitly in a constituency statute.

The proposition that any competent manager would consider the effects of a corporate decision on stakeholders' interests (and hence on that stakeholder's future interaction with the corporation) as a standard step in the decision-making process appears to underlie the reconceived duty of good faith as set forth in s 172 of the *Companies Act 2006* (UK). In Australia, the fiduciary and statutory duty to act in good faith in the best interests of the company⁶⁷ has not been specifically modified to either allow or require the consideration of stakeholder interests. The Corporations and Markets Advisory Committee (CAMAC) has suggested, however, that considering stakeholder interests would not run afoul of s 181 of the *Corporations Act* if it benefits the shareholders as a whole,⁶⁸ and the PJC agreed that there is nothing in the current legislation to inhibit directors from taking account of stakeholders other than shareholders.⁶⁹ Indeed, as discussed above, the PJC has endorsed the ESV approach, although the PJC did not go so far as to suggest that directors and officers could be in breach of their duty to act in the best interests of the company if they ignored the effect of corporate decisions on stakeholders. But that is the logical next step. There is no logical reason why the managers of a company who cause the company harm through their failure to consider or prepare for the effect of a decision on a critical stakeholder could not find themselves on the wrong side of a claim for breach of directors' duties.⁷⁰ In particular, the directors' duty of care and corresponding statutory duty at s 180(1) of the *Corporations Act* uses a reasonable director standard. If competent management includes the consideration of stakeholders in corporate decision making and taking steps to mitigate stakeholder harm as a standard component of risk management, then failing to do so could be seen as not reasonable. Conversely, as Langford points out, in some cases stakeholders themselves may have standing under s 1324 of the Act to

⁶⁶ The duty of care might be enlivened if the failure to consider the particular stakeholder(s) and consequent effects on the company was not considered reasonable.

⁶⁷ *Corporations Act 2001* (Cth) s 181(1)(a).

⁶⁸ CAMAC, above n 40, at pp 82, 86, 91-2; see also Langford, above n 37.

⁶⁹ Parliamentary Joint Committee on Corporations and Financial Services, above n 40, at p 53 para 4.40.

⁷⁰ For a compelling example in the context of the need to proactively manage for the effects of climate change, see Sarah Barker, *Directors' Duties in the Anthropocene: Liability for Corporate Harm Due to Inaction on Climate Change* (December 2013) Corporate Law, Economics & Science Association <http://www.clesa.net.au/blog/2015/1/14/directors-duties-in-the-anthropocene-liability-for-corporate-harm-due-to-inaction-on-climate-change>. See also Thomas Clarke, 'The Widening Scope of Directors' Duties: The Increasing Impact of Corporate Social and Environmental Responsibility' (2016) 39 *Seattle University LR* 531.

protect their interests from corporate conduct that constitutes a breach of the *Corporations Act*.⁷¹ Therefore, far from directors needing to fear liability for choosing to consider stakeholders in their decision making, the management literature aligns with existing Australian law to suggest that directors might be opening themselves up to liability – even under the standard shareholder primacy regime – if they do *not* do so.

B. Stakeholderism and Corporate Social Responsibility

CSR is notoriously difficult to reduce to a single definition, theory, model, or set of objectives.⁷² Some conceptions of CSR view it in terms of the shareholder-stakeholder debate that so dominates corporate law.⁷³ In the sustainability context, CSR is often used to refer to the notion of companies voluntarily taking responsibility for their impact on society even where those negative externalities do not attract an obligation to pay for the harm.⁷⁴ I term that conception 'reactive CSR' because in that case companies are reacting to problems they have created. CSR only refers here to companies voluntarily engaging in sustainability and the mitigation of other societal issues relevant to their operations, such as for example abuses occurring in the context of global supply chains.

CSR should not be taken to include steps taken as a result of legal obligations to prevent or mitigate harm. In that regard, a growing number of theorists are now suggesting that companies have a fundamental, existential obligation to adequately plan for and manage sustainability issues in order to avoid breaches of directors' duties as a result of a failure to mitigate risk in this area.⁷⁵ For example, Barker argues that the nascent legal obligation to proactively manage and mitigate risks relating to climate change takes obligations with regard to climate change out of the realm of CSR or stakeholderism and squarely into directors' wealth maximisation purview.⁷⁶

Other definitions of CSR focus on companies voluntarily taking the initiative to engage in socially beneficial behaviour with no direct connection to any negative impact they may have on society, such as when companies engage in charitable endeavours or organise community events simply in order to be (or appear to be)

⁷¹ Langford, above n 37, at 67-8. See also Victoria Schnure Baumfield, 'Injunctions and Damages Under s 1324 of the Corporations Act: Will McCracken v Phoenix Constructions Revive the Narrow Approach?' (2014) 32 *C&SLJ* 453 and the authorities cited therein.

⁷² See generally Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business*, Edward Elgar, Cheltenham, 2010, pp 34-42.

⁷³ *Ibid*, at p 112.

⁷⁴ Eg, *ibid*, at pp 36-7, 46.

⁷⁵ Barker, above n 70; Clarke, above n 70.

⁷⁶ Barker, above n 70, 12-13.

good corporate citizens or neighbours.⁷⁷ I will refer to this conduct as ‘philanthropic CSR’.

CSR can also be divided into two branches based on what is intended to be accomplished. The first says that companies should engage in CSR because it is in the companies’ (and therefore the shareholders’) best interest to do so.⁷⁸ To the extent that CSR is viewed from that perspective, there is a large overlap with what Donaldson and Preston classify as instrumental stakeholder theory.⁷⁹ The second branch views CSR as relating not to acting in a socially responsible way because it is beneficial for the business to do so but rather as gratuitous behaviour that companies should engage in simply because it is the right thing to do (ie, what Horrigan terms ‘intrinsic CSR’).⁸⁰ Intrinsic CSR may encompass both the reactive and philanthropic strains of CSR identified in the previous paragraph, and can be seen to align with Donaldson and Preston’s definition of normative stakeholder theory.

In Australia, although no binding legal *duty* does this, Principle 3 of the ASX Corporate Governance Principles and Recommendations explicitly directs companies to act ‘ethically and responsibly’, in a manner that is ‘consistent with the reasonable expectations of investors *and the broader community*’.⁸¹ Companies listed on the Australian Securities Exchange are expected to comply with the ASX Corporate Governance Principles as a general matter unless, under the ‘if not, why not’ principle, they explain why they are not complying with particular Principles in their publicly-filed annual reports.

The commentary to Principle 3 suggests that companies should be ‘good corporate citizens’, including by acting fairly in their dealings with stakeholders such as employees, suppliers, customers, and the broader community. Marshall and Ramsay cite Owen J’s statement in *The Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* that ‘it does not follow that in determining the content of the duty to act in the interests of the company, the concerns of shareholders are the only ones to which attention need be directed or that the legitimate interests of other groups can safely be ignored’ as evidence that directors may sometimes consider stakeholder interests even where the shareholders do not benefit thereby.⁸² They note, however, that under existing case law, except for the insolvency context, where

⁷⁷ See, eg, Hugh Alexander Grossman, ‘Redefining the Role of the Corporation: The Impact of Corporate Social Responsibility on Shareholder Primacy Theory’ (2005) 10 *Deakin LR* 572 at 581-2 (discussing ‘sincere CSR’).

⁷⁸ *Ibid*, at 579-80 (Grossman refers to this as ‘insincere CSR’).

⁷⁹ Indeed, Horrigan terms this ‘instrumental CSR’: Horrigan, above n 72, at p 35.

⁸⁰ *Ibid*, at p 35; Grossman, above n 77, at 581-2 (ie, what Grossman refers to as ‘sincere CSR’; it may also be referred to as ‘altruistic CSR’).

⁸¹ ASX Corporate Governance Council, above n 40, at p 19 (emphasis added). See also Marshall and Ramsay, above n 40, at 292 (discussing the ‘widely held view . . . that current Australian company law permits directors sufficient freedom to pursue stakeholder interests without requiring that they do so’).

⁸² Marshall and Ramsay, above n 11640, at 298, quoting *The Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2008) 39 *WAR* 1 at 534 paras 4393-4395.

creditors' interests become significant, normally directors can only consider the interests of non-shareholder stakeholders 'with a view to the benefit of the shareholders' – ie, under an instrumental approach.⁸³ None of this contradicts the argument in the previous subsection that a consideration of and attempt to accommodate stakeholder interests is in fact *necessary* to ensure that shareholders themselves benefit, according to the management literature.

The *ability* (but not the requirement) for companies to engage in socially responsible behaviour has been legally recognised for quite some time now. For example, in *AP Smith Manufacturing Co v Barlow*, the New Jersey Supreme Court upheld a company's charitable donation to Princeton University over a shareholder's objection, stating that 'modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate.'⁸⁴ According to Berle, *AP Smith* illustrated that 'modern directors are not limited to running business enterprise for maximum profit, but are in fact and recognised in law as administrators of a community system'.⁸⁵

AP Smith extended on older English and Australian case law allowing for socially responsible behaviour such as *Hutton v West Cork Railway Co*, in which the court in colourful language held that seemingly gratuitous corporate spending was permissible where it would ultimately benefit the company,⁸⁶ and *Miles v Sydney Meat-Preserving Co Ltd*, in which the High Court of Australia allowed a company to engage in seemingly altruistic behaviour where the shareholders had agreed to do so (and where it was likely in the company's long-term self-interest).⁸⁷ The language in *Miles* is instructive. There, Griffith CJ wrote for the majority that:

The law does not require the members of a company to divest themselves, in its management, of all altruistic motives, or to maintain the character of the company as a soulless and boweless thing, or to exact the last farthing in its commercial dealings, or forbid them to carry on its operations in a way which they think conducive to the best interests of the community as a whole, or a substantial part of it, rather than in a way which they think detrimental to such interests, though more beneficial (in a pecuniary sense) to themselves.⁸⁸

⁸³ Marshall and Ramsay, above n 11640, at 298-99. Interestingly, Marshall and Ramsay found based on empirical research that 'the majority of directors surveyed had what might be termed a "stakeholder" understanding of their obligations': *ibid*, at 311.

⁸⁴ 98 A2d 581 (NJ 1953).

⁸⁵ Bryan Horrigan, above n 72, at p 89; see also Adolf A Berle, 'Modern Functions of the Corporate System' (1962) 62 *Columbia Law Review* 433 at 443. See generally AA Berle, Jr, 'The Corporation in a Democratic Society' in Melvin Anshen and George Leland Bach (eds), *Management and Corporations 1985*, Greenwood Press, Westport, 1960, p 63.

⁸⁶ (1883) 23 Ch D 654 at 673 ('The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company').

⁸⁷ (1912) 16 CLR 50.

⁸⁸ *Ibid*, at 66.

More recent cases have not deviated from this position. Nor have statements of soft law in either the United States or Australia. In the United States, for example, § 2.01(b) of the American Law Institute's Principles of Corporate Governance provides that '[e]ven if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business ... (2) May take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and (3) May devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes'.⁸⁹ Principle 3 of the ASX Corporate Governance Principles, discussed above, gives similar guidance to Australian companies, although it does not include similar language explicitly authorising companies to make reasonable charitable donations where those donations are not seen to benefit shareholders.⁹⁰

But merely having the latitude to act philanthropically is no longer the issue. The management literature makes clear that supporting corporate stakeholders is not mere charity but 'strategic', ie, essential to the corporate enterprise.

C. Critics of Stakeholder Management: The Shareholder/Stakeholder Divide, Revisited

Many corporate law theorists disagree that corporations should be managed in the interests of stakeholders, or some permutation thereof, rather than solely for the benefit of shareholders. The shareholder primacy view (also known as shareholder wealth maximisation) posits that all stakeholders benefit by a model that places shareholders first because shareholders, as residual claimants who receive no fixed return on their investment, only benefit to the extent that the firm is managed in a way that increases overall wealth. That is good for all participants in the corporate enterprise.⁹¹

Because of its focus on the company's interests, some proponents of shareholder primacy implicitly agree with the instrumental stakeholder approach,⁹² although they

⁸⁹ American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, 1994, p 55.

⁹⁰ ASX Corporate Governance Council, above n 40, at p 19.

⁹¹ There are too many sources for this proposition to list. For a brief smattering, see, eg, Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law*, Harvard University Press, Cambridge, 1991; Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice*, Oxford University Press, New York, 2008, pp 23 et seq; Reinier Kraakman et al (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 2nd ed, Oxford University Press, New York, 2009; George W Dent, Jr, 'Stakeholder Governance: A Bad Idea Getting Worse' (2008) 58 *Case Western Reserve LR* 1107.

⁹² See, eg, Jensen, above n 1, at 298 although he goes beyond this because he *explicitly* agrees that '[a] firm cannot maximise value if it ignores the interest of its stakeholders'. Shareholder primacy theorists may find it significant that this

might argue that taking a stakeholder's needs into account because the firm has no choice is not really an application of stakeholder theory at all. Instead, some shareholder primacy proponents seem to define stakeholder theory as only covering 'moral stakeholder' situations, ie, situations where the firm has no strategic interest in taking the particular stakeholder need into account although it might be ethical to do so. Indeed, economist Milton Friedman argued that cloaking attention to the needs of strategic or instrumental stakeholders under the related term of 'corporate social responsibility' was 'hypocritical' and 'approaching fraud'.⁹³ But even shareholder primacy proponents who accept the obligation to placate strategic or instrumental stakeholders would not agree with the normative arguments in favour of stakeholder theory, much less the multi-fiduciary model.

Moreover, critics raise concerns about the practicality of actually implementing the stakeholder model. For example, Dent, focussing on employees, suggests a number of problems with the fairly common proposal to provide board representation to non-shareholder stakeholders:

- There is no reason that any particular stakeholder constituency would have a greater motivation than shareholders do to take other stakeholders' concerns into account. For example, in companies that suffered corporate scandals in the early 2000s such as Enron and Tyco, employees who were aware of corporate wrongdoing did not speak up to warn fellow employees or other members of the public not to invest in the company or to sell their shares, or to alert law enforcement and stop the misconduct.⁹⁴
- If stakeholder governance produced greater returns for the corporate entity, firms would have voluntarily adopted that model.⁹⁵
- 'American organised labor has also shown little interest in board representation. And Europe is moving toward the shareholder model.'⁹⁶ Dent appears to be arguing here that the European model of co-determination characterised by employee representation in management is on the decline. Indeed, Dent argues that a model that has brought greater harmony between management and employee has been the implementation in many firms of employee stock ownership plans (ESOPs), which have brought 'their interests closer to those of the shareholders.'⁹⁷

admission comes from the same Professor Jensen who authored one of the fundamental texts upon which the standard account of the theory of the firm is based: Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305.

⁹³ Milton Friedman, 'A Friedman Doctrine - The Social Responsibility of Business is to Increase its Profits', *The New York Times Magazine* (New York), 13 September 1970, pp 32, 123.

⁹⁴ Dent, above n 91, at 1114-15.

⁹⁵ *Ibid*, at 1115.

⁹⁶ *Ibid*, at 1116.

⁹⁷ *Ibid*, at 1117.

- If one agrees that stakeholders other than shareholders should have representation in management, how would that actually be implemented? It would be difficult to establish a fair and legitimate selection process, for example, for local communities and for other interest groups.⁹⁸

Dent's arguments, as previously noted, focus on providing stakeholders with board representation. From a management literature perspective on stakeholder theory, that argument is to a certain extent beside the point since the wisdom of conducting a stakeholder audit and attempting to accommodate stakeholders where feasible is conceptually independent from the issue of stakeholder board representation.

That does not obviate the entirety of the criticisms that stakeholder theory has attracted, however. Other commonly voiced concerns include:

- 'It would be too complex and onerous to expect company directors and managers to change the way in which they operate so as to take into account interests other than those of shareholders',⁹⁹
- 'Stakeholder theory cannot provide a specific objective function for the corporation',¹⁰⁰ and
- If managers or directors are accountable to all stakeholders they will really be accountable to none, since any corporate decision could be justified by finding some stakeholder who would benefit. As such, the rule will be unenforceable and the true beneficiary of such legal rules is top management itself.¹⁰¹

These arguments, however, only apply to the multi-fiduciary model, not to ESV, which is what the management literature supports. Rather than expecting corporate management to act in the public interest, Dent suggests that the better course is for legislatures to legislate if there is particular conduct that we do (or do not) want directors to undertake, such as occurs in the context of employment law, occupational health and safety, pollution, product liability, etc. That course is preferable because: (1) it would lessen the risk of anarchy arising from allowing directors to do whatever they think is socially optimal; and (2) it would also provide an easier way to hold directors accountable if they do not comply.¹⁰² Dent is certainly correct that specific legislative solutions should be considered where particular matters have been causing harm. But the management literature emphasises the constant change with which management must contend. It would be impossible for specific legislation to cover every scenario that directors and officers

⁹⁸ Ibid, at 1118.

⁹⁹ Marshall and Ramsay, above n 40, at 292; Keay, above n 63, at 277-81.

¹⁰⁰ Robert Phillips, R Edward Freeman and Andrew C Wicks, 'What Stakeholder Theory is Not' (2003) 13(4) *Business Ethics Quarterly* 479 at 485.

¹⁰¹ See, eg, Jonathan R Macey and Geoffrey P Miller, 'Corporate Stakeholders: A Contractual Perspective' (1993) 43 *U Toronto LJ* 401 at 403, 405; Keay, above n 63, at 283-4, 293-4; Phillips, Freeman and Wicks, above n 100, at 484.

¹⁰² Dent, above n 91, at 1124.

might confront, particularly as new issues arise over time. Legislation is typically an *ex post* solution that is passed after a problem has manifested and only addresses future misconduct. Stakeholder management principles provide critical guidance to fill the gap where legal rules are lacking.

Not even all business ethics theorists agree with the central tenet of stakeholderism that companies should be managed for the benefit of stakeholders. Boatright, for example, agrees that corporations should serve the interests of all stakeholders, but disagrees that this requires management to act in the interests of all stakeholders.¹⁰³ He cites the standard law and economics arguments in favour of deferring to shareholders as the corporation's residual risk-bearers.¹⁰⁴ Further, he argues, management need not take particular steps to act in stakeholders' interests because stakeholders have the power to participate in the market to achieve their desires. By this, Boatright appears to be referring to most stakeholders' power to (1) negotiate in their dealings with firms and (2) walk away if they cannot reach satisfactory terms.

Boatright's argument echoes Macey and Miller, who argue that almost all stakeholders can and do protect their interests by contract, and that protecting their interests this way rather than by requiring corporate management to serve stakeholders' interests benefits them as well as shareholders.¹⁰⁵ That may be true for stakeholders such as lenders, suppliers, many customers, and even employees (where they have enough leverage to negotiate), but what about local communities? Macey and Miller acknowledge that local communities often will not have any contract with the firm. They argue, however, that local communities receive adequate protection through the political process and their elected officials, who presumably will change the law if corporate conduct threatens to or is harming the community.¹⁰⁶ Furthermore, they assert, requiring directors to act in the interests of the local community will 'transform[] the role of top managers of public companies from that of private businessmen into that of unelected and unaccountable public servants.'¹⁰⁷ Macey also observes that shareholders can opt out of shareholder primacy because they can contractually agree to have stakeholder interests placed ahead of shareholders'. Shareholders can vote to excuse directors from certain breaches of contract, and they can similarly mutually agree with other constituencies 'that shareholder claims should be subordinated to the claims of nonshareholders.'¹⁰⁸

In illustration of how stakeholders can protect themselves by contract, Hill and Thomas applied agency theory to the stakeholder issue and suggested that stakeholders may use the same principles as are used to align management

¹⁰³ Boatright, above n 3.

¹⁰⁴ *Ibid*, at p 72.

¹⁰⁵ Jonathon R Macey, 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 *Stetson LR* 23; Macey and Miller, above n 101.

¹⁰⁶ Eg, Macey and Miller, above n 101, at 421-2.

¹⁰⁷ *Ibid*, at 422.

¹⁰⁸ Jonathan R Macey, 'Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective' (1999) 84 *Cornell LR* 1266 at 1272-3.

interests to a firm's shareholders. For example, a stakeholder can offer management incentives to act in a desired way, such as the general public (through its legislature) offering a company tax breaks to control pollution. Or stakeholders can require the use of a bonding mechanism (ie, 'credible commitments'), such as a consumer who will not make a significant purchase without an adequate warranty whereby the manufacturer has committed to providing a certain standard of quality.¹⁰⁹

As with Dent's arguments about the ability to legislate on particular matters, the arguments that stakeholders can protect themselves by contract or walk away are certainly true in some cases, but not in all. Moreover, once the argument descends to advising stakeholders to walk away, the discussion is counterproductive. A firm that alienates key stakeholders is not going to last long, or is going to be forced to change, in some cases as a result of the legislative responses to which Dent refers. Shareholders' interests cannot be separated from stakeholder interests. Over any time horizon long enough to include stakeholders' ability to react to harmful corporate decisions and policies, shareholders will not be served by policies taken at stakeholders' expense. Just ask the shareholders of British Petroleum and Volkswagen. The potential for unhappy stakeholders is a reality for all businesses, and the literature reviewed in this article explains how and why it is in *shareholders'* best interests to pay attention to stakeholders' interests and create joint maximum value where possible. Table 1 provides examples of the negative consequences that companies have faced as a result of attempts to profit at the expense of stakeholders.

IV. Conclusion

In 1984 Freeman argued that it was not only morally correct but an essential component of strategic management for companies to take into account the effect of their activities on stakeholders. This article examined the development of stakeholder theory in the management literature, and explored who qualifies as a stakeholder, how stakeholders gain power and influence, and the conditions under which businesses are most likely to find it in their interests to take stakeholders into account (stakeholder salience). The management literature makes clear that a failure to consider the effect of corporate decisions and policies on a firm's stakeholders could and likely will lead to harm to the firm, and that accordingly competent managers will conduct stakeholder audits and consider how to mitigate the risk of adverse stakeholder reactions to corporate decisions as core aspects of running the business. Forging positive relationships with stakeholders is also an opportunity to create value. Lawyers should care about these points because they go squarely to the issue of shareholder wealth maximisation and illustrate the convergence between shareholder primacy and stakeholder principles in the form of Enlightened Shareholder Value (ESV).

Furthermore, because the need to understand and attempt to mitigate the impact of corporate decisions on stakeholders is a fundamental component of risk management, there is a compelling argument that corporate harm caused by a

¹⁰⁹ Hill and Jones, above n 17, at 139.

failure to consider the impact of corporate decisions or policies on stakeholder interests could constitute a breach of the directors' duty to act in the best interests of the company or even the directors' duty of care. If directors are expected to take certain steps, then it can be argued that the failure to do so is not reasonable.

Corporate social responsibility principles provide further support for the permissibility of considering the interests of corporate stakeholders, but do not obviate the growing legal risks of failure to do so. Finally, shareholder primacy theorists' arguments against stakeholder theory of the nature that it lacks a single objective function do not speak to ESV but only to the multi-fiduciary model, which this article does not argue for. Stakeholder theory as conceived by our management colleagues is a standard management tool and it should be recognised as such when director conduct is under legal review.

Table 1: Selected examples of harm caused by attempts to gain at the expense of corporate stakeholders

Company	Error	Stakeholders' Reactions/Negative Consequences for the Company
Volkswagen	Dieseldate: Fraudulent scheme misrepresenting level of automotive emissions discovered in September 2015.	Payment of over \$10 billion (USD) to United States government to settle government claims; additional sums to be determined to be paid to other governments; hundreds of lawsuits pending; share price remains down approximately 50%.
British Petroleum	Deepwater Horizon: Safety breaches and corner cutting at Deepwater Horizon oil platform lead to 2010 oil well explosion causing eleven deaths and massive Gulf of Mexico oil spill.	Over \$14 billion (USD) in clean-up costs; \$18.7 billion (USD) in fines; additional billions of dollars in compensation payments to claimants who suffered economic loss; ongoing reputational damage; share price still way below pre-spill levels.
Airlines operating in the United States	Numerous instances of US airlines failing to provide US passengers with food, water or lavatory access during excessive delays on the tarmac in some cases longer than 8 hours.	Federal government introduction of Airline Passenger Bill of Rights, specifying maximum limit of 3 hours that plane can remain on the tarmac for domestic flights and 4 hours for international flights (of both US and foreign carriers); requirements that water and lavatories remain available, compensation provisions for

		delays and cancellations, etc.
Enron and certain copycat competitors	Manipulation of California's deregulated electricity markets in 2000-01.	Prosecution of perpetrators resulting in settlements as large as \$1.7 billion (USD); re-regulation of energy markets to allow regulator to prevent, investigate and prosecute market manipulation.
Global garment manufacturers	2013 Bangladeshi factory collapse: Allegations of unsafe conditions and abuse of garment workers in global supply chains.	Negative publicity; consumer boycotts; early suggestions to attach liability to international brands and retailers for abuses in the supply chain – may yet lead to law changes.
Manufacturers and re-sellers of products where entity has market power	Opportunistic price gouging by, eg, pharmaceutical companies (eg, Mylan Pharmaceuticals' 2016 400% price increase in the cost of EpiPens in the US), various Australian retailers charging multiples of the price charged abroad for everything from books to makeup, etc.	Negative publicity; possible competition law consequences; possible legal imposition of price caps, increasing consumer flight to foreign sources of supply (via the internet or by travelling overseas); legalisation of parallel importing in Australia.
Australian "Big 4" Banks	High fees, failure to pass on interest rate cuts, etc.	Negative publicity; threat of Parliamentary investigation and sanction; consumer flight to lesser known competitors, etc.
Various global corporations (eg, Apple, Google, Microsoft, Mylan, James Hardie)	Corporate inversions, questionable uses of transfer pricing, and change of domicile to avoid paying tax in high-cost jurisdictions.	Negative publicity; threat of government investigations; proposals to change tax laws to require corporations to pay reasonable minimum levels of tax to countries where operate or have significant revenue.