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***Stakeholder Theory Contributions to the
Corporate Responsibility Debate***

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Abstract

Different approaches to corporate responsibility can be identified throughout the business ethics and corporate responsibility literature. Stakeholder theory, one of these approaches, has emerged in recent years as the most prominent. This approach calls for a shift from the supremacy of economic interests of stockholders and attempts to derive alternatives for corporate governance that include and balance the interests of all those affected by corporate conduct. This thesis consists of a review of relevant literature to identify three major contributions stakeholder theory brings to the CR debate: (1) it implicitly introduces the organic model into the CR debate and thereby forces a fundamental change in the way corporations are conceived within ethics frameworks; (2) in recognition of the expanding ethical sphere of corporations, it extends corporate responsibility beyond economic performance, the owners of the corporation, expertise, and the law and government regulations; and (3) it provides a foundation for identifying what responsibilities corporations do have.

Introduction

... if insight into specific conditions of value and into specific consequences of ideas is possible, philosophy must in time become a method of locating and interpreting the more serious of the conflicts that occur in life, and a method of projecting ways for dealing with them: a method of moral and political diagnosis and prognosis.

(Dewey 1910: p. 17)

As business' reach and potential for causing harm to the environment, individuals and society increase, a need for re-defining the nature of corporations and their responsibilities arises. Ethicists, economists, corporate executives, governments and citizens are increasingly concerned about what business is accountable for, and to whom. As Freeman and Evan (1993) point out, during the last century, product liability laws, different acts to protect employees' rights, as well as laws protecting local communities where firms operate, have emerged (Freeman and Evan 1993: p. 39). These developments indicate a shift from the supremacy of economic interests of stockholders to an acknowledgement of the interests of others affected by corporate conduct. In other words, it indicates a renewed interest in corporate responsibility (CR). Several approaches to CR exist but stakeholder theory has emerged in the last two decades as the

most popular. As two prominent CR theorists write: “. . . the rejection of the normative foundation of stockholder wealth maximization led many stakeholder theory advocates to reject the neo-classical theory of the firm and to adopt first the doctrine of corporate social responsibility and then stakeholder theory” (Jones and Wicks 1998: p. 211). Further, as Andriof and Waddock write, “stakeholder thinking has matured from servant logic supporting the advancement of other theories to a theory of the firm in its own right” (Andriof et al. 2002: p. 30).

Stakeholder theory attempts to describe, prescribe, and derive alternatives for corporate governance that include and balance a multitude of interests. The theory holds that corporate executives are responsible to shareholders and other groups affected by the corporation—to everyone who has a *stake* in the operations of that business. This includes shareholders but also employees, consumers, suppliers, and the surrounding community. The theory developed in large part because managers saw it as a means for developing more balanced and more robust strategies that reflect the evolution of the organisation. Also, with increasing attention to corporate power and the consequences of failures in CR, a more comprehensive approach to corporate conduct, predominantly nurtured from and by business ethics and philosophy scholars, emerged. This thesis consists of a review of CR, business ethics, and stakeholder theory literature in an attempt to identify the major contributions stakeholder theory brings to the CR debate. It will also be argued that stakeholder theory, as opposed to other major approaches to CR, is the only normatively adequate approach.

Three main contributions stakeholder theory brings to the CR debate will be identified: (1) a redefined nature of the corporation; (2) the extension of the concept of

responsibility; and, (3) the adoption of a discursive approach to ethics. It will be shown how each of these contributions has led to either increased descriptive accuracy or normative adequacy in the CR debate. Each contribution will be explained by providing an exposé of the relevant literature.

In chapter 2, it will be argued that two dogmas of CR have made it very difficult conceptually to develop more accurate theories of CR. The first dogma is the *business and society* dichotomy—the belief that a sharply defined division exists between *business* and *society* (Andriof et al. 2002: p. 11). The second dogma of CR is what Freeman termed the *separation thesis* (Freeman and Evan 1993: p. 39)—the belief that a dichotomy exists between *business* and *ethics*. Five models that define the nature of corporations will be presented. Of the five main models of the corporation that will be identified, four are based in part or in whole on these two dogmas. It will be shown that of the (1) machine model, (2) private property model, (3) private contract model, (4) social contract model, and (5) organic model, only the latter eliminates the two pervasive theses, and therefore, is the most descriptively accurate and normatively adequate model of the corporation. An organic conception of the corporation is at the heart of stakeholder theory. However, stakeholder theorists did not develop the organic model of the corporation, nor did they modify or alter it considerably. What will be shown is that stakeholder theory redefines the corporation in organic terms and that this redefinition enables it to avoid the two dichotomies. By implicitly introducing the organic model into the CR debate, stakeholder theory forces a fundamental change in the way corporations are conceived within ethics frameworks. This is a novel and important contribution to the CR debate.

In chapter 3, it will be shown that stakeholder theory extends the concept of CR in recognition of the expanding ethical sphere of corporations. This extension is a recognition that, because corporate managers wield such great power, they are directly or indirectly responsible to those they affect—to groups other than shareholders. However, many economists and scholars still endorse a laissez-faire capitalism as the most legitimate type of economic system on the grounds that it best respects the freedom of market participants while encouraging the virtues of efficiency and productivity. They endorse a system where corporations have responsibilities to stockholders only. To provide a better understanding of this contribution, the extension of CR by stakeholder theory will be presented along with arguments attempting to restrict CR. Four main arguments used to limit CR to stockholders will be presented: the (1) “performance” argument; (2) “loyalty” argument; (3) “lack-of-expertise” argument; and, (4) “concern-for-corporate-power” argument (Brummer 1991: p. 103-19). In response to these arguments, it will be argued that, in fact, CR extends (1) beyond economic performance; (2) beyond the owners of the corporation; (3) beyond expertise; and, (4) beyond the law and government regulations. As the extension of responsibility must be understood as a consequence of the introduction of the concept of "stakeholder," the first part of chapter 3 will consist of an analysis of this concept.

In the last chapter, it will be shown that stakeholder theory also makes an important contribution of a procedural nature by providing a foundation for identifying what responsibilities corporations have exactly. It will be shown that, explicated in terms of discursive ethics, stakeholder theory overcomes shortfalls CR approaches have

traditionally faced. Stakeholder theory's discursive ethics will be presented as another contribution to CR, but this exposé will be of a descriptive rather than normative nature.

As CR gained acceptance both in academia and the business world, interest in measuring the effectiveness of CR practices and evaluating the social and ethical performance of corporations grew. In fact, during the last decade, social and ethical accounting, auditing and reporting (SEAAR) has become a main concern for many business ethicists, social activists and businessmen. The final section of chapter 4 will consist of a preliminary exploration of SEAAR as a tool that could be used to operationalise stakeholder theory. Initial steps will also be taken to determine whether SEAAR frameworks—which are said to be based, in large part, on stakeholder theory—are consistent with fundamental principles of this theory.

To avoid ambiguity or confusion in the usage of concepts, the next chapter consists in an examination of central concepts used throughout this thesis.

- Chapter 1 -

Defining Concepts

Three central concepts used throughout the thesis will be defined in this chapter. These concepts are “corporate responsibility,” “corporation,” and “stakeholder theory.”

Corporate Responsibility

What exactly does CR mean? As early as 1973, theorists recognised the vagueness of the term “corporate responsibility.” As Votaw writes: “it means something, but not always the same thing, to everybody. To some it conveys the idea of legal responsibility or liability; to others it means socially responsible behaviour in an ethical sense; to still others, the meaning transmitted is that of ‘responsible for’, in a causal mode; many simply equate it with a charitable contribution” (Votaw 1973: p. 11). The reason for this ambiguity rests in the fact that, generally, business ethicists and CR theorists use the term “responsibility” without giving a clear explanation of what they

mean by it. To avoid ambiguity, we will define explicitly how “responsibility” will be used in this thesis.

As will become evident, different theories of corporate responsibility will define and use “responsibility” differently. Brummer suggests there are 10 different senses in which the concept of responsibility is used and distinguishes between the descriptive and evaluative uses (Brummer 1991: p. 20-45). He explains there are four descriptive uses: (1) used to mean simple causal agency; (2) used to refer to the capacity to act in a responsible or irresponsible manner; (3) used in the role application sense to refer to the set of performances or duties usually associated with the social or institutional roles assigned to an individual; (4) equated generally with an agent’s duties, within or outside an institutional or social role context. Brummer also identifies six evaluative uses: (5) role acceptance; (6) role enactment, e.g., acting dependably and conscientiously; (7) independent decision making in taking on roles neither initially assigned to nor expected of one; (8) to commend persons for any independent decision making that has a positive effect on society; (9) act according to one’s duties; (10) being held accountable. In this work, not all uses of the concept will be considered. In fact, for the purposes of this thesis, it will suffice to concentrate on two interrelated uses of responsibility: causal agency and role enactment.

The current CR literature lists two definitions of responsibility mostly from business ethicists. The first is “responsibility” in terms of causal connections. For this first conceptualisation, there is no need for a definition of responsibility based on some independent theoretical account of the conditions of being responsible. One is not responsible because of a non-empirical authority of right one chooses to acknowledge nor

because society demands certain things. Individuals are morally responsible because their acts will provoke reactions. In this case, responsibility is closely linked to a focus on the future and the connection of means and ends. I am responsible because consequences will follow from my actions.

“Responsibility” will also be used in both a descriptive and evaluative sense referring to one’s role. “Responsibility” in this second sense simply means the specific professional or domestic assignments or commitments one has in such or such a role. Brummer states that these commitments are connected with certain patterns of rights and duties that are wholly or largely spelled out within the institutional framework of the role itself (Brummer 1991: p. 22). The term can be used adjectively to mean an individual who performs his or her role conscientiously and dependably. This meaning of the term then concerns the way in which individuals perform their institutional roles.

Different *types* of responsibility also exist. Brummer identifies four types of corporate responsibility—economic, legal, moral and social (Brummer 1991: p. 20). Some theorists contend corporations have responsibilities in some of these areas but not all. Theorists who use the concept of responsibility to mean role-enactment emphasise economic and legal responsibilities of corporations, whereas theorists who use the concept in terms of causality, emphasise moral and social responsibilities. Because “responsibility” will be used both as causal agency and as role enactment throughout this thesis, all four types of responsibility will be dealt with. However, as Waddock points out, in most cases where theorists and business ethicists write about corporate social responsibility, the “social” should be dropped (Waddock 2002: p. 8). This is because responsibility—be it legal, social, economic or moral—is integral to corporate practice.

As Andriof et al. maintain this fact is widely recognised by business and academic circles since the late 1990s (Andriof et al. 2002: p. 13). For this reason, rather than using the concept of corporate *social* responsibility, the broader concept of corporate responsibility will be used.

Corporations as Moral Subjects

Many theorists have written on whether it is even possible for corporations to be moral subjects (see Hessen 1979; Hayek 1976; Friedman 1970). However, corporations have been defined as having three specific characteristics. First, they have entity status under the law. Second, they have virtual perpetual duration. That is, a corporation continues despite the death of a shareholder whose shares pass to his heirs; theoretically, the corporation may last forever. Third, corporations have limited liability for both debts and torts. In other words, the owners' liability for the business's debts or penalties is limited to what he or she has invested in the business. Because of these characteristics, we consider them moral subjects under the law. As such, one can assume corporations are capable of moral choice and action and have moral duties and responsibilities (Goodpaster 1991: p. 54). One cannot claim that corporations are subject to economic and legal duties but are immune from strictly moral or social obligations or responsibilities that apply to other moral agents. Throughout this thesis, the possibility of attributing responsibility to corporations will be assumed and further, that corporations should be held accountable for the same kinds of conduct for which any moral agent is held responsible.

Stakeholder Theory

Stakeholder theory is used in different ways and for different reasons. It is also supported with very different arguments, depending on the motives of the user. This is due to the fact that stakeholder theory differs from other theories of the firm in that it is intended both to explain and to guide the structure and operation of the corporation. As Donaldson and Preston maintain, there are three aspects of stakeholder theory and the confusion around these different aspects have raised problems in the evolution of stakeholder theory (Donaldson and Preston 1995: p. 63). The first aspect is the descriptive/empirical. The second is instrumental, and the third is normative. Theorists often write about stakeholder theory without specifying which aspect they are mostly concerned with. This leads to ambiguity and critics maintaining that stakeholder theory lacks rigour.

Donaldson and Preston summarize the *descriptive thesis* as “a model describing what the corporation is. It describes the corporation as a constellation of co-operative and competitive interests possessing intrinsic value. . . . The model can also serve as a framework for testing any empirical claims, including instrumental predictions, relevant to the stakeholder concept (but not for testing the concept’s normative base)” (Donaldson and Preston 1995: p. 65). Donaldson and Preston claim stakeholder theory has been used to describe the nature of the firm; the way managers think about managing; how board members think about the interests of corporate constituencies; and, how some corporations are actually managed (Donaldson and Preston 1995: p. 65). The descriptive

justifications of stakeholder theory attempt to show that the concepts embedded in the theory correspond to observed reality.

The *instrumental thesis* can be summarised as the linking of stakeholder management practices and the achievement of various corporate performance goals (Donaldson and Preston 1995: p. 68). The push behind this endeavour stems from the proposition that corporations practicing stakeholder management outperform other corporations with regards to indicators such as profitability, stability, and growth. In fact, many studies attempt to establish the link between stakeholder theory and the bottom line, and most tend to suggest that adherence to stakeholder principles and practices achieves conventional corporate performance objectives as well or better than rival approaches (Donaldson and Preston 1995: p. 68). As Shankman writes however: “Despite this instrumental relevance for firm survival, stakeholder theory is ultimately justified on the basis that firms have responsibilities to stakeholders for moral reasons” (Shankman 1999: p. 322).

Finally, the *normative thesis*, the fundamental basis of stakeholder theory, is the recognition that individuals and groups other than stockholders have legitimate interests in procedural and/or substantive aspects of corporate activity, and that these interests are of intrinsic value. Donaldson and Preston maintain that in normative uses, the correspondence between the theory and the observed facts of corporate life is not a significant issue, nor is the association between stakeholder management and conventional performance measures a critical test. The normative stakeholder theory assumes that each stakeholder of the firm has an intrinsic value regardless of that individual or group’s actual power or legal entitlement. The normative theory attempts to

interpret the function of, and offer guidance about, the investor-owned corporation on the basis of some underlying moral or philosophical principles.

The three approaches to stakeholder theory are mutually supportive, but the normative base serves as the critical underpinning for the theory in all its forms. As Donaldson and Preston write: “the three aspects of the stakeholder theory are nested within each other . . . The external shell of the theory is its descriptive aspect; the theory presents and explains relationships that are observed in the external world. The theory’s descriptive accuracy is supported, at the second level, by its instrumental and productive value—if certain practices are carried out, then certain results will be obtained. The central core of the theory is, however, normative” (Donaldson and Preston 1995: p. 74).

As Jones and Wicks note however, there exists no consensus among stakeholder theory advocates as to the moral foundation for stakeholder theory (Jones and Wicks 1998: p. 207). They maintain that virtually all stakeholder theorists are concerned with moral processes and outcomes but that identifying the most appropriate processes and outcomes remains a contentious domain. The normative rationale of stakeholder theory appeals to underlying concepts such as individual or group rights, social contract, utilitarianism, deontology, and procedural ethics. Freeman also recognises this multiplicity of ethics principles in stakeholder theory and therefore proposes to use the theory first and foremost as a metaphor through which particular accounts of the different values and interests prevailing in a given situation are brought forth (Freeman 1994: p. 410). In this sense, “stakeholder theory” can be understood as a shell that is filled by ethics principles and theories. It is an ethics framework specifically addressing CR but that does not a-priori specify which ethics principles will be used.

Throughout this thesis, “stakeholder theory” should be understood as a normative theory for corporate conduct. While its descriptive accuracy will help establish it as preferable to other theories of CR, the aim is, nonetheless, to provide an overview of stakeholder theory as a framework that enables managers to acknowledge and change their perceptual biases, assumptions and practices and assists them in making responsible decisions. Also, stakeholder theory will be presented as drawing on numerous ethics principles and theories.

- Chapter 2 -

A New Model of the Corporation

While many models of the corporation exist (see Brummer 1991; Morgan 1998), five main models can be identified: the (1) machine model; (2) private property model; (3) private contract model; (4) social contract model; and (5) organic model. Some of these models overlap and theorists often—consciously or unconsciously—use more than one model in a single system.

The CR literature reveals two dogmas, which have made it very difficult to develop more accurate conceptual frameworks for CR. The first dogma is the *business and society* dichotomy—the belief that a dichotomy exists between *business* and *society* (Andriof et al. 2002). The second dogma of CR is what Freeman termed the *separation thesis* (Freeman 1993)—the belief that a dichotomy exists between *business* and *ethics*. It will be argued that the organic model of the corporation, implicit in stakeholder theory,

is the only model that eliminates these two pervasive theses, and therefore, is the only descriptively accurate and normatively adequate model of the corporation. The organic model is the only theory of the corporation that enables business scholars and ethicists to move from the “*Business and Society*” discussion to the much more productive and descriptively accurate discussion of “*Business in Society*” (Andriof and Waddock 2002). It is also the only model to recognize the embeddedness of ethics in business conduct.

It is not the intent here to present stakeholder theory as the origin of the organic model of the corporation. What will be shown is that stakeholder theory is implicitly based on the organic model of the firm and its adoption by the stakeholder theory is a novel and important contribution to the CR debate as it enables theorists to overcome the two dichotomies.

In the first part of this chapter, the two dogmas of CR will be presented and analysed. In the second part, the different models of the corporation will be described and it will be shown that all the models except for the organic model—upon which stakeholder theory is based—are founded on the descriptively and normatively inaccurate *business and society* dichotomy, and the *separation thesis*.

Two Dogmas of Corporate Responsibility

The Separation Thesis:

It has been said *that business is business and ethics is ethics and never the twain shall meet*. This conception, which holds that ethics and business are distinct and

independent realms, has come to be known as the “Separation Thesis”—after Edward Freeman coined the term during a 1993 conference (Freeman 1993). As Freeman stated in a presentation given at the conference, the separation thesis is the prevalent view in western culture. Businessmen and academics that embrace this idea hold that business and ethics each have their own concepts, language, and logic. For instance, a separation theorist would conceive of ethics as dealing with values and responsibility to society, and conceive of business as dealing with profits, competition, and responsibility to shareholders. And yet, he would conceive of the latter as independent of the former. These theorists hold that the ideas and methods of moral philosophy cannot—and should not—find their way into the language and methods of either business or modern economics. The businessman, according to these theorists, should be like Ackoff’s metaphoric picture of the corporate executive, who, when he enters his office, first hangs his coat, and then proceeds to remove his personal values before he puts on his work clothes and the business world’s value-set (Ackoff 1999: p. 15). This leads Quinn and Jones to maintain that “the very language of moral discourse is at odds with the dominant language of description in business” (Jones and Quinn 1995: p. 262). They go on to write: “the vocabulary of profit and self-interest nurtures in corporate employees a worldview at odds with one that nurtures their moral sensibilities” (Jones and Quinn 1995: p. 263).

To advocates of the separation thesis, this dichotomy is not only theoretical. It is not simply a superficial dichotomy, which enables them to understand business ethics and the business of business. Separation theorists believe the disconnect between business and ethics goes beyond semantics. The research agenda of the business ethics and CSR

fields provides hints of this. In recent years, numerous empirical studies on the relationship between corporate social responsibility or business ethics and financial performance have been conducted and have received much attention (see Pava and Krausz 1997; Verschoor 1998; Preston and O'Bannon 1997; Waddock and Graves 1997). As Wicks points out, these studies reinforce the idea that the economic and ethics realms are distinct and that it is the appeal to economic return that determines how corporations ought to behave—i.e., academics try to show that social responsibility does not preclude financial performance in an attempt to convince business to conduct its activities more ethically (Wicks 1996: p. 91).

The assumption then, is that the driving force behind corporate behaviour is profit maximization and that social responsibilities should be considered only to the extent that they further this objective. The empirical studies attempting to link CSR or corporate ethics and business performance are grounded in a conception of business ethics as instrumental. To avoid the separation thesis, one must adopt an agnostic view about whether ethics or good business conduct is good business. In other words, ethical business is intrinsically good, not instrumentally so. Hence, while wealth considerations are not precluded from any ethical or cost-benefit analysis, CR cannot be justified solely with reference to the economic gain of a firm or its stockholders.

Wicks suggests “[t]he separation thesis frustrates efforts of people to systematically introduce their moral imagination when they act in the business world, and it prevents people from making a persuasive case that corporations should aim for a higher standard of conduct. It limits how we act in the present, but it also confines expectations for the future” (Wicks 1996: p. 90). By preventing systematic connections

between business and ethics, the separation thesis has the effect of marginalizing discourse on business' role and place in society, and it prevents practitioners from using moral imagination. They rely instead exclusively on profit-maximization strategies.

The separation thesis, however, is flawed theoretically. Because “business” implies action—e.g., transactions, profit seeking, production, etc—corporations cannot be immune from the same ethics principles pervading the rest of human interaction. Actions—regardless of the context in which they are carried out—are always linked to ethics. This is an unavoidable conclusion of human consciousness and freedom and the fact that human beings live within collectivities. In other words, in responding to one's environment, one is constantly confronted with choices. Because one has the freedom to choose between options, in choosing, one is making an ethical statement. Because human beings are rational, it is assumed that one's choices are the result of rational deliberation and that one's action are based on normative reasons. Whether the choice is based on a categorical imperative, a calculation of over-all happiness versus over-all suffering, carnal desires, or the position of the stars, the ability to choose brings any human action within the sphere of ethics. Human actions and ethics are integrally linked. This is true of the two main ethics traditions—i.e., teleological ethics and deontological ethics. The first tradition holds that actions acquire their moral status from the consequences that flow from them while the second holds that actions are inherently right or wrong based on formal laws. Regardless of the tradition, then, ethics can be defined generally as the study, analysis, or pursuit of the good in human actions. It attempts to answer the question “What ought I/we to do?” The scope of ethics therefore extends to all fields where human action exists or is possible—including business.

This then implies that corporations do, in fact, have responsibilities. For, as mentioned earlier, the concept of “responsibility” is fundamentally linked with ethics. Regardless of the moral justification for a particular action—be it of a teleological or deontological nature—to say that one ought to do X is to say that one has a moral responsibility for doing X. But to whom are corporations responsible? The second dogma of CSR, which holds that business is somehow independent from society, rather than an integral part of society, provides the basis for business theorists’ claims that corporations have responsibilities solely to shareholders.

The Business and Society Dichotomy:

Solomon writes that “our present way of conceptualizing business has somehow gone very wrong, not just in its details but at its very conception” (Solomon 1992: p. 19). One of the conceptual errors Solomon refers to is the way in which classical theories of business have conceived of business and society as distinct. The classical theories of business and economics view corporations as closed systems. As Andriof et al. write, “the conception came to be that corporate walls and the boardroom defined the firm’s environment, distinct from society” (Andriof et al. 2002: p. 30). This second dogma of CSR is not often explicitly stated, but it is implicit in most theories of the corporation.

Andriof et al. suggest that the language of the field of study that developed around business in its environment reflects this dual conception. They state that the field of corporate responsibility and business ethics talks of “business and society, as if business were and could be separated from society surrounding it and on which it depends”

(Andriof et al. 2002: p. 12). As Frederick puts it: “It would be as if the entire business system and all business practitioners were sealed within a glass sphere, cut off from nature and all of its myriad effects” (Frederick 1998: p. 40). Pruzan and Thyssen attribute this view to the prevalence of analytical thought over synthetic thought. They attribute the myopic focus of corporate executives on short-term results—and their disregard for how these results are obtained—to the fact that theorists tend to *analyse* society in components which sees business on one side and all other social structures on the other. They explain that the pursuit of knowledge has become one of knowing “more and more about less and less” (Pruzan and Thyssen 1994: p. 24). Scientific and technological advances are made possible by decomposing wholes into parts that are carefully studied. This analytic method has been applied to all fields of knowledge—including business, where the consequence has been the elimination of any knowledge or consideration that are not purely economics-based. What is needed however, is for business theorists to *synthesise* business and other social structures in a single system. They write that “[w]holes have qualities and characteristics we cannot identify if we do not supplement the analytic approach with a synthetic approach, where wholes are studied as entities interacting with their environments” (Pruzan and Thyssen 1994: p. 24).

Conversely, Andriof et al. maintain that we have come to conceive of business in this way because it is much more practical for executives (Andriof et al. 2002: p. 11). This analysis of business *and* society leaves only the investors as potential parties to whom corporations have responsibilities. Through this conception, theorists have defined the corporation’s primary obligation as the satisfaction of investors.

In reality, business and society are interpenetrating systems. Business cannot exist outside of the social context. It exists because it provides society with services or products for which there is a social demand. And, it exists because it is within a society that provides it with the infrastructure needed to carry out its activities, the human resources and natural resources it needs and the laws that will protect it. Because of this symbiotic relation between society and business, because of this interdependency, business conduct will invariably affect society. Corporate action affects—positively or negatively—diverse groups and therefore, cannot be conceived as distinct from society (Epstein 1987: p. 104). As Brummer explains, business life has no clear point of beginning or end: “business decisions made many years ago may still have an impact on people’s lives” (Brummer 1991: p. 37). Epstein argues further that the effects of corporate actions are not only felt over time but also across spheres (Epstein 1987: p. 104). He contends that the scope of a corporation’s effects on society extends to include all aspects of society—overall economic, political, ecological, social and cultural impact.

This leads Frederick to contend that what is needed is a Copernican-like revolution (Frederick 1998: p. 41). The present situation, he maintains, is “the corporation becomes the sun around which society revolves—the central star of our societal system and the vital core whose productive rays may now enrich, now impoverish, or at times devastate the societal planets that swing around it in irregular orbits” (Frederick 1998: p. 41). Frederick argues that corporations must be decentred, and society as a whole—with business as a part—must become the basic normative reference for CR. He insists this paradigm shift is necessary because a corporate orientation alone cannot comprehensively encompass the normative issues that challenge

business. Corporations must consider the social impacts of operating under despotic, oppressive regimes; of foregoing the purchase of environmentally safe technologies in order to increase profits; of targeting vulnerable populations in their marketing strategies; of using child labour or of laying off all child labourers. They must consider the social impact of raising prices rather than heeding government requests to help stymie inflationary growth; of exacerbating tensions between the “haves” and “have-nots”; of the restrictive control of intellectual property rights and the sale of life-saving drugs only the wealthiest can afford. These are obvious examples of corporate practices that have an important impact on society. However, a traditional corporate orientation will base normative decisions with regard to these issues predominantly on economic factors. The paradigm shift Frederick calls for would see corporations basing normative decisions primarily on benefits to society—or at the least, non-maleficence—and secondly, on wealth-producing factors.

This paradigm shift does not only avoid the business-society dichotomy but avoids also the other dogma of CR, the separation thesis. But can this shift occur under current models and theories of the corporation? In the second half of this chapter, it will be argued that only the organic model of the corporation eliminates the two dogmas and thereby, adopts this paradigm shift. It will be argued that only the organic model provides the necessary conceptual framework that enables business scholars and ethicists to move to a “business *in* society” conception and to recognise the embeddedness of ethics in business conduct.

Five Models of the Corporation

Businesses often take the form of corporations. Originally, a corporation was any group of people who joined together for a common purpose. However, we now generally reserve the term for organisations seeking profits. Today, corporations have distinct legal status, and the law grants them specific benefits. For instance, they are considered as persons, they have perpetual existence, and their owners have limited liability—as stockholders, the liability of owners is limited entirely to the money they have put into this separate legal person (Brummer 1991: p. 9). While it is separate and apart from its employees, stockholders, directors, or officers, the corporation can act only through its stockholders, officers, or agents. Legally, the corporation is based on the principle of delegated agency—i.e., managers and employees are supposed to act on behalf of the absent stockholders (Brummer 1991: p. 47).

While these are established facts, different theories of the corporation exist. Different metaphors have been used to better understand and guide the complex institutional structures corporations are. The metaphor used to describe the nature, function and structure of corporations has a profound affect on how we define properties of the corporations, such as its responsibilities, how it ought to conduct business, what guiding principles it ought to use. Furthermore, as Brummer states “not only do they [metaphors] emphasize certain corporate features with which the relations of accountability are said to be connected, they also typically stress various internal and external groups of persons toward whom the corporation is alleged to have its most direct, pressing, or dominant set of responsibilities” (Brummer 1991: p. 47).

Freeman and Evan echo Brummer as they state that a theory of the corporation gives us a normative understanding of the corporation (i.e., it tells us why corporations exist, and what they should be like, even if many of them are not actually like that) (Freeman and Evan 1993: p. 38). It indicates how companies should be structured and controlled so as to fulfil their function. As Brummer argues, “many of the important differences of opinion arising in the corporate responsibility debate are traceable to differences over these models” (Brummer 1991: p. 46). In fact, as will be demonstrated, most models of the corporation are restricted by the conceptual framework the two dogmas of CR have established.

The four main models of the corporation—the (1) machine model, (2) private property model, (3) private contract model, (4) social contract model—are all based on one or both of the two dogmas of CR. As will be shown, a discrepancy exists between the way in which corporations are generally conceived of and what they are in reality. It will become clearer through the optics of the different models of the corporation that these dichotomies are descriptively inaccurate and normatively inadequate beliefs that business is distinct and separate from society, and that a dichotomy exists between business and ethics.

The Machine Model¹:

The machine model of the corporation is based on a particular analysis of the market. Generally, advocates of this model analyse the market system in two markets—

¹ Some of these models overlap and theorists often—consciously or unconsciously—use more than one model in a single system.

the market for the factors of production (firms buy labour, material, capital, knowledge); and, the market for products (householders buy goods and services from firms). The function of the firm is to efficiently transform resources it buys in the factor market into products it sells in the product market (Mulligan 1986: p. 267). Market prices guide the firm in successfully performing this function. Households have preferences—i.e., they demand the lowest prices for the factors of production they most prefer to part with, and they pay the highest prices for the products they most prefer to consume (Mulligan 1986: p. 266). When a firm that takes the resources people most prefer to give up and transforms them into the goods and services people most prefer to consume, it maximizes its profit and it maximizes the satisfaction of human preferences. In this sense, for advocates of this theory, profit is both a measure of economic success and success in producing human satisfaction (Mulligan 1986: p. 267). The firm then is but a mathematical entity working on the mathematical problem of optimizing the diverse preferences of consumers. In other words, business should not directly consider moral issues when it makes decisions since the moral preferences of workers, investors, vendors, and customers are already factored into market prices, along with all their other preferences (Mulligan 1986: p. 267).

The machine model of the corporation clearly separates the business and ethics into two distinct realms by rejecting the idea that corporations are moral agents and that they may be subjects of moral valuation. This model holds that corporations are but private instruments created to serve economic and social purposes and therefore should not be treated as moral agents capable of acting in their own behalf (Brummer 1991: p. 63). The machine model is generally associated with one form of methodological

individualism—i.e., the theory that contends that only the individual human members of a corporation are the proper subjects of moral assessment. For methodological individualists such as Hayek, the corporation is but an instrument created to serve economic purposes and their legitimacy is determined according to their level of effectiveness in fulfilling such purposes (Brummer 1991: p. 63).

The argument generally advanced in defence of the separation thesis is based mainly on Adam Smith's important contribution to economic theory and capitalism. Advocates of the separation thesis maintain that in perfectly competitive free markets the pursuit of profit by itself ensures that members of society are served in the most socially beneficial ways. Corporations are seen as machines or tools transforming raw material into goods or services. To be profitable, firms have to produce only what the members of society want and have to produce it as efficiently as possible. They contend that members of society benefit most when managers conceive of the corporations they run as tools and avoid imposing their values on it so that profit is their sole objective (Velasquez 1996: p. 203).

Those who advocate the machine model make four assumptions, which are all problematic. First, they assume that markets are perfectly competitive. These theorists maintain that the laissez-faire economic system, perfectly competitive and in which only the invisible hand intervenes, is the most efficient system (see Friedman 1970; Shaffer 1977; Hayek 1976). However, markets are never "perfectly" competitive as these theorists assume. This means that, in some instances, corporations can maximize profits in spite of inefficient production because they do not have to compete.

Second, these theorists also assume that any steps taken to increase profits will necessarily be socially beneficial. For instance, in describing Friedman's position, Brummer writes "Shareholders are better off because they realize a greater or more secure return on their investment. . . . Consumers are more satisfied because firms have an incentive to respond to their demands for various goods or services with products that are priced more attractively because the firms are not reducing net earnings or their assets by spending on social causes. . . . Workers would be more satisfied because financially successful firms have the incentive and wherewithal to hire more of them and to provide them with better wages, salaries, working conditions, and other benefits. . . . Finally, society benefits when all forms seek to be economically competitive and constrain their social spending because prices and profit will allocate the resources of society in the most nonwasteful manner" (Brummer 1991: p. 106). Machine model theorists only consider the benefits the corporation can produce. These theorists fail to recognize—or choose to ignore—the fact that while corporations may well produce benefits in terms of wealth, in so doing, they may produce negative effects on various constituents—e.g., pollution, production of dangerous products, use of child labour, indirect support to repressive and dictatorial governments. Economists and businessmen often refer to these negative effects as "externalities." "Externalities" refer to the practice of internalizing benefits and externalizing the costs of actions. For example, companies who profit from selling tobacco products share their profits internally while they leave the costs tobacco products produce on the public health and health care systems to be assumed by the population as a whole. The same can be said of corporations who are heavy polluters: they profit from not purchasing more environmentally efficient technologies and governments are left to

bear the costs of heavy smog and polluted rivers. As Clarkson points out however, “[t]he notion that important aspects of corporate performance can be ignored by managers because they are external (perhaps as a result of being deliberately *externalized*) is incorrect” (Clarkson 1995). As Freeman and Evan contend, externalities are beyond the control of the invisible hand (Freeman and Evan 1993: p. 40).

A third assumption is that corporations produce what society wants. The fact is however, that corporations produce what the *buying* public wants. As Velasquez writes, “the wants of large segments of society (the poor and the disadvantaged) are not necessarily met because they cannot participate fully in the marketplace” (Velasquez 1996: p. 204). Similarly, Milligan maintains business cannot substitute moral initiative with heeding the market, nor heeding public expectations since markets and public expectations can be morally good or bad (Mulligan 1986: p. 266). Mulligan further argues that market prices may be reliable measures of economic value but not of moral value. He maintains that “[e]ven if we grant prices do sometimes adequately communicate well-defined householder preferences, prices still prove nothing concerning how morally worthy those preferences are” (Mulligan 1986: p. 266). In effect, this model also paints a picture of the world where only consumers exist. Because the model is based on preferences, everyone is considered a potential consumer and corporations are accountable inasmuch as consumers may choose to abstain from buying products. In fact, however, victims also exist. Corporate actions may victimize groups and individuals who are not even remotely interested in the consumption of the products of that corporation. For instance, the Ogoni of Nigeria care very little about the products Shell has to offer. Shell has been extracting oil from Ogoniland for several decades and

as a consequence has drastically altered the environment of a group of people who depend on the land for sustenance. What the Ogoni are not interested in is how cheaply they can purchase Shell gasoline, as very few own vehicles. They are interested in how Shell will fix the environmental degradation it has caused over several decades.

Fourth, these theorists promote a system on the grounds that it is devoid of ethics. However, as Velasquez points out, they are in fact making a normative judgement when they argue that “because people should do whatever will benefit those who participate in markets, managers should devote themselves to the single-minded pursuit of profits” (Velasquez 1996: p. 207). This claim is clearly normative in nature and any normative claim is inherently tied to ethics. One’s position may be founded solely on economic principles or principles of greed, but while that position may not be *ethical* it is invariably *ethics-related*.

As demonstrated, the machine model relies on false assumptions but it also fails to appreciate the complexity of relations between the corporation and its constituents. Machine model theorists fail to see that business and society are interpenetrating systems since the corporation’s effects on society are not restricted to economic impacts. Corporations leave an important impact on all aspects of society—economic, political, ecological, social and cultural. The machine model ignores altogether the fact that corporations may have negative effects on groups outside corporate walls.

As demonstrated, the machine model is based predominantly on the separation thesis. The business-society dichotomy also plays a role but it is less significant. In other models of the corporation, as will be evident in the next section, the business-society dichotomy is the more prevalent of the two dogmas.

The Private Property and Private Contract Models:

Both the private property model and the private contract model emphasise ownership and the manager-shareholder relation. Advocates of these particular theories of the corporation maintain that the most important factor in determining the responsibility of corporations is the fiduciary responsibility of the managers towards shareholders. At first glance, it does not seem that the separation thesis could give rise to these models as they do use ethical principles—i.e., the notion of a relationship where one actor or group has certain obligations, which are to be fulfilled for another actor or group by virtue of their economic relationship (Shankman 1999: p. 320). However, as will be shown below, for these theories of the corporation, ethics applies only to the relation between owners and managers but should be avoided in considering most other relations. The private property and private contract models rely mostly on the business-society dichotomy as they attempt to abstract business from its social context and emphasize the cleavage between business and society.

The most important (structural) characteristic of the corporation for the private property model is the ownership relation. Those who buy shares of the corporation are said to be that corporation's owners. Owners acquire the right to use the corporation as a means to the production of wealth when they legally buy shares in that corporation (Friedman 1970: p. 33). As the possession of a right implies an obligation on the part of the rest of society to respect the claims of the holder contained in the right, executives, managers, employees, or society must not interfere with these claims or interests. As Boatright explains, the shareholder-management relation derives mainly from the notion

of equity in the treatment of property owners (Boatright 1994: p. 80). He explains that when business ventures were undertaken by individuals with their own assets, the business was comprised of different investors' actual personal assets. As the business's assets were ultimately those the investors entrusted to the business, the business could rightly be thought of as the investors' property. However, while the ownership of corporations is different today, the logical structure of the business ownership has nonetheless been used for the ownership of corporations.

As for the private contract model, the corporation is seen as a form of association involving a complex network of private agreements existing among and between internal and external constituents. The most important is the one between owners and managers, but this is not the only one. Owners of the corporation agree to abide by the terms of the contract that specify the rights, privileges, and duties of holding stock in the corporation. On the other hand, executives are viewed as stewards of the corporation's assets who have promised to protect the investment of the shareholders. Brummer maintains that while wealth enables the shareholder to enter the agreement (by buying shares), consent, promise making, and voluntary association are core principles underlying this model (Brummer 1991: p. 48). While the private contract model does view the corporation as extending beyond the immediate business sphere—i.e., beyond shareholders to all who have a contract with the corporation—it is still cut off from society. Groups that are not linked to the corporation through a contract—most of society—are still dismissed as external to the business sphere.

The main argument used to defend these models—advanced most notably by Milton Friedman—is the “loyal agent’s argument”. As Friedman contends, corporate

executives are employees of the owners of the corporation. And, as an employee (loyal agent) the corporate executive must act in accordance with the owner's desires. Because the owner's desire is *generally* to "make as much money as possible," the executive should single-mindedly pursue profit maximization (Friedman 1970: p. 34). Managers have taken the stockholders' money with the understanding that it will be invested to make a profit. If the managers were to use the money for another purpose, or take into consideration the interests of other constituencies in the conduct of business, they would be failing in their contractual and moral obligations to the stockholders and thus be violating their rights (Miller and Ahrens 1993: p. 188). This leads Friedman to maintain that corporate managers must respect the right to property of investors and therefore consider their sole social responsibility to be the maximizing of shareholder financial return (Friedman 1970: p. 36). Furthermore, as the ownership relation is the primary consideration in determining how revenues should be spent within the firm, Friedman contends corporate executives have a duty to use whatever resources available to increase profits for shareholders.

There are two assumptions underlying this argument. First, it is assumed that the executive's loyalty duty is limitless. As Velasquez points out however, laws of agency, which establish limits to the agency relation, exist in most industrialized countries. Velasquez writes that "the law of agency states that . . . in no event would it be implied that an agent has a duty to perform acts which are illegal or unethical" (Velasquez 1996: p. 210). Similarly, using the four principles identified by Quinn and Jones (1995)—honouring agreements; avoiding lying; respecting the autonomy of others; and, avoiding harm to others—Shankman argues that all theories of the firm—even agency theory—

must uphold an implicit moral minimum, which includes certain fundamental rights and principles (Shankman 1999: p. 320). These principles are embedded in economic theories of market competition. These principles provide the necessary conditions of any market—i.e., a working assumption that agreements will be respected. Hence, managers are expected to carry out their duties towards shareholders so long as these duties do not contravene basic principles of the free market.

The second assumption underlying the loyal agent argument is the assumption that because managers have responsibilities to the owners of the corporation, they do not have responsibility to any other constituencies. Friedman contends corporate executives have a duty to use whatever resources available and legally justifiable to increase profits for shareholders. Assuming shareholders can be regarded as the owners of the corporation because they possess certain rights as to the board of directors and the receipt of dividends, it does not follow however, that managers have a duty to run the corporation solely in the interests of shareholders. As Boatright argues: “It is entirely consistent to hold that shareholders are the owners of a corporation and that the managers have a fiduciary duty to run the corporation in the interests of other constituencies” (Boatright 1994: p. 76). A lawyer may have responsibilities towards the firm that employs him/her. However, no one would ever argue that these responsibilities have primacy over responsibilities to the lawyer’s client. It is a fact that professionals will have conflicting duties and that, in some cases, duties owed to employers will be outweighed. Boatright maintains there is a logical gap between the property rights of shareholders and the duties of managers. Because the investment of shareholders ought to be protected, it is necessary to create a governance structure, which assigns them a

significant role. Different laws and corporate governance regulations have been enacted in industrialised countries to ensure managers protect the investments of shareholders in running the corporation. However, running the corporation in a way that forsakes any considerations of negative effects of corporate actions on groups external to the corporation cannot be held on normative, practical, nor logical grounds.

Friedman also argues that corporations can legitimately be expected to concern themselves only with maximizing profits, since safeguarding public goods against corporate actions should be the government's responsibility. However, the democratic and economic spheres are not distinct or closed systems. In fact, the corporate sector can have significant influence over the political sphere. As Miller and Ahrens maintain: "The economic power of corporations can be translated into political power in a variety of ways, and many of the more effective ways are completely legal and above-board. . . . [B]usiness practices influence politicians such as contributions to campaigns and political action committees, intensive lobbying, political advertising, and giving jobs to former government officials. Corporations are able to influence judicial decisions, legislation, and regulatory policy because they have the wherewithal to sway public opinion and to ensure that their interests are effectively represented before Congress and the government's regulatory agencies" (Miller and Ahrens 1993: p. 192).

Ethical principles do play a role in the private property and private contract models of the corporation, although not a significant one. These models view the relation between shareholders and corporate executives, and the relation between corporate executives and those who are party to a contract with them, as based on ethical principles such as loyalty, integrity, promise-keeping, responsibility. However, advocates of these

models maintain that the same ethical principles should not apply to the relation between the corporation and other groups. While the separation thesis is used in varying degrees, the business-society dichotomy, however, plays a significant role in these models. Conversely, the next model—the social contract model—integrates ethics in the business sphere to a much higher degree but maintains the cleavage between business and society.

The Social Contract Model:

The social contract model of the firm is influenced mostly by the business-society dichotomy but it does not avoid the separation thesis entirely. This model is opposed to the private contract model of the corporation. Advocates of this theory of the corporation also see the corporation as a wealth-producing vehicle, but they view ownership rights and wealth production rights as a social permission or privilege gained. Many political philosophers of the Enlightenment hold that people become citizens by making binding agreements about their rights and freedoms, and the contribution of each to the common good. People, they argue, endorse the social contract because of enlightened self interest—i.e., they accept the social contract as limitation in everything they do based on the reasonable expectation that they will benefit from it. The social contract in the corporate context can be defined as “the set of generally accepted relationships obligations, and duties that relate to the corporate impact on the welfare of society” (Reidenbach and Robin 1989: p. 65). Much as the political philosophers of the Enlightenment contend, those who adopt the social contract view of the corporation hold that as corporations get their authority from society through such instruments as charters

of incorporation, licences, regulations, and laws, they must accept the social contract as limitation in everything they do. Society agrees with this exchange as long as the social benefits exceed the social costs.

As Brummer explains, because the public consents to giving corporations entity status, limited liability, and virtual perpetual existence, corporate executives are responsible for considering the interests of the public (Brummer 1991: p. 9). While private property and private contract model theorists contend that the chief obligation of managers is to be responsive to the wishes of shareowners, social contract model theorists contend managers should be responsive rather to the need of the general public—i.e., those who have given the corporation permission to produce wealth (Brummer 1991: p. 165). Social contract model theorists maintain that it does not matter whether an individual manager agrees with the expectations of society. He or she is required to respond to them simply because they state the conditions under which the members of society have given their continued permission to the corporate form of business enterprise (Brummer 1991: p. 164).

This model clearly presents society and business as distinct parties negotiating acceptable terms and conditions according to which corporations can pursue their (economic) interests. As Wicks maintains, this conception casts business and society as independent and separate (Wicks 1996: p. 96). Donaldson, whose model of the corporation is based on the concept of the social contract, argues that based on the principle of justice or fairness, the minimum demand society places upon corporations is that no party to an agreement should be made worse off by it (Donaldson 1993: p. 168). However, there is still a sense in this interpretation that business, in its purest form, is

devoid of ethics, and that ethics are added by society.² It is assumed that managers can't or won't engage in ethical deliberation and choose to conduct the operations of the corporation according to their ethical analysis. Society must therefore provide business with rules. However, nothing prevents society from establishing unethical rules. For instance, at the end of the 20th Century, societies established rules that were disadvantageous to businesses and corporations of least developed countries—i.e., excessive duties and levies on imports.

While the social contract model of the corporation attempts to give a picture of more integrated ethical and business spheres than the previous models, it cannot claim to give a picture where business and ethics are entirely integrated. If a contract is to be truly “social” all those who will be affected by its terms and who will have to adhere to the terms, must have the opportunity to influence its development. However, many vulnerable populations in society do not have a voice and therefore cannot participate in establishing the terms of the contract. For instance, third-world populations, “techno-peasants,” children and incompetent adults, illiterate populations, very seldom get to participate in broad governmental or corporate consultations. However, under the social contract model of the corporation, ethics apply to those actions of the corporation that affect groups who have a voice and participate in establishing the conditions of the contract. One must then conclude that business and ethics are only partially integrated under this model since large segments of society are still deemed as outside the ethical

² Some stakeholder theorists—e.g., Bowie 1979; Donaldson 1995; Carroll 1979; Davis 1979—have used the social contract concept but have used it differently. These theorists use the contract to interpret the relations of stakeholders in the corporation rather than understanding it as a contract between society and business. In other words, stakeholders collectively define the ends of the corporation through this contract. The contract is no longer merely the definition of external constraints by society on the corporation in the latter's pursuit of profit.

sphere in which business operates. Not only is there a distinction between business and society but there is a distinction between those in society whose interests are taken into consideration and those whose interests are disregarded.

It has been shown that the two dogmas of CR influence theories of the corporation, and that in fact, all four theories so far presented are based entirely or in part on these dogmas. These models of the corporation have led to a descriptively inaccurate and normatively inadequate framing of the CR debate. However, as Andriof et al. maintain, the organic model of the corporation, implicit in stakeholder theory, avoids these two dogmas and is thereby contributing in an important way to the re-shaping of the CR debate (Andriof et al. 2002: p. 10).

The Organic Model of the Corporation:

Andriof et al, maintain “[t]he evolution of stakeholder thinking has led to a new view of the firm as an organism embedded in a complex web of relationships with other organisms” (Andriof et al. 2003: p. 13). In this section, it will be shown that the organic model of the corporation, as espoused by stakeholder theory, is the only model to avoid the pernicious business-society and business-ethics dichotomies. Stakeholder theorists did not develop the organic model of the corporation, nor did they modify or alter it considerably. What will be shown is that the organic model of the firm, adopted by stakeholder theory, is a novel and important contribution to the CR debate.

According to this model, the corporation is *organic* in two ways. First, according to the narrow view, theorists view the firm as an entity that is more than the mere sum of

its parts, and as an entity whose existence depends in great part upon the presence of different constituencies—e.g., employees, suppliers, customers, communities, society. The organic model recognizes that the parts of a whole are uniquely interdependent and that the functioning of each of the parts affects the functioning of the other parts. Based on this fact, they conclude that the different constituencies (the parts) that make up the corporation (whole) must work and make decisions collaboratively. Used in this sense, the concept made an important contribution to the business management and organizational sciences. However, stakeholder theory and business ethicists generally emphasize another meaning of “organic”.

The second aspect of the concept of ‘organic’ relevant to developing a model of the corporation has profound normative consequences on CR. Understood in a broader sense, “organic” is used to mean that the corporation itself is a part inextricably linked to a greater whole or system, and that the system is greater than the sum of its parts. It is in this latter sense that “organic” will be used throughout this thesis.

Waddock uses Wilber’s (1995) concept of “holon” to explain the organic conception of the corporation. She writes: “Holons are simultaneously both wholes and parts. . . . [O]rganizations are holons, in the sense that they are whole systems, have integrity, in and of themselves. But, simultaneously, they are inextricably embedded as parts of a broader system” (Waddock 2001: p. 26). She goes on to write that as holons, corporations must recognize “their status not only as integral wholes (consisting of other holons like strategic business units, divisions, plants or other facilities, departments, teams, and individuals, and so on), but also as parts of society, inextricably wedded to the whole” (Waddock 2001: p. 26).

Post et al. recognize that there are continuous reciprocal interactions between the corporation and its environment, with the corporation shaping its environment and the environment in turn, shaping the corporation (Post et al. 2002: p. 7). As they point out, the corporation is “a complex web of relationships, not a series of dyadic corporation-stakeholder links.” (Post et al. 2002: p. 8) Implicit in the organic model of the corporation is the recognition that it is the relationships rather than the transactions that provide the ultimate sources of organizational wealth. Also implicit is a conception of wealth that extends beyond profit maximization. Post et al. use the concept of the “extended enterprise,” which recognizes the organic nature of the corporation. They explain that while the concept of extended enterprise originated at Chrysler Corporation, where it was used to shape information exchange and cost reduction practices within the supply chain, it was subsequently generalized and academics now use it to mean a model of the corporation operating within a network of relationships that extend beyond the purely economic. They describe the extended enterprise as the hub within a network of interrelated constituencies that create, sustain, and enhance its value-creating capacity (Post et al. 2002: p. 16). They maintain that the long-term survival and success of a firm is determined by its ability to establish and maintain relationships within the entire network of constituencies: “these relationships are the essential assets that managers must manage, and they are the ultimate sources of organizational wealth” (Post et al. 2002: p. 8). But what are the consequences of adopting an organic model of the corporation? How does the organic model avoid the two dichotomies?

The organic model is figuratively based mostly on Darwinism. Theorists have used Darwin’s theory of the economy of nature to found a *systems* perspective that is

fundamentally relational in that it demands attention to the ways in which one's own practices and behaviours impact others (Andriof et al. 2002: p. 12-13). Interestingly, however, Darwinism is used both by advocates of the organic model and advocates of the private property and private contract models. Darwin's theory of evolution provides the principle of natural selection where the strongest and fittest survive to carry on the species. According to the theory, competition on the basis of strength and fitness creates the evolutionary force that perpetuates a species that is continuously evolving. As Andriof et al. maintain, the business system reflects the competitive dog-eat-dog world when viewed through the lens of most theories of the corporation (Andriof et al. 2002: p. 13). However, Darwin's insights can be interpreted by business theorists and ethicists in two very different ways. The Darwinian theory of evolution also describes the economy of nature that embodies the notion that all parts cohere in one system and are interdependent and that what affects one part will affect the rest. As Ackoff maintains, corporations should be viewed as components of an ever-widening system (Ackoff 1981: p. 15); a system Brummer describes as "a web of moral and interpersonal projects and relations that provide a basis for the goal setting of single firms." Brummer goes on to write: "Beyond this is the system of relations and social institutions of which particular corporations form a part" (Brummer 1991: p. 65). Hence, theorists may choose to emphasize the principle of natural selection and promote a dog-eat-dog system, in which the two dichotomies prevail. Or, they may choose to emphasize—as more biologists and physicians are now doing—the reality of symbiosis or collaborative initiatives that ensure the system as a whole survives (Andriof et al. 2002). The second interpretation gives rise to a business system where business cannot be understood outside of its social context,

nor as independent of ethics. The organic model, in fact, makes it clear that business is an inherently social activity.

Based on the organic model, Andriof et al. see stakeholder theory as a theory of the way companies interact with their environment—i.e., a theory that acknowledges there are people and organizations other than stockholders who are affected by the operations of a firm (Andriof et al. 2002: p. 13). This is because when corporations are conceived of as embedded in greater, more complex holons and made up of smaller holons, the fact that what happens to one holon affects what happens to other holons within the system becomes evident. Waddock states that “Such relatedness is, of course, the fundamental insight of stakeholder theory.”

The organic model of the corporation upon which stakeholder theory is built provides the proper grounds for integrating business and society and business and ethics. As Andriof et al. write, by adopting the organic model, “[t]he stakeholder approach to the firm reframed the relationship between business and society in a fundamental way by explicitly recognising the embeddedness of the corporation” (Andriof et al. 2002: p. 21). They go on to say that “[t]his more relational view of the firm, while initially corporate-centric (the common ‘spoke-and-wheel’ picture suggesting this centrality), began to shift scholarly understanding of the relationship of the firm to society toward more of a business in society framing, although the language did not shift accordingly” (Andriof et al. 2002: p. 21). As this quote clearly shows, based on the organic model, stakeholder theory avoids the business and society dichotomy. But how does it avoid the second dogma of CR?

In “Ethics in Organizations: A Framework for Theory and Research,” Nicholson lays out a conceptual framework to address ethical questions arising in the business context (Nicholson 1994). In defining the different ethical domains, he writes “‘ethical domains’ denotes the orientation of the firm in relation to its context, i.e. the ethical focus of organizations’ goals and strategies and how these relate to their internal and external environments” (Nicholson 1994: p. 583). Rather than speaking of the two realms as business on one side and society on the other, Nicholson talks about an external ethical domain and an internal ethical domain corresponding to contingencies in the external and internal environment of the corporation. In defining the different domains, Nicholson maintains that “there is no need, and it would quickly lead to logical contradictions, to try to separate moral from non-moral goals, since ethical appraisal may attach to any of the actions and intentions of a human agency” (Nicholson 1994: p. 584). It is clear for Nicholson that once business and society are conceived as interdependent domains of the same system, the separation thesis cannot be logically justified.

As Andriof and Waddock maintain, companies “need better understanding of the dynamics and expectations fundamental to living, acting and working in a network” (Andriof and Waddock 2002: p. 20). Stakeholder theorists maintain that the organic model fosters this understanding. It provides a framework that enables a moral point of view that is not external to business but rather an integral part of business practice. It does not view economic activity as having its own logic and structure outside the context of human relationships. Nor does it view business ethics as a superimposition of external values on business. It views business ethics simply as the application of principles to business cases specifically but that are consistent with the general field of ethics (Wicks

1996: p. 96). Ethical business is simply good business once it is recognized that there is no special esoteric realm for ethics. The organic model conceives of the world as a single system where subsystems and subparts are interconnected and interdependent. In such a system, ethics cannot be conceived as an independent subsystem, but rather the unavoidable fact that because there is but one system and all of its parts are interconnected and interdependent, any action by the parts of the system will have positive or negative consequences on the rest. Ethics and business cannot be separate as “business ethics” in such a system is but another way of talking about business conduct.

Others have argued this point in a slightly different way. Both Epstein (1987) and Swanson (1995) conceive of ethics as integral to action. Arguing that businesses’ economic and duty-aligned perspectives are not sufficiently integrated, Swanson attempts to recast managerial decision-making in terms of ethical and value-based processes. And, Epstein clearly frames the economic activities of the corporation within the sphere of ethics in indicating that the aim of business ethics and corporate responsibility is but the “development of organizational decision-making processes whereby, consistent with the limitations of incomplete and imperfect information, corporate decision makers collectively anticipate, respond and manage the total ramifications of organizational policies and practices” (Epstein 1987: p. 105). Business theorists fail to recognize the embeddedness of ethics in business, Pruzan and Thyssen maintain, because money, which was once a means of exchange for corporations, has been transformed to the goal (Pruzan and Thyssen 1994: p. 24). Profit seeking may well be the primary objective of the corporation, but as Pruzan and Thyssen contend, “how much a firm owns and how much it earns is not interesting in itself. What really matters is how it earns its money

and how it uses its resources” (Pruzan and Thyssen 1994: p. 24). As profit-seeking can be conducted in a good or evil manner, no special rules render businesses immune from ethical judgement or render inoperative otherwise accepted ethical principles in the business setting (Quinn and Jones 1995: p. 36). In other words, considerations as to the means for value creation cannot be conceived as alien to business.

The organic model conceives of the corporation as part of a larger system. It gives a picture of business within the larger social system. Organic model theorists do so because they recognize that corporate actions affect the whole of society and therefore, business cannot possibly be distinct from it. The fact that corporate actions may affect groups outside the corporation leads organic model theorists to conclude that business is also clearly within the realm of ethics. The relational and systems approach of the organic model implies that corporations act and that these acts can have positive or negative consequences and therefore, are subject to ethical evaluation. Frederick sums up the organic models avoidance of the two dogmas of CR when he draws parallels between today’s business conceptions and pre-renaissance savants. He writes that “[b]usiness must be placed within and understood as part of a cosmological context. Only then will the force and impact of its values and actions become apparent. . . . The cosmos does not revolve around the corporation, nor does the corporation deserve a special, centred status. Now is the time to abandon our pre-Copernican-like assumption of corporate centrality and seek instead to describe business’s normative function as one part of a larger cosmological whole” (Frederick 1998: p. 45). Similarly, Wicks writes that the idea is not of finding ways of pursuing both economic and ethical goals, of connecting the two realms of business and ethics: “Business ethics must become a pleonasm rather than an

oxymoron” (Wicks 1996: p. 114). When business is conceived as part of the social whole, corporations no longer have two sets of obligations—i.e., economic obligations and social obligations. The economic responsibilities of corporations are no longer perceived as conceptually distinct from their social and ethical responsibilities (Wicks 1996: p. 92). Under the organic model of the corporation, firms must assume their proper place within society whereby their profit orientation is recognised while it is also recognised that profit-producing activities are always undertaken within a broader social and ethical framework.

Five models of the corporation were examined and analysed. These models have both descriptive and normative aspects. They seek to provide an accurate description of corporations and their nature, and based on this description, they prescribe how corporations should behave. Through this chapter, it was shown that all but one of the models—the organic model—base their descriptive claims on the two dogmas of CR which inevitably leads to false or incomplete descriptions. It was shown that the only model to avoid the two dogmas of CR is the organic model. The adoption of this model by stakeholder theory is an important contribution to the CR debate. The second major contribution of stakeholder theory to the CR debate is the extension of the concept of CR.

- Chapter 3 -

The Extension of Responsibility

With the advent of technologies and practices, such as the Internet, genetically modified organisms, borderless trade and production, the ethical sphere has changed. It has broadened in terms of both space and time. In the words of one philosopher: “the day-by-day sphere of human interaction . . . is overshadowed by a growing realm of collective action where doer, deed, and effect are no longer the same as they were in the proximate sphere, and which by the enormity of its powers forces upon ethics a new dimension of responsibility never dreamed of before” (Jonas 1984: p. 6). Stakeholder theory is based on this insight. In other words it is the recognition of the spatial spread and time span of the cause-effect trains that technological practice sets afoot.

Technological advancements have changed the ethics sphere, but stakeholder theorists further maintain that socio-economic and political revolutions of the latter part of the 20th Century, combined with technological advancements, have drastically altered the scope

of CR. Because corporations are changing, a need for re-defining the nature of corporations and their responsibilities arises. Indeed, as argued in the second chapter, stakeholder theory recognises the true nature of corporations, but its greatest contribution to the CR debate is unarguably its extension of the scope of CR. It is its recognition that, because managers wield such great power, they are directly or indirectly responsible to those they affect—to groups other than shareholders.

As demonstrated in the second chapter, not all economists and scholars are convinced that corporations have responsibilities that extend beyond the firm and its owners. In fact, the models they develop clearly demonstrate that. Many still endorse a laissez-faire capitalism as the most legitimate type of economic system on the grounds that it best respects the freedom of market participants while encouraging the virtues of efficiency and productivity. They endorse a system where corporations have responsibilities to stockholders only. Four main arguments used to limit CR to stockholders can be identified throughout the literature: the (1) “performance” argument; (2) “loyalty” argument; (3) “lack-of-expertise” argument; and, (4) “concern-for-corporate-power” argument (Brummer 1991: p. 103-119). It will be shown in this chapter that stakeholder theory makes an important contribution to the CR debate by refuting these arguments and clearly demonstrating that, in fact, CR extends beyond (1) economic performance; (2) the owners of the corporation; (3) expertise; and, (4) the law and government regulations. This extension of responsibility follows from the more accurate conception of the nature of corporations provided by the organic model. Through this model of the corporation, stakeholder theory developed the concept of “stakeholder.” The first part of this chapter consists of a review of the Stakeholder

Theory literature in an effort to examine and analyse the concept of "stakeholder" which leads to the extension of CR.

Introduction of the Concept of Stakeholder

While he didn't explicitly use the term "stakeholder," as early as 1980, Thomas M. Jones defined CR as "the notion that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contract" (Jones 1980: p. 59). Since this early definition of CR in stakeholder terms, stakeholder theory has emerged as the most popular and promising approach to CR. Consequently, many scholars have attempted to define more clearly stakeholder theory, and more specifically, the concept of "stakeholder."

Throughout the stakeholder literature, there is little divergence on what type of entity may constitute a stakeholder. Stakeholders may be owners or non-owners of the firm, owners of capital or owners of less tangible assets, actors or those acted upon, those existing in a voluntary or an involuntary relationship with the firm, rights-holders, contractors, moral claimants, resource providers to or dependents of the firm, risk-takers or influencers (Mitchell et al. 1997: p. 856). In fact, almost any entity *could* be recognized as a stakeholder. The question is 'who *should* be recognized as a stakeholder?' Hence, disagreements within the stakeholder theory are of an ethical rather than ontological nature.

As stakeholder thinking has unfolded, and theorists attempted to answer the question of who should be recognized as a stakeholder, two approaches have emerged.

There is a broad view and a narrow view for identifying stakeholders (Windsor 1992; Andriof et al. 2003; Mitchell et al. 1997). As Mitchell et al. write in their influential article “Toward a Theory of Stakeholder Identification and Saliency,” the broad view of stakeholder identification focuses on a stakeholder’s ability to *influence* the firm’s behaviour, direction, process or outcome, whereas the narrow view of stakeholder identification in an organisation focuses on a stakeholder’s legal, moral or presumed claim on the corporation—i.e., the level of *risk* the stakeholder bears (Mitchell et al. 1997: p. 857).

The Broad View:

Freeman is recognized as being the first to define the concept of “stakeholder” in the context of CR. Since his seminal work “Strategic Management: A Stakeholder Approach,” he has provided various definitions of the concept. His classical definition however is: “A Stakeholder in an organization is any group or individual who can affect or is affected by the achievement of the organization’s objective” (Freeman 1984: p. 38). Since Freeman’s first definition, theorists adopting the stakeholder theory as a descriptive theory of the firm—as opposed to a normative or instrumental theory—have provided slightly different definitions of stakeholders while keeping with the general spirit of Freeman’s definition. Thompson et al. define stakeholders as broadly as “those groups in relationship with an organization” (Thompson et al. 1991: p. 207). Bryson contends a stakeholder is “[a]ny person, group, or organization that can place a claim on the organization’s attention, resources or output, or is affected by that output” (Bryson, 1995:

p. 27). In general, the broad view is based on the empirical reality that companies can indeed be vitally affected by, or they can vitally affect, almost anyone. In the words of Mitchell et al., the attempt of those who favour the broad view is “to recognize and respond effectively to a disparate, yet systematically comprehensible, set of entities who may or may not have legitimate claims, but who may be able to affect or are affected by the firm nonetheless, and thus affect the interests of those who do have legitimate claims.” Mitchell et al. maintain, however, that the broad view is “bewilderingly complex for managers to apply” (Mitchell et al. 1997: p. 857).

As Clarkson argues in “A Stakeholder Framework for Analysing and Evaluating Corporate Social Performance”: “. . . it is not practical to include as stakeholders all those who can affect or are affected by the achievement of a firm’s objectives. . . . [T]he permutations of stakeholders become infinite . . .” (Clarkson 1995: p. 93). Donaldson and Preston also maintain such broad definitions open the stakeholder set to actors who—while they may affect the firm in some way—form part of the firm’s environment but have no specific stake in the firm itself. Hence, they argue “it is essential to draw a clear distinction between influencers and stakeholders: some actors in the enterprise (e.g., large investors) may be both, but some recognizable stakeholders (e.g., the job applicants) have no influence, and some influencers (e.g., the media) have no stakes” (Donaldson and Preston 1995: p. 67).

The definition may be too broad as it leaves the notion of stake and the field of possible stakeholders unambiguously open to include virtually anyone. In fact, as Phillips argues in “Stakeholder Theory and a Principle of Fairness,” a broad definition such as Freeman’s makes it possible to include terrorists and competitors as stakeholders

(Phillips 1997: p. 52). However, the difficulty in applying this broad definition of “stakeholder” is but an afterthought for many stakeholder theorists and business ethicists. In their influential article “The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications,” Donaldson and Preston identify three approaches to stakeholder theory: the instrumental approach, the descriptive approach, and the normative approach. The first is the descriptive/empirical approach. Donaldson and Preston summarize it as “a model describing what the corporation is. It describes the corporation as a constellation of co-operative and competitive interests possessing intrinsic value. . . . The model can also serve as a framework for testing any empirical claims, including instrumental predictions, relevant to the stakeholder concept (but not for testing the concept’s normative base)” (Donaldson and Preston 1995: p. 71). Stakeholder theory has been used to describe the nature of the firm; the way managers think about managing; how board members think about the interests of corporate constituencies; and, how some corporations are actually managed. The descriptive justifications of stakeholder theory attempt to show that the concepts embedded in the theory correspond to observed reality.

The second approach is instrumental. Donaldson and Preston summarise it as the linking of stakeholder management practices and the achievement of various corporate performance goals (Donaldson and Preston 1995: p. 71). The push behind this endeavour stems from the proposition that corporations practicing stakeholder management outperform other corporations with regards to indicators such as profitability, stability, growth. The third approach, the normative approach, is the fundamental basis of stakeholder theory. It is the recognition that individuals and groups other than

stockholders have legitimate interests in procedural and/or substantive aspects of corporate activity, and that these interests are of intrinsic value. Donaldson and Preston maintain that in normative uses, the correspondence between the theory and the observed facts of corporate life is not a significant issue, nor is the association between stakeholder management and conventional performance measures a critical test. The normative theory attempts to interpret the function of, and offer guidance about, the investor-owned corporation on the basis of some underlying moral or philosophical principles.

The three approaches to stakeholder theory are mutually supportive, but the normative base serves as the critical underpinning for the theory in all its forms. As Donaldson and Preston write: “the three aspects of the stakeholder theory are nested within each other . . . The external shell of the theory is its descriptive aspect; the theory presents and explains relationships that are observed in the external world. The theory’s descriptive accuracy is supported, at the second level, by its instrumental and productive value; if certain practices are carried out, then certain results will be obtained. The central core of the theory is, however, normative” (Donaldson and Preston 1995: p. 74).

While each approach is justified, the last approach is at the core of the theory (Donaldson and Preston 1995: p. 67). That is, fundamentally, stakeholder theory is a moral theory of the corporation. However, when theorists use the broad definition of “stakeholder,” they are generally adopting a descriptive—i.e., non-moral (see Goodpaster 1991)—approach to stakeholder theory. To remain normative, stakeholder theory must define “stakeholder” more narrowly.

Narrow View:

As stated above, because descriptive stakeholder theory remains an attempt at describing more accurately the corporation, it generally relies on a broad definition of “stakeholder.” As they tend to be more practical, both instrumental stakeholder theory and normative stakeholder theory generally rely on a narrower definition of “stakeholder.” Instrumental stakeholder theorists (e.g., Mitchell et al. 1997: p. 857) insist the narrow view of stakeholders is based on the practical reality of limited resources, limited time and attention for dealing with external constraints. According to Donaldson and Preston however, the narrow view is usually based on a search for legitimacy that would justify managers’ focus on the claims of a few stakeholders, and on the reparation for harms done through corporate action to stakeholders. Hence, the search for legitimacy has lead some theorists to narrow the definition of “stakeholder” based on the corporation’s economic interests, and other theorists to narrow the definition based on appropriate distribution of risks, harms, and benefits from corporate actions.

Instrumental stakeholder theory restricts the definition of “stakeholder” to those groups who represent a substantial risk to the corporation’s economic interests. For instance, Freeman provides a later definition where he contends stakeholders are “those groups without whose support the organization would cease to exist” (Freeman 1994: p. 410). Eden and Ackermann also adopt an instrumental approach, and contend stakeholders can only be people or groups who have the power to directly affect the organization’s future (Eden and Ackermann 1996: p. 503). With these definitions, it is plain that to be considered a stakeholder, one must possess a certain amount of power—

i.e., one must have considerable influence on the corporation's profitability. In some cases, this could include the media, courts, and governments. Mitchell et al. maintain that stakeholders can be identified based on three criteria: power, urgency, and legitimacy (Mitchell et al. 1997: p. 854). According to their theory, the level of stakeholder salience is determined by how many of the criteria the stakeholders meet. Should a stakeholder have a legitimate claim on the corporation, but lack power and urgency, Mitchell et al. maintain it would have little salience in the eyes of management (Mitchell et al. 1997: p. 865). For Mitchell et al., the notion of reciprocal impact is very important. Of the three criteria, a stakeholder's power to affect the corporation is prioritised. The corporation may affect stakeholders but it will consider the effects of its actions on stakeholders mainly if the stakeholders can in turn influence the welfare of the corporation.

In contrast, in "Stakeholder Management Theory: A Critical Theory Perspective" (1999), Reed tries to steer stakeholder theory away from this instrumental approach. He maintains "stakes" are understood to impose normative obligations. He defines "stake" as "an interest for which a valid normative claim can be advanced" (Reed 1999: p. 453). Hummels argues there is a shift in stakeholder theory from emphasis being put on the effect stakeholders have on the firm to the emphasis being put on the effects the firm has on stakeholders: "Stakeholders are not primarily seen as actors who can influence the organization's continuity, but as *individuals and groups who have a legitimate claim on the organization to participate in the decision-making process simply because they are affected by the organization's practices, policies and actions*" (Hummels 1998: p. 1404). Donaldson and Preston echo Hummels and maintain a *normative thesis* is the fundamental basis of stakeholder theory. They base stakeholder theory on a distinctly

Kantian ethic as they maintain that this involves acceptance of two main ideas: “(a) Stakeholders are persons or groups with legitimate interests in procedural and/or substantive aspects of corporate activity. Stakeholders are identified by their interests in the corporation, whether the corporation has any corresponding functional interest in them. (b) The interests of all stakeholders are of intrinsic value. That is, each group of stakeholders merits consideration of its own sake and not merely because of its ability to further the interests of some other groups, such as the shareowners” (Donaldson and Preston 1995: p. 67).

Normative stakeholder theory, like instrumental stakeholder theory, narrows the definition of stakeholder but focuses specifically on legitimacy. It restricts the definition of “stakeholder” to those groups who, because of risks they bear, have a legitimate moral claim on the corporation, regardless of whether they can influence the corporation or not. For instance Donaldson and Preston hold that “[s]takeholders are identified through the actual or potential harms and benefits that they experience or anticipate experiencing as a result of the firm’s actions or inactions” (Donaldson and Preston 1995, p. 86). Clarkson (1995), who also adopts a Kantian ethic as the normative basis of stakeholder theory defines “stakeholder” as “voluntary or involuntary risk-bearers.” He maintains voluntary stakeholders bear some form of risk as a result of having invested some human or financial capital, or something of value, in a firm. By contrast, involuntary stakeholders are placed at risk as a result of a firm’s activities. Clarkson argues that without the element of risk, there is no stake. For Clarkson then, a stakeholder is an individual—or group of individuals—that has some form of capital either financial or human, at risk and, therefore, has something to lose or gain depending on a firm’s behaviour. As Mitchell et

al. contend, the use of risk to denote “stake” provides a way to narrow the stakeholder universe to those with legitimate claims, rather than basing the restriction of the stakeholder universe on power and influence (Mitchell et al. 1997: p. 857).

The narrow definition of “stakeholder” not only recognizes the stakes of those who are affected by corporate actions, it generally recognizes the stakes of those who may *potentially* be affected by corporate action. Mitchell et al. point out that many theorists distinguish between actual and potential relationships. As they maintain, potential relationships can be as relevant as the actual ones. Clarkson echoes Mitchell et al. on this point and establishes the idea of involuntary stakeholders as those with something not wilfully placed at risk. In his words: “Many stakeholders (e.g., investors, employees) are linked to the corporation through explicit contracts. With many others (e.g., customers), contractual relations may be largely implicit, and subject to specific interpretation only in problematic circumstances. Still other interests (third parties outside the network of explicit and implicit contracts) are non-contractual and often involuntary, and the parties involved may even be unaware of their relationship to the corporation until some specific event, favorable or unfavorable, draws it to their attention” (Clarkson 1995: p. 94).

As has been shown, two views to identifying stakeholders have emerged since Freeman’s seminal definition. Scholars who attempt to narrow the definition of stakeholder emphasize the *legitimacy* of the individual or group’s stake or claim, while scholars who favour a broad definition emphasize the individual or group’s *power* to influence the corporation’s behaviour, whether or not the stake or claim is legitimate. For descriptive stakeholder theorists—and to some extent instrumental stakeholder

theorists—the identification of stakeholders is essentially stakeholder theory’s greatest contribution.

However, for the normative stakeholder theorist, the identification of stakeholders is but the first step in the *stakeholder process* (Zadek et al. 1997: 13). According to the normative stakeholder theorists, the identification of stakeholders dictates the scope of responsibility of the corporation (Donaldson and Preston 1995; Hummels 1998; Andriof et al. 2002; Clarkson 1994). In fact, this extension of responsibility based on ethical grounds is, as will be argued in the next section, what normative stakeholder theorists hold to be stakeholder theory’s greatest contribution to the CSR debate.

Traditionally, CR has been restricted to fiduciary responsibilities towards stockholders. Four main arguments have generally been used to advocate this restrictive conception of CR. Through the *performance argument*, economists and business theorists contest that because restricting CR to responsibilities owed to stockholders will lead to the best overall, no other responsibilities should be expected from corporations. Through the *loyalty argument*, they hold that because managers have promised to manage the corporation based solely on the interests of stockholders, managers have a moral obligation to forsake any consideration as to the interests of other groups affected by corporate actions if doing so will have a negative impact on the proverbial bottom line. Using the *lack of expertise argument* some economists and business theorists maintain that managers are not trained to base decisions on anything else than economic criteria and therefore, shouldn’t attempt to evaluate performance based on any criteria other than economic, nor should they attempt to engage in *socially responsible* activities. Finally, using the *concern for corporate power argument*, they insist that corporations should not

accept responsibilities that go beyond the law because doing so would be unduly usurping powers that should be reserved to public sector. In the next section, using the organic model of the corporation upon which stakeholder theory is based and the narrow conception of “stakeholder,” as defined by normative stakeholder theory, it will be shown how stakeholder theorists address these arguments and extend the concept of CR.

Responsibility Beyond the Stockholders

Of the four arguments used to restrict corporate responsibility, two are most often used to limit corporate responsibilities specifically to those owed to stockholders. The first can be termed the *performance argument* and the second the *loyalty argument*. The first argument, consequentialist in nature, holds that corporate responsibilities should be limited to those owed to the stockholders because such limitations in responsibilities will yield the highest level of performance. The second argument, deontological in nature, holds that corporate responsibilities are limited to those owed to stockholders based on the special relationship between stockholders and corporate executives.

The classical view of CR maintains that when corporations respond to stockholders by focusing strictly on lowering costs and increasing profits, both economic and social performance is optimised. Classical theorists (see Friedman 1970; Hayek 1976) hold that socially, performance is optimised through a strict limitation of CR to stockholders as it best preserves the freedom and liberty of all parties in the social system. In fact, Friedman defiantly maintained that businessmen who talk of the responsibility of corporation extending beyond profit maximization are “unwitting

puppets of the intellectual forces that have been undermining the basis of a free society these past decades” (Friedman 1970: p. 33). Economically, it is argued, those most closely associated with the corporation—i.e., consumers, employees and stockholders—will be better off if corporations have responsibilities only to stockholders. Because to be profitable corporations must produce only what the members of society want and produce it as efficiently as possible, by seeking profits above all else, corporations may also create value for consumers. It is argued that when corporations seek to maximise profits, they also maximise the satisfaction of human preferences (Brummer 1991: p. 63). As stated earlier, in this sense, for advocates of this theory, profit is both a measure of economic success and success in producing human satisfaction (Mulligan 1986: p. 267). In such a system, business should not directly consider moral issues when it makes decisions since the moral preferences of workers, investors, vendors, and customers are already factored into market prices, along with all their other preferences (Mulligan 1986: p. 268).

This leads Jensen to claim that should corporations accept responsibilities beyond those owed to stockholders and therefore no longer have profit as their *only* goal, political mechanisms would interfere with economic mechanisms (Jensen 2001: p. 70). Theorists such as Jensen, Friedman and Hayek maintain that since society is better served by the specialization of function of its various institutions, corporations can best serve society by focusing exclusively upon their institutional economic functions. These theorists however, adopt a very narrow view of CR. They assume that advocates of CR are calling for more philanthropy from corporations. For instance, in “Capitalism Against Business Ethics,” Barry writes: “Too often, a quite inappropriate form of ethics is used for the appraisal of business. . . .The word morality nowadays is too infected with the

contemporary passion for imposing demands on business that have nothing to do with the activity itself' (Barry 2002). What advocates of CR—and more specifically, stakeholder theorists—call for however, is not an increase in philanthropy but rather a recognition from corporations that their actions may create negative effects on third parties and that they are morally responsible for those affects.

Another assumption underlying the performance argument is that value creation is somehow immune from ethics valuation. However, as has been shown in the second chapter, the economic aspects of corporate decision-making cannot be readily distinguished from the social or moral aspects. Performance cannot be understood independently of ethical conduct. Integral to the evaluation of performance must be the question of whether it was performed justly or ethically. While the objective of corporations can be to produce wealth, the production of wealth must be carried out ethically. The criteria for evaluating the corporation's performance in achieving this objective are not solely economic. It is this fact that leads Pichler—a renowned corporate executive during the 80s and 90s—to hold that corporate executives cannot overlook the rights and freedoms of other stakeholders, whether this has an affect on profit margins or not (Pichler 1983). To produce wealth through ethical means, the corporation must assume responsibilities towards all those its wealth-producing activities affects. The question normative stakeholder theory asks is not whether a *laissez-faire* system based on methodological individualism is more economically efficient than a system based on stakeholder theory, it asks whether it is *ethical*. In Shankman's words: "Despite the instrumental relevance for firm survival, stakeholder theory is ultimately justified on the

basis that firms have responsibilities to stakeholders for moral reasons” (Shankman 1999: p. 322).

This fact is evidenced by many stakeholder theorists (see Freeman 1999; Freeman and Evan 1993; Donaldson and Preston 1995) using the Rawlsian concept of fairness as the basis for stakeholder theory. In his classic work, *A Theory of Justice*, John Rawls (1971) develops a conception of justice as fairness. Using elements of Kantian philosophy, he describes a method for the moral evaluation of social and political institutions. Rawls suggests that to eliminate all personal biases and prejudices in moral valuation, one must imagine oneself behind a *veil of ignorance*. Behind this veil, an individual would know nothing of him or herself (i.e., natural abilities, position in society, sex, race, nationality, individual tastes) and therefore individuals would simply be specified as rational, free, and morally equal beings. Because behind the veil of ignorance, an individual would not know whether he or she would suffer or benefit from the structure of any biased institutions, the safest principles—i.e., those most likely to serve rational self-interest—will provide for the highest minimum standards of justice in the projected society. There is no presumption on the part of stakeholder theorists using this Rawlsian veil of ignorance that bargains reached on the basis of this veil would maximise efficiency. This recourse to fairness, as Donaldson and Preston maintain, elevates normative criteria over instrumental ones (Donaldson and Preston 1995: p. 82). They further maintain elevating the principle of fairness to a central role has “shifted the attention from ordinary economic contracts . . . to ‘heuristic’ contracts that rest upon broad normative principles governing human conduct” (Donaldson and Preston 1995: p. 83).

Because stakeholder theorists view the corporation implicitly through the organic model, they conceive of ethics as integral to production, not simply as one more criterion by which to evaluate the marketability of the corporation. Business theorists refer to impacts on third parties as "*externalities*," because they occur outside the range of the firm's internal and market relationships. By creating this dichotomy, the *internal* impacts—i.e., increased share value, increased dividends to stockholders, reduced prices for consumers, etc—can be judged solely on economic performance. However, as Clarkson explains: "economic benefits or environmental harms that may be experienced by communities as a result of corporate operations . . . , although clearly external to the firm as an organization, are nonetheless real, and perhaps significant: they are, therefore, within the normal purview of responsible management" (Clarkson 1995). Because the impacts of corporate action establish a scope of responsibility beyond solely the economic, performance may be one criterion for evaluating corporate actions but it must be subsumed within the broader overarching ethical evaluation. As a consequence of corporate action, some stakeholders are made worse off while others are made better off. As Brummer notes, moral valuation cannot be distinct from business decisions "since it is precisely in these situations that we would like to know how much better or worse off, so that we might judge the overall welfare, performance, or fairness of the alternative proposals" (Brummer 1997: p. 125).

The second argument used to limit corporate responsibilities to those owed to stockholders is deontological in nature. Focussing on the relationship between shareholders and corporate executives, these theorists maintain corporate executives must protect and augment the property interests or wishes of the stockholders, such as their

fiduciary duty requires of them (Friedman 1970; Hayek 1976; Levitt 1979). This duty is grounded in property rights and/or in principles of promise keeping. As stated in the second chapter, historically, those who invested their capital into whatever kind of business had an entitlement (and an obligation) to govern that business. Based on an extension of their natural right to own private property, capital investors either govern the business themselves or do so with support of agents (managers) whom they appoint. When corporate executives accept their positions, it is argued that they promise to act in whatever way will generate the greatest revenue (Etzioni 1998: p. 680). Because the corporate executive is an employee of the owners, Friedman argues, s/he has direct responsibility to the owners only, and should therefore seek only to make as much money as possible while conforming to the rules of the game. Friedman further explains that as a person in his/her own right, the corporate executive can “feel” socially responsible, but these feelings should not be confused with *corporate* responsibility. For the corporate executive to be socially responsible on the firm’s time and expense is for him/her to act against the interest of his/her employers (Friedman 1970: p. 34).

Stakeholder theorists contest these claims on three fronts. First, they maintain that to conceive of stockholders as owners is but a legal artefact. Boatright explains that as business ventures were at one time undertaken by individuals with their personal assets, the business’s assets were ultimately those the investors entrusted to the business (Boatright 1994: p. 76). Consequently, the business could rightly be thought of as the investors’ property. Today, stockholders are more like gamblers. What leads theorists to describe investors as such is that corporations now rarely pay dividends to stockholders. In almost all cases, corporations retain earnings available for dividends to re-invest in the

company. And, for those corporations that *do* regularly distribute dividends, managers are free to stop doing so at any time. Hence, investors don't buy into corporations in the hope of receiving parts of the profits the corporations produce. They buy stocks in hope that they rise in price so they may sell them for more than they paid. The ownership of corporations is clearly different today, but the logical structure of the business ownership has nonetheless been used for the ownership of corporations. As Clarkson (1995) maintains, the distinctive position of shareowners among stakeholders is not due to their fractional *ownership* interest in the corporate entity. Special status is generally accorded to stockholders because they voluntarily accepted to invest their capital in the corporation and they risk losing it. As Clarkson points out however, owning stock is not *riskier* than other forms of association with the corporation. In "Principles of Stakeholder Management," he writes: "Indeed, the possibility of job loss (to employees), product failure (to customers), etc., may be much more significant to the parties involved than the impact of any single corporate bankruptcy on a well-diversified shareowner. But employee and customer risks (like the risks of lenders) arise because the corporation may fail to fulfil its contractual obligations. By contrast, shareowner risks are an inherent feature of their ownership contract. They have agreed to take whatever is left over, or the current market value of whatever is expected to be left over in the future" (Clarkson 1995). Normative stakeholder theorists define "stakeholders" as risk-bearers and therefore, as Hummels maintains, the claim of the shareholders to a return on their investment does not necessarily have priority over the interests of other stakeholders (Hummels 1998: p. 1406). Because investors risk losing their investment, their interests should be considered in executive decision-making. And, in fact, this is precisely why

corporations have boards of directors. The role of the board of director of the corporation is to ensure the interests of shareowners are protected. However, other groups and individuals also bear risks from corporate actions and therefore, their interests should also be considered in executive decision-making. In fact, as Hummels contends, all stakeholders can claim a “reasonable return on their vested interests, rights and values” (Hummels 1998).

Secondly, stakeholder theorists argue that the agency theory relies on a fallacious analysis of the principles of promise keeping. When one adopts an organic model of the corporation, as Shankman observes “the logic of the agency imperative is . . . limited; in reality, the agency relationship is constrained by a host of moral principles derived from the logic and context of the market itself. The scope of responsibility extends far beyond that which is implied in the economic relationship that the agent has with the principal” (Shankman 1999: p. 320). As Brummer explains it, corporate executives are not only fiduciaries or respecters of the ownership rights of stockholders, “they are policy makers whose decisions can have a direct and significant impact upon thousands, if not hundreds of thousands, of persons” (Brummer 1991: p. 133). Stakeholder theorists hold that the role of the fiduciary does not supplant the role of promise keeper or rights respecter (Brummer 1991: p. 133). Because stockholders have these responsibilities in the first place, as agents of the stockholders, corporate executives must have them as well.

Corporate executives promise to serve the interests of the stockholders. Some classical theorists contend that the moral issue here is simply that of promise keeping. However, this line of argument seems to miss an important point. The fact that one carries out an unethical action because one promised to carry it out does not affect the

action's status as unethical. As Alpern argues, not all promises carry equal moral weight. In fact, a promise to do wrong carries *no* moral weight (Alpern 1984: p. 469). Those who hold this position, the *promissory argument*, maintain managers must forsake the pursuit of social objectives because they have promised stockholders to increase their profits. As mentioned in chapter 2, this position is based on a form of separation thesis where ethics must be upheld within the confines of corporate walls but should be disregarded when considering effects of corporate actions outside those walls. Stone rejects this argument maintaining that no such promise is ever made between the two parties. He then adds that even if such a promise was made, it could not be construed to mean "maximizing profit in every way you can possibly get away with . . ." (Stone 1995: p. 142). Further, normative stakeholder theorists hold that this promise is not immune from ethical valuation. If the promise is made, the question of its moral validity remains. Further, even if proponents of this argument base their position on legal claims, this does not preclude ethics valuation. The relation between ethical and legal prescriptions will be explored in more detail in the latter part of this chapter.

Third, stakeholder theorists argue that property rights, in fact, provide the foundation for the extension of CR to all stakeholders. As Donaldson and Preston maintain: "There is a subtle irony in proposing that the stakeholder model can be justified on the basis of the theory of property, because the traditional view has been that a focus on property rights justifies the dominance of shareowner's interests" (Donaldson and Preston 1995, p. 83). They maintain that rather than providing a basis for the traditional stockholder view, the current trend of thinking on property runs in the opposite direction: "the normative principles that underlie the . . . theory of property rights also provide the

foundation for the stakeholder theory” (Donaldson and Preston 1995, p. 85). They view the theoretical definition of property as a “bundle of many rights, some of which may be limited.” Donaldson and Preston note the rights of property owners are limited under any system of law (Donaldson and Preston 1995: p. 86). They also note that property rights are more accurately described as relations between individuals. This brings them to write that “the notion that property rights are embedded in human rights and that restrictions against harmful uses are intrinsic to the property rights concept clearly brings the interests of others (i.e., of non-owner stakeholders) into the picture” (Donaldson and Preston 1995, p. 83). They point out however, that bringing non-owner stakeholders into the conception of property does not, by itself, provide justification for stakeholder arguments assigning managerial responsibilities toward specific groups. It merely points to the fact that the contemporary theoretical concept of private property limits the rights of property owners and in doing so, refutes the argument according to which the responsibility of corporate managers is to consider solely the interests of shareowner construed as property owners. Donaldson and Preston maintain that regardless of which theory of distributive justice property rights are based on—utilitarianism, libertarianism, or social contract theory—when “stakeholder” is defined in terms of risks an individual or group bears, property rights provide a basis for stakeholder theory. Stakeholder theorists do not maintain that the stakes of all stakeholders constitute formal or legal property rights. They simply hold that “[a]ll that is necessary is to show that such characteristics, which are the same as those giving rise to fundamental concepts of property rights, give various groups a moral interest, commonly referred to as a ‘stake,’ in the affairs of the corporation.” Property rights arise out of a need to protect property

owners from the risk of government, private groups or individuals unjustly taking what is theirs. As Ignatieff writes in his popular book “The Rights Revolution”: “the concept of rights comes from the struggles of the male landholders of England and France to throw off the tyranny of barons and kings and establish rights of property and due process of law” (Ignatieff 2000: p. 4). Therefore, property rights, when analysed in detail, support a stakeholder approach to the firm rather than an agency approach: rights protect against risks and therefore, property rights imply that where groups or individuals bear risks of injustice, they should be protected in some way (Shankman 1999: p. 326). In the case of normative stakeholder theory, it is argued that because stakeholders bear risks of being negatively affected by corporate actions, corporations must consider the interests of those stakeholders in their decision-making.

Conceived in these terms, stockholders are simply another group of stakeholders. The responsibility of corporations extends *beyond* the stockholders but stockholders are nonetheless included in that scope of responsibility. The implication is that stockholders also have legitimate claims and their claims must be recognized. The social activist theory—another approach to CR—contends that stockholders and shareholders should be regarded as secondary stakeholders. It maintains that the primary purpose of the corporation should be the enhancement of social welfare (see Finlay 1977; Richman 1977). In other words, these social activists argue that corporations have a duty to engage in social projects regardless of the fact that these projects may not be related to the corporation’s area of expertise or objective of generating profits—in ethically acceptable ways—by producing quality goods or services. According to them, individual

liberties of profit seekers—even when profits are sought through ethical business conduct—are trumped by the needs of society.

Stakeholder theorists have recognized the danger of deforming stakeholder rights in this way. Clarkson maintains that “stakeholder theory should not be used to weave a basket big enough to hold the world’s misery” (Clarkson 1994). Similarly, Phillips explains that a “friendly misinterpretation” of stakeholder theory is conceiving of the theory as establishing rights to a corporation’s profits for each of the corporation’s stakeholders (Phillips 2003: p. 32). Both theorists recognise the usefulness of the theory for establishing an ethics framework for corporate action but are wary of overextending the theory. An overextension of stakeholder theory could result in the rights of stockholders to a fair return on their investments being trumped by illegitimate claims of other stakeholders (broadly defined). Stakeholder theory recognises all legitimate claims, including a fair return for investors. Recently, prominent corporations have systematically exploited stockholders. Enron, Worldcom, Tyco, and others deceived stockholders about the true state of the companies, and their rights were flagrantly flouted as corporate executives enriched themselves at the expense of stockholders (Ackman 2002). As Donaldson and Preston assert, stakeholder theory does not advocate the right of stakeholders to the detriment of stockholders. Stockholders *are* stakeholders, and hence, their rights are just as important (Donaldson and Preston 1995: p. 85).

Some stakeholder theorists (see Goodpaster 1991) propose that stakeholder analysis—such as described by Freeman (1984)—is inadequate because it does not fully recognize the rights of some of the stakeholders—the stockholders. According to Goodpaster, when stakeholder analysis is understood to give equal importance to the

interests of all stakeholders, it does not render business more ethical but rather leaves business confronted with a paradox—the “stakeholder paradox” (Goodpaster 1991). Goodpaster holds that the duty to stockholders is more evident and, in a sense, more important than the duty to other stakeholders. He claims that the asymmetry between duties owed to stockholders and stakeholders gives rise to a potential conflict of interest, where managers are confronted with a choice between fulfilling a fiduciary duty and serving stakeholder interests. As he explains it, the stakeholder paradox is the fact that “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” (Goodpaster 1991: 58). So what is the way out of the paradox?

Goodpaster finds a way out of the stakeholder paradox while respecting the two fundamental ideas of stakeholder theory espoused by Donaldson and Preston—i.e., identification of stakeholders based on legitimacy, and the inherent value of stakeholders. Goodpaster maintains that stakeholder synthesis that is motivated by concern about potential impediments to the achievement of strategic objectives of the corporation cannot be associated with ethics. It cannot be associated with ethics as stakeholders are taken into account in the decision-making process “as external environmental forces, as potential sources of either good will or retaliation” (Goodpaster 1991: p. 51). He calls this “strategic” stakeholder synthesis and maintains that this type of stakeholder synthesis can be equated with “business without ethics.” “Multifiduciary” stakeholder synthesis is where managers give “the same care to the interests of employees, customers and local communities as to the economic interests of stockholders” (Goodpaster 1991: p. 53). Goodpaster maintains that this type of synthesis can be equated with “ethics without

business.” But he insists these are not the only options available. He believes there can be morally significant non-fiduciary obligations to stakeholders other than stockholders surrounding the fiduciary relationship between managers and stockholders. He bases this position on the “*Nemo Dat Principle*” according to which “investors cannot expect of managers . . . behaviour that would be inconsistent with the reasonable ethical expectations of the community” (Goodpaster 1991: 59). According to Goodpaster, the conscience of the corporation is a logical and moral extension of the consciences of its principals. Without expanding its list of principals, without forsaking its private economic mission, the corporation can have, and act according to, obligations owed to those affected by its actions—i.e., to all those who qualify as stakeholders such as defined by normative stakeholder theorists. Goodpaster concludes an ethical model for business is possible if it gives both “partial” moral consideration as it respects the fiduciary relationship between managers and stockholders, and “impartial” moral considerations as it respects the equally non-fiduciary relationships between management and other stakeholders (Goodpaster 1991: p. 60).

So far, it has been shown how normative stakeholder theory establishes a foundation for CR beyond responsibilities owed to shareowners. There is indication that this extension of CR is gaining acceptance in the field of Law. In recent years, several legal developments have occurred so that the interests of other groups besides stockholders are better protected, and so that the corporation can no longer legally be run for the benefit of stockholders alone. As Freeman and Evan point out, during the last century, product liability laws, various acts to protect employees’ rights and protect them against discrimination, as well as laws protecting local communities where corporations

operate, have emerged (Freeman and Evan 1993: p. 40). These developments indicate a shift from the supremacy of stockholder interests to an acknowledgement of stakeholders' interests. Interestingly, however, theorists who contest the stakeholder theory of the firm or who call for very limited corporate responsibilities often use the law as their main argument. They argue that CR should be restricted to those prescribed by law.

Responsibility Beyond the Law

In Canada, a major modification to corporate law was recommended in the Broadbent-Bennett report of 2002, entitled "Canadian Democracy and Corporate Accountability." The report recommended that the fiduciary duty of directors be changed so that "as long as directors take into account shareholder interests they can also take into account the interests of all other stakeholders" (AccountAbility 2002). As Donaldson and Preston maintain, stakeholder theory now plays a role in the United States as the implicit basis for legal opinion and statutory law (Donaldson and Preston 1995: p. 64). They provide several examples in cases and decisions. For instance, they point out that the Delaware Supreme Court decision in *Unocal* lists constituencies other than shareholders upon whom the impact of a hostile takeover must be considered. The decision mentions creditors, customers, employees, and the community as "*other constituencies*." While normative stakeholder theory has crept into legal theory and is now establishing the legal groundwork for an extension of CR, historically, and still today, many economists and business theorists advocated against an extension of CR on

the grounds that the law should be the proper indicator of society's expectations of corporate behaviour.

Friedman states that corporate executives' sole responsibility is to make as much money as possible "while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom" (Friedman 1970: p. 33). Classical theorists generally claim that beyond what the law prescribes, corporations have no responsibilities. Theorists who maintain the scope of CR should be legally defined generally rely on the *corporate-power* argument. These theorists are concerned with the power firms would have were they to become providers of social services or standards developers. Levitt for instance holds that there is a danger that corporate values will become the values of society should people not only depend on corporations for their economic well-being but their social well-being as well (Brummer 1991: p. 58). It is further argued that capitalist societies would become more and more like feudal estates or nation-states, as business took on this social role and thereby, became the dominant centre of economic, political, and social power (Brummer 1991: p. 58).

These theorists then conclude that "it is our [society's] responsibility to establish a framework of law such that an individual in pursuing his own interest is led by an invisible hand to promote an end which was no part of his intention" (Friedman 1979: 136). These advocates believe that the call for greater CR should be directed at the government. If it is judged that the current situation is not acceptable, society should demand government enact new laws and develop new regulations rather than demand business engage in activities that would have negative effects on their profit margins. If society desires some good or service not provided by the market, it should either seek to

build a market for it (Shaffer 1997, p. 13), or it should urge government either to provide the good directly or at least to supply firms with the necessary motivation to provide the good (Brummer 1991: p. 58). Since corporate executives are not accountable to the general public, society should not give them more power to carry out social tasks. These theorists contend that social power without social accountability is an imprudent political policy as it is a form of taxation without representation (Friedman 1970: p. 35).

Therefore, they maintain that until the lines of their social accountability can be clearly established, executives must refrain from an aggressive pursuit of social goals.

Stakeholder theorists argue against this view on two fronts. First they argue that numerous examples exist of corporate actions that do not break any laws but are nonetheless clearly unethical. In his article "*Why Shouldn't Corporations be Socially Responsible?*" Stone rejects the view that the forces of the market, combined with laws, are enough to keep corporations in bound. He points out that examples of failures to act in socially responsible ways abound (Stone 1995: p. 142). Following are several examples of cases where no laws were broken but corporate actions were unambiguously unethical.

In "When Good Companies Do Bad Things," Schwartz and Gibb summarize the case of a major food and beverage company: "Health officials and consumer groups became concerned at the effects in developing countries of Nestlé's marketing campaigns for its breast milk substitutes. The position these advocates took was that Nestlé, by aggressively promoting the formula, was discouraging the proactive promotion of breastfeeding among poor women—a problem both because breast milk is well-established to be the healthiest food for newborns and because substitutes require the

addition of water, which exposes children to risks of infection and malnutrition through the generally poor quality of water in the target countries” (Schwartz and Gibb 1999: p. 24). Nestlé kept selling its formula in developing countries for at least seven years. What Nestlé did is perfectly legal: those purchasing the Nestlé product did so willingly. However, stakeholder theorists would argue that international nongovernmental organisations, local public health authorities and community groups working in those same target countries to raise awareness about water quality and the benefits of breast milk over substitutes are, in fact, stakeholders and should have been consulted. Either Nestlé knowingly marketed and promoted unhealthy and dangerous practices or consciously avoided consulting those who knew about the detrimental effects of using breast milk substitutes.

The *Jerusalem Indymedia* reports the case of an industrial machinery company. It reports that the Israeli military destroyed, since the beginning of the Palestinian uprising in September of 2000, over 3000 Palestinian homes, offices, buildings and other civilian structures including hundreds of thousands of fruit and olive trees—the main livelihood for many Palestinians. While both Amnesty International and Human Rights Watch have condemned these forms of collective punishment as inhumane, the main supplier of the specially designed bulldozers, which the Israeli military uses to carry out this destruction, maintained sales to the Israeli military (Indymedia 2002). While it is perfectly legal for a corporation to sell equipment to a military, it is ethically objectionable when the corporation’s product will be used to perpetrate unethical and inhumane actions, especially when the product was, apparently, specially designed for this purpose. The production and sale of military equipment is often ethically ambiguous. However, this

case is fairly clear-cut as it is plain that the products will not be used for defensive purposes.

In “*Gunboat Petroleum: Burma’s Unocal/Total Pipeline*,” Edith T. Mirante recounts the case of Burma and Unocal. In the 90s, Unocal and Total secured a contract with the Burmese government to build a pipeline across southern Burma. Burma, the largest nation in mainland Southeast Asia, is governed by a military regime that seized power from a democratic government in 1962. It suppressed a people's uprising in 1988 and denies office to the party of Nobel Laureate Aung San Suu Kyi, the landslide victor in elections held in the 90s. The 700-kilometer pipeline was completed in 1999. According to Mirante, consequences of the project include: “indigenous people killed, raped, tortured, and enslaved by Burma army pipeline security forces”; the displacement of aboriginal communities; and, the destruction of a “treasury of the last primary tropical rainforest on mainland Asia” (Environmental News Network 2002). As a sovereign state, the Burma and its government may enact whichever laws it deems necessary and may govern in whichever way it considers appropriate.³ The Burmese government provided Unocal/Total Pipeline with the means, authority and permission to conduct its business unethically. Unocal/Total Pipeline was therefore a legally abiding corporation but no one would argue its conduct was ethical.

Another example of legal yet ethically objectionable corporate behaviour is the case of the Pollution in the Alamo Bay and the Gulf of Mexico from chemical industries and oil refineries. This pollution has dramatically reduced the shrimp and fish

³ While international organisations were created in the 20th Century (e.g., United Nations, Amnesty International, Human Rights Watch) to guard against oppressive regimes and human rights violations perpetrated by governments, it is unclear how much authority they have and how that authority may be exercised. For these reasons, abuses by regimes or the enactment of unethical and unjust laws may take place over several years before intervention by the international community.

population, making it difficult for many communities along the Gulf, who have relied on fishing for decades, to make a living (Evans 2003). The corporations operating on the shores of the Alamo Bay respected the State's environmental laws. However, by externalising the costs of the pollution they produced, they were acting unethically. The relation between the corporations and stakeholders in the community was unjust. The corporations profited from foregoing the purchase of expensive environmental technologies to reduce the release of environmentally harmful products in the Alamo Bay. However, the costs of that pollution—e.g., reduced fish stocks—were born by the community.

Similarly, many corporations legally profit from selling hazardous products such as tobacco, seek to render them more addictive, and leave the astounding costs on the public health system to be assumed by the general public. In "The Cigarette Papers," Glantz et al. writes: "Tobacco is the leading preventable cause of death: cigarettes and other tobacco products kill 420,000 American smokers and 53,000 non-smokers every year. This toll exceeds the deaths resulting from alcohol abuse, AIDS, traffic accidents, homicides, and suicides combined. Nevertheless, the tobacco industry continues to promote and sell its products, unhampered by any meaningful government regulation except for mostly local restrictions designed to protect non-smokers from the toxins in second-hand tobacco smoke." Stakeholder theorists would argue that the Canadian taxpayer—a stakeholder of the tobacco corporations as s/he must pay for the publicly funded health care and public health system—is being unjustly affected by tobacco corporations' activities. While legal, it is unethical for tobacco companies to pass on the costs of their products' effects to society.

While many corporations do act ethically, the above-mentioned examples are illustrative of an important proportion of corporations who maintain their responsibilities extend only to those required by law. However, Epstein suggests there is widespread recognition that the law, although certainly a necessity, is not a sufficient means for expressing key societal values and establishing standards of business performance (Epstein 1987: p. 102). While there are trends towards stakeholder thinking in law, corporate governance frameworks, and in empirical cost/benefit analyses, Donaldson and Preston maintain that, as a fundamentally normative theory, whether the law prescribes that corporations recognize the interests of stakeholders or not, corporations do, in fact, have responsibilities based on principles antecedent to law (Donaldson and Preston 1995: p. 85). Quinn and Jones suggest there are four core principles antecedent to law or any contract: (1) avoid harm to others; (2) respect the autonomy of others; (3) avoid lying; and, (4) honour agreements. They write that “[a]cting with regard to these principles is the moral obligation of all humans, no matter what profession or position” (Quinn and Jones 1995: p. 23). The absence of respective law does not forsake any of these fundamental principles. Individuals are entitled to demand protection under such normative principles regardless of the legal framework that they may live under. Based on this view, in “Stakeholder Management Theory: A Critical Theory Perspective,” Reed presents what he sees as the fundamental justification of stakeholder theory on normative grounds. He maintains that since a firm may threaten the individual and the community in at least two dimensions (i.e., harm and autonomy), there are stakes in the activity of any firm. Reed stresses that capitalist business practice is not self-justified or granted per

se. It may only represent a generalisable interest as long as it provides efficient markets and fair distribution of harms and benefits (Reed 1999: p. 43).

Jonker and Foster advance another argument of particular relevance to cases that involve corporations operating in countries governed by corrupt or oppressive governments (Jonker and Foster 2002: p. 186). They maintain that interests of some stakeholders may be overlooked by the legal system based on economic rationalism—i.e., accepting injustices done to certain groups in exchange for greater economic gains for citizens in general. Governments may call on corporations to assume responsibility for the outcomes of their actions. However, this responsibility is often framed by larger principles defined by governments. These may be principles of legitimacy, which include what is good for the country and what is in the national interest. Or they may include principles of self-interest based on what is good for the governing party (Jonker and Foster 2002: p. 190). If the laws of the land are not ethical and do not provide the necessary framework to ensure fair distribution of harms and benefits, they cannot be used as a measure of ethical legitimacy. As explained earlier with the Unocal/Total Pipeline case, corporations operating in such countries, where laws enable them to conduct their activities unethically, may not justify their actions on the fact that they are abiding by the law.

Another argument by stakeholder theorists against the limitation of CR to legal requirements concerns the process through which laws come to be. As has been shown earlier, the organic paradigm adopted implicitly by stakeholder theorists enables these theorists to overcome the separation thesis and the business-society dichotomy. Through this paradigm, stakeholder theorists recognise the fact that systems interpenetrate and are

co-dependant and that, as a consequence, the legal system is not completely independent from business. Stakeholder theorists have argued that because laws are often influenced by business, responsibility must go beyond what laws require. In many democracies, the success of election campaigns depends on how well financed the campaign is. Therefore, one may argue that in soliciting campaign funds from corporations, politicians may promise these corporations more lenient regulations and laws. Further, as Mulligan states, we cannot count on law to “define a worthy, impartial social mission for business” since businesses are often engaged in lobbying to lawmakers and lawmakers often have to rely on data from business’s to make decisions. For these reasons, he contends, “the law is not enough to stipulate, in any important affirmative respect, what the mission of business ought to be” (Mulligan 1986: p. 268).

Responsibility Beyond Expertise and Knowledge

Advocates of the view that corporations have no responsibilities beyond profit maximisation also use the *lack-of-expertise* argument. These advocates hold that corporate executives lack the expertise to be socially responsible. Because they are trained in economics and management theories, it is assumed that corporate executives lack the knowledge to effectively predict the social and ethical impacts of their actions, or to judge the success of projects by any criteria other than economic ones. Those who argue along these lines conclude that corporate executives should restrict themselves to those areas of decision-making in which they are trained (Brummer 1997: p. 110). Friedman, for instance, maintains corporate social responsibility is not only unjust to the

owners of the corporation but is also flawed on the “grounds of consequences” (Friedman 1970: p. 35). He argues the corporate executive does not know how to be responsible. While s/he may be an expert at managing the business, contends Friedman, the corporate executive does not necessarily know what actions will have positive social consequences (Friedman 1970: p. 36).

In all other sectors of society, individuals and groups deemed to be intellectually competent are held accountable for their actions. Neither the thief, the fraudster, nor the assaulter may successfully plead ignorance to charges against him/her. In all cases, society expects them to be responsible for their actions because it is assumed that they can understand right from wrong. While the appropriateness of corporate actions in terms of ethics may be more difficult to determine, stakeholder theorists maintain that the responsibility of corporations and their executives should be regarded in much the same way as the responsibilities of individuals in other parts of society. As argued in the second chapter, stakeholder theorists conceive of corporations through an organic model, where corporations affect their environment and the environment in turn affects the corporation. Also, as mentioned earlier in this chapter, for (most) stakeholder theorists, the concept of “corporate responsibility” is simply that fact—i.e., actions have repercussions and because the corporation is part of a larger system, it has a duty to consider the effects of its actions on the rest of the system. Because the non-economic aspects of corporate decisions are unavoidable, corporate executives must assess the overall impact of their policies, and if corporations do not have the necessary experts in social or ethical planning, they should hire them.

Ignorance does not waive responsibility but some theorists have argued that even if it did, executives *do* have the skills necessary for moral evaluation. While most stakeholder theorists agree that there are individuals who, by education and training, are more sensitive to the ethical implications and complexities of various management decisions, they generally reject the idea that ethics valuation and the drawing of hypotheses as to the social and ethical impacts of corporate actions requires a distinct type of expertise that corporations lack. Ethics valuation is not an obscure or gnostic expertise. Nor is it alien to business, as the separation thesis advocates would have it. As Michalos claims, urging people to adopt an ethical point of view such as CR advocates ask of corporate executives, is “tantamount to urging them to develop a uniquely inclusive trait” (Michalos 1999: p. 57). Corporate executives are generally successful business people who owe their success to their ability to analyse situations and foresee the effects of actions. Business executives are trained to effectively take into account various factors and variants in making business decisions. He goes on to say that, for corporate executives, the appraisal of decisions and actions is already “a habit of mind, a mental set or disposition to think of all actions from the point of view of their impact” (Michalos 1999: p. 57). The same type of analysis is used in making ethics-related decisions: one must take into account all possible outcomes and risks, their likelihood, what interests are at stake, etc. In “A Critique of Milton Friedman’s Essay ‘The Social Responsibility of Business is to Increase its Profits’”, Mulligan echoes this point and writes: “Human life . . . requires action in the absence of certainty, and business people in particular have a bias toward action. They do not wait for perfect foreknowledge of consequences, but instead set a decision date, gather the best information available,

contemplate alternatives, assess risks, and then decide what to do” (Mulligan 1986: p. 268). In fact, Mulligan believes that decisions as to socially responsible and ethical actions require many of the same reasoning schemes as decisions about marketing and the development of new products.

Stakeholder theorists also reject the lack of knowledge argument because one of the basic principles of stakeholder theory enables corporations to overcome this lack of knowledge. As will be explained in the next chapter, stakeholder theory calls for stakeholder engagement. It calls for the participation of stakeholder groups and representatives in establishing the right course of action in situations where many constituents would be affected (see Freeman 1999; Andriof et al. 2003; Bryson 1995; Clarkson 1995; Donaldson and Preston 1995). Stakeholder theorists hold that to be responsible, corporations must accept accountability to those its actions affect. These theorists therefore respond to the lack of expertise and knowledge argument by stating that if corporations do not know what course of action is the most ethically appropriate, they should ask stakeholders. It is not always obvious what the ethical implications of a particular course of action are but an open, transparent discussion with the parties that will or could be affected by the course of the action should suffice in exposing those implications.

In this chapter, it has been shown that the ethical sphere of corporations has broadened in terms of both space and time, and that, as a consequence, the scope of CR has been drastically altered. Based on the organic model of the corporation, stakeholder theory developed the concept of "stakeholder." The first part of this chapter consisted of

an analysis of the concept of stakeholder theory based on a review of the stakeholder theory literature. This concept leads to stakeholder theory's greatest contribution to the CR debate—i.e., the extension of the scope of CR in response to a changing reality. However, many economists and scholars still argue that this extension is unwarranted. The four main arguments used to limit CR to stockholders have been identified in this chapter. These consist of the performance argument, the loyalty argument, the lack of expertise argument, and the concern for corporate power argument. Based on a more accurate description and understanding of the true nature of corporations, stakeholder theory, it has been shown, refutes these arguments and advances the CR debate by clearly demonstrating that, in fact, CR extends beyond economic performance, the owners of the corporation, expertise, and beyond the law and government regulations. However, while it has been demonstrated that CR goes well beyond profit maximisation, so far, stakeholder theory remains silent as to what exactly those responsibilities are. The next chapter consists of an overview of stakeholder theory's approach to ethics, which addresses the issue of identifying specific corporate responsibilities.

- Chapter 4 -

Discursive Ethics

The previous chapter set out to identify the extension of the concept of responsibility as a major contribution by stakeholder theory to the CR debate. While this contribution is more substantive in nature, stakeholder theory also makes an important contribution of a procedural nature. By conceiving of corporations through an organic model, stakeholder theory paints a picture of corporations that is much more complex than has traditionally been provided. This complexity extends to the corporation's relationships with the rest of the system. As has been demonstrated in the last chapter, its relationships are much deeper and numerous than CR traditionalists have argued. However, in light of this new appreciation of the true nature of corporations, the normative question stakeholder theory first sets out to answer remains unanswered: how should corporations behave? Stakeholder theory does not determine what exactly those relationships entail in terms of responsibilities.

Stakeholder theory provides a discursive approach to ethics, which seeks simply to develop processes for discussing options for action without setting up—a priori—any kind of criteria by which to judge the different options. This discursive approach focuses on dialogue and establishes rules for how it will unfold. Ethics conceived as a consensus on moral issues that is reached through fair dialogue, or that may be defended through fair dialogue provides a foundation for carrying out and defining the responsibilities of “organic” corporations.

This final chapter describes limits to ethics knowledge that has traditionally made it difficult for corporate executives to apply CR frameworks. While stakeholder theorists reject the “lack of expertise/knowledge” argument, it recognises that limits do, in fact, exist. The second part of the chapter looks at how stakeholder theory overcomes these limits through its discursive approach to ethics. It is argued that the third contribution stakeholder theory brings to the CR debate is an approach enabling the practical application of CR. The final part will consist of an overview of social and ethical accounting, auditing and reporting (SEEAR), an increasingly popular corporate practice that evolved out of stakeholder theory’s discursive ethics.

Limits of Moral Rationality

Epstein, an expert in business and ethics policy, maintains that corporate responsibility pertains “principally to development of organizational decision-making processes whereby, consistent with the limitations of incomplete and imperfect

information, corporate decision makers collectively anticipate, respond and manage the total ramifications of organizational policies and practices” (Epstein 1987: p. 105). A key aspect of this definition is knowledge or information. Managers must anticipate, respond to, and manage the consequences of corporate activities based on the knowledge and information available. Information gathering and analysis are unavoidable steps in ethical deliberation. This information consists, among other things, of who will be affected by the action; how these parties will be affected; how the corporation will be affected; what the alternatives are. Many argue, however, that for the decision to be truly ethical, it must also be based on knowledge that goes beyond determining consequences. In fact, from an ethics perspective, it should matter whether the intention of the corporation is to harm or provide benefits to these parties through its actions. It should matter whether parties that will be affected agree with the actions and policies of the corporation. Gathering both sorts of knowledge is problematic however. Donaldson and Dunfee maintain that because of spatio-temporal and cognitive limitations, and because a multiplicity of value systems exists, one’s ethics knowledge is always limited (Donaldson and Dunfee 1994: p. 256). They attribute these limits to “bounded moral rationality.” This concept refers to two limitations in moral reasoning. The first is the limit on the ability of general moral theory to model the full range of accepted moral convictions; and, the second is the limit on the ability of individuals to discover and process *all* morally relevant facts (Donaldson and Dunfee 1994: p. 257).

Impossibility of modelling the full range of accepted moral convictions:

The first case of bounded moral rationality derives from the fact that an archimedean point outside the situation, from which one can decide on the most ethical course of action, does not exist. Ackoff (1999) and Beaulieu (2002) maintain that corporate executives are forced to take decisions in situations that are rarely clearly defined and delineated. Ackoff calls these situations “messes”—Beaulieu calls them “issues.” These are complex systems of strongly interacting problems, co-constructed by corporations and stakeholders, and of a level of complexity such that unilateral corporate solutions are inadequate (Ackoff 1999; Beaulieu 2002). Corporate messes and issues are constructed by various groups that have their own rules and norms, which makes it impossible for shared values and holistic perspectives to be based on a single group’s values. The archimedean point of view is the perspective from which the individual or group conducting the action has all the necessary knowledge to determine the value of that action—e.g., the individual or group knows how those affected will interpret the actions and what values they will attribute to different elements of the situation. Assuming such an archimedean perspective is a conclusion naturally drawn if the organic model is not, at least, implicit in the CR theory. When the organic model of the corporation isn’t implicit in the CR scheme of executives, executives analyse situations into two distinct elements—i.e., the corporations and the non-corporation, or into the social realm and the business realm. They then place the corporation in a false archimedean position from which it may judge the rest of the world based on its values

alone. Under such models, corporate executives are deemed to be part of the business realm, from which vantage point they may stand back and look at the rest of society as if it was distinct from it. From this vantage point, it is impossible for corporate executives to take into account all morally relevant facts, such as intentions, core moral and spiritual beliefs, and feelings of pain and pleasure experienced by different stakeholders. When one falsely adopts an archimedean perspective, one understands situations largely based on one's subjective data. Subjective data from other stakeholders is deemed irrelevant, as it is not part of the business realm. However, to fully understand a situation, one must understand not just one's own moral perspective but, simultaneously, the moral perspective of all those affected by one's actions. Even when executives attempt to apply moral reasoning from this archimedean position, it is as if foreign principles are added to the economic-based perspective (Hummels 1998). As a consequence, this often leads to the subordination of normative preconditions for legitimate business activities to economic interests.

One example of this is that, traditionally, CR has been approached from a purely economic-based perspective, whereby corporate action is judged based on fair distribution of outcomes. The distribution can be based on the harms and benefits to stakeholders from corporate actions, or can be based on the duties owed to different stakeholders by the corporation. However, Hummels holds that this perspective is too restrictive—the criterion of fair distribution of outcomes, whether based on consequences or duties owed, is inadequate (Hummels 1998: p. 1407). He argues firstly, that this approach does not account for the ways in which the distribution takes place. Secondly, he argues that it does not pay attention to the “conceptualization of the values and

interests of the stakeholders themselves” (Hummels 1998: p. 1407). To provide an example of the predominance of the economic perspective, Hummels notes that most corporations believe that as long as stakeholders are financially compensated for harm or suffering incurred from corporate action, the corporation is acting responsibly. However, determining the appropriate financial compensation for an infringement is not always possible. The price of culture and heritage and their consequent loss cannot be measured. For example, the Ogoni of Nigeria perceive their environment to be an integral part of their being. The Shell corporation may compensate the Ogoni for the destruction of their land, but can it compensate the Ogoni children and their progeny the thousands of years of culture and opportunity lost as a result of that destruction? Appropriate compensation cannot be determined without understanding first what it is that has been violated. Approached solely from an economic perspective, those things that have not been attributed a financial value are disregarded and considered unimportant. Following those lines, the Shell corporation may conclude that financially compensating the Ogoni for oil spills is cheaper than cleaning up these spills and decontaminating the affected land. However, if the issue for the Ogoni is the threat of losing their traditional way of life, no amount of money will ever be enough.

Impossibility of discovering and processing all morally relevant facts:

For many theorists, the apparent fact that it is impossible to model the full range of accepted moral convictions leads them to argue that the solution resides in linking the ethical character of actions or policies to their practical outcome. In following this line of

thought, corporations carefully analyse the immediate consequences of actions on those affected and assess the quality and comparative value of the pleasure and pain experienced, as well as analyse the subtle, indirect, far-reaching, and long-term effects. The question is whether such knowledge is possible. As mentioned earlier, Donaldson and Dunfee argue that it is not. In fact, they maintain the second set of limits on moral rationality is the ability of individuals to discover and process *all* morally relevant facts (Donaldson and Dunfee 1995: p. 256).

In *The Imperative of Responsibility*, Hans Jonas claims that “Modern technology has introduced actions of such novel scale, objects, and consequences that the framework of former ethics can no longer contain them” (Jonas 1984: p. 6). He goes on to write that “the old prescriptions of the ‘neighbor’ ethics—still hold in their intimate immediacy for the nearest, day-by-day sphere of human interaction. But this sphere is overshadowed by a growing realm of collective action where doer, deed, and effect are no longer the same as they were in the proximate sphere, and which by the enormity of its powers forces upon ethics a new dimension of responsibility never dreamed of before” (Jonas 1984: p. 26). Much the same can be said of corporations. They wield such power and influence and the effects of their actions are of such magnitude that knowing the total effects of their actions on different stakeholders has become impossible. Similarly, as Brummer points out, stakeholder theorists do not only suggest that managers are not sufficiently informed about the indirect effects of their corporate actions, but that it is impossible for managers to trace through the lines of causality that exist when a myriad of interacting elements apply simultaneously to a situation (Brummer 1991: p. 65-70).

Recognising these limits, stakeholder theorists propose an approach to CR, based on discussion between all those affected. This approach provides a means to achieving consensus on the most appropriate response to ethical issues corporations face.

Stakeholder Theory's Discursive Approach to Ethics

Stakeholder theory adopts a discursive approach to ethics, which enables executives to manage corporations responsibly regardless of the limits to their ethics knowledge. A substantial body of work on participatory approaches to decision-making processes has emerged in the 1980s and 90s. Theoretical roots of these approaches can be attributed to Jurgen Habermas' discursive ethics (Habermas 1979). In this section, the account provided of Habermasian ethics is that of stakeholder theorists. In other words, Habermas' theory will be viewed through stakeholder theory.

Discursive ethics views rationality as a social construction, inseparable from social, cultural, and ecological life, which constitutes the context of human experience. It is based on the criticism according to which any theory that attempts to justify an ethics system on principles distinct from history and culture is undertaken in vain due to the impossibility of escaping our embeddedness in culture and language (Phillips 2003). For this reason, discourse ethics presupposes no norms other than the acceptance of a reasoned, reflective, and practical potential for discourse: that is, the mutual recognition and acceptance of others' ability to respond. Ethical issues must be resolved through discourse because it is assumed that the societal validity of standards in the long term depends on these standards being recognized and accepted as valid by all those who are

affected by them. For discourse ethics, the aim of discourse is rationally motivated consensus on norms.

Stakeholder theorists use the fundamental idea of discourse ethics—that the interests of all participants must be assessed and claims are valid only if all those potentially affected can consent to the validity—and apply it to business (Phillips 2003: p. 110). By adopting implicitly an organic model of the corporation, stakeholder theory is a *natural* match with discursive ethics. This approach to CR provides a way to reach consensus on ethics issues through the recognition of the limits bounded moral rationality imposes on corporate executives. The organic model, implicit in stakeholder theory, assumes the embeddedness in culture, language and society—the very idea discourse ethics uses as a starting point. Because culture and language are at the very foundation of societal and ethical norms, and because cultures and languages vary enormously, norms will also vary and often conflict. Stakeholder theory is a recognition of the conflicting norms between parties that are affected by the corporation. It is a recognition that management, shareholders, employees, suppliers, and local communities, have different perceptions of the organisation, its impacts and what principles should guide its actions. Stakeholder theory provides a framework for deriving stakeholder obligations. It provides the conceptual and practical framework that enables theorists and corporate executives to determine that obligations exist, but it does not a priori tell them what those obligations are (Phillips 2003: p. 109).

The stakeholder approach is grounded on the principles of universal inclusion and consensual validity. The first principle states that anyone capable of speech and action, who will potentially be affected by the norms under dispute, must be able to participate in

the discussion on equal terms. The second principle states that action is legitimate if all those possibly affected would arrive at an agreement that such action should be taken. Under this approach, communication must be “dominance free” or must take place in an “ideal speech situation”—i.e., a situation where discussion takes place in the absence of any type of coercion except for the force of the better argument (Sauer 2000: p. 101). As one stakeholder theorist explains, what discourse ethics provides is then a means of testing moral norms through discourse with other rational subjects, rather than a means of generating moral norms (Phillips 2003: p. 111). The aim of these discussions is not to convince others to adopt a certain position. No one will be entirely convinced to adopt another party’s point of view. The aim is to find a consensus.

Freeman and Evan argue that the corporation must be understood by unpacking “a number of stakeholder theories, each of which has a ‘normative core,’ inextricably linked to the way that corporations should be governed and the way that managers should act” (Freeman and Evan 1993: p. 44). Each stakeholder theory is an account of how value-creating could be understood differently. As Evan and Freeman put it, stakeholder theory is “a genre of stories about how we could live” (Evan and Freeman 1993: p. 44). Based on this insight, Pruzan and Thyssen contend that “when a given subculture cannot prove that its perspectives are right [i.e., when stories diverge or conflict], then all subcultures must, as a point of departure, be attributed the same rights” (Pruzan and Thyssen 1994: p. 26). This right is “the right to exist and to articulate its views—but not the right to harm other subcultures” (Pruzan and Thyssen 1994: p. 26).

Payne and Calton maintain that for corporations to address issues responsibly, the formation of stakeholder networks is necessary (Payne and Calton 2002: p. 121). They

go on to define these stakeholder networks as “an interactive field of organisational discourse occupied by all stakeholders who share a complex, interdependent, ongoing problem domain and who want/need to talk about it” (Payne and Calton 2002: 122). According to Freeman and Evan, what stakeholder theory seeks to do is to re-define the value scheme of corporations (Freeman and Evan 1993: p. 45). The maximisation of profits—one criterion among many—can no longer be the sole indicator of the performance of corporations. In fact, according to stakeholder theory, the value system that ought to guide the actions of corporations will vary according to the stakeholder. Jones and Wicks explain that many stakeholder theorists see the challenge of stakeholder theory as developing and evaluating a broad array of narrative accounts of the nature and purpose of the firm and the activities of people who work for it (Jones and Wicks 1999: p. 208).

As mentioned earlier, stakeholder theory establishes that obligations between stakeholders and the corporation exist. It remains silent however, on what the content of those obligations is exactly. The content of the obligations is established and tested in and according to each particular context. It is for this reason that process plays such an important role in stakeholder theory. It does not, however, advocate a relativist approach to ethics. Rather than taking any norm to be as good as any other, stakeholder theorists maintain norms must be analysed and justified through discourse between those affected by them (Phillips 2003: p. 112). For such an approach to yield legitimate results however, certain conditions must be met.

In Hummels’s words: “the importance of the organizational stakeholder debate can be found in the creation of possibilities for clarifying and discussing the meaning of

organizational policies, practices and actions and their internal and external effects” (Hummels 1998: p. 1415). This clarification can only be reached through what Habermas called the ideal speech situation—i.e., a mutual and reciprocal recognition of the claims of *all* stakeholders will take place as long as those claims are supported by valid arguments. All those who are affected or who may be affected by corporate activity should have the opportunity to voice their concerns to decision-makers. For stakeholder theorists, fundamental value conflicts don’t have to be resolved. What is required is that compromises are seen as fair. Consensus is the aim sought since no one will be entirely convinced to adopt another party’s point of view. Pruzan and Thyssen explain that “In a pluralistic society consensus as to right or wrong cannot be presupposed. Therefore, coordination of action calls for agreement via an ongoing conversation, which defines who can participate, what is to be discussed, how to communicate, how deep to go and how the conversation should begin and end. . . . The parties involved each have their own perspective and thus the starting point is conflict. But the aim of the conversation is consensus via attunement” (Pruzan and Thyssen 1994: p. 26). This search for consensus is evident in stakeholder theory as well as in the actions of corporations who adopt the theory. For instance, in its 1991 ethical accounting statement, one of the first corporations to adopt stakeholder theory through SEAAR, Sparekassen Nordjylland, writes “An action is not necessarily ethical just because I can accept it. It is ethical if all parties involved can accept it. Ethics refers both to a conversation process and to the action which is the product of the conversation” (Sparekassen Nordjylland 1991).

This dialogue between stakeholders enables what Ulrich and Maak (2003) see as a much-needed integrative business ethics approach. This approach, they explain, starts

from a critical reflection on economic reason itself, whereby the normative grounds of business are reconstructed through dialogue with stakeholders. This prevents the adoption of what they call “moral economics”, i.e., normative preconditions for legitimate business activities are subordinate to economic interests (Ulrich and Maak 2003). However, while stakeholder theory is concerned with ethical appropriateness of corporate and managerial activity, this in no way means that economic necessities are ignored. As Jones and Wicks emphasize, it does not seek “to shift the focus of firms away from marketplace success toward human decency. Rather, it seeks to come up with understandings of business in which these objectives are linked and mutually reinforcing” (Jones and Wicks 1999: p. 207). The interests of stakeholders do not have priority over those of the corporation. The ideal speech situation will give every participant the same opportunity to express him/herself and only the force of argument should be used to attribute value to different positions and interests. Evan and Freeman, in fact, hold that “the attempt to prescribe one and only one ‘normative core’ and construct ‘a stakeholder theory’ is at best a disguised attempt to smuggle a normative core past the unsophisticated noses of other unsuspecting academics who are just happy to see the end of the stockholder orthodoxy” (Evan and Freeman 1993: p. 45). However, as has been explained in chapter 3, this entails a shift in corporate thinking.

What is needed is a framework that seeks to link the interests of stakeholders with the interests of the corporation in mutually reinforcing ways. By engaging in stakeholder dialogues and defining the preconditions for legitimate business activities through this process, the question asked is no longer “What are the least destructive ways of creating value?” but rather “Is this particular type of value creation legitimate and are the means

legitimate?” Corporate executives no longer ask the traditional question of the adequateness of economic compensation for the infringement of stakeholders’ values, rights or interests, but rather the question of the meaning to stakeholders of being so affected by the organisation’s practices or policies (Hummels 1998: p. 1410). To answer these questions, corporate issues must be fully understood—i.e., the stories of all stakeholders must be taken into account. Stakeholder dialogues enable corporations to know how their actions are affecting or could potentially affect stakeholders and how stakeholders would like their concerns addressed. In this sense, stakeholder theory makes a major contribution to the CR debate by providing a means for corporations to morally assess their actions and policies based on consensus regardless of limits on moral rationality.

Stakeholder engagement depends in large part on the timely exchange of information to ensure that all parties are working within the same framework of knowledge. The main method used to engage stakeholders is through social and ethical accounting, auditing and reporting (SEAAR). In the next section, this practice will be explored and an overview of different SEAAR frameworks will be provided.

SEAAR, Instrument of Dialogue

Auditing evolved over four generations (Swift and Dando 2002: p. 90). The first generation of auditing consisted of detailed inspections of each entry in the account books. This eventually evolved into sampling of entries—the second generation. Over the 1980’s, auditing had become so popular and divergent, audits would often overlap

and organisations were spending an enormous amount of resources conducting them. In an effort to streamline the audit process and reduce time and financial resources spent on them, the third generation of audits was developed. This type consisted in a more holistic approach, where the various standards were re-aligned so the audits were more integrated. As Swift and Dando explain, however, “these types of audit by their nature still tend to remain grounded in one area of the firm” —i.e., the finance area (Swift and Dando 2002: p. 90). The fourth generation, which emerged in the 1990’s, “was designed to give accountants greater power to understand more of the functions of business and to add value to a basic, routine statutory financial audit” (Swift and Dando 2002: p. 91). This type of audit seeks to give an account of other aspects of the organisation’s performance, such as ethical conduct, social capital and other forms of intangible assets that are not reflected on balance sheets. In parallel with this broadening of scope, the practice of social and ethical auditing was developing (Swift and Dando 2002: p. 91). Many SEAR instruments, which can be considered as part of fourth generation accounting practices, have emerged over the last few years. The Organisation for Economic Co-operation and Development (OECD) published a report in 2001 in which it compares eight: the OECD Guidelines; the Caux Principles for Business; the Global Reporting Initiative (GRI); the Global Sullivan Principles; the Principles for Global Corporate Responsibility: Benchmarks; Social Accountability 8000 (SA8000); AccountAbility1000 (AA1000); and, the United Nations Global Compact (OECD 2001). Of these instruments, many act mostly as guidelines—e.g., the OECD Guidelines; the Caux Principles for Business; the Global Sullivan Principles; the Principles for Global Corporate Responsibility: Benchmarks; and, the United Nations Global Compact—and

others attempt to go beyond the commitment to CR into monitoring and reporting as a way to shape dialogue with stakeholders—e.g., GRI, SA8000, and AccountAbility 1000 (AA1000). The SA8000 is a voluntary, factory-based monitoring and certification standard for assessing labour conditions and therefore does not cover the full spectrum of CR issues. The scope of the AA1000 and GRI is much broader as these SEAAR Frameworks seek to report on the economic, environmental and social/ethical dimensions of all of the organisation's activities.

The Accountability Institute website states that “In its most fundamental sense, SEAAR is a performance measurement tool used by excellent organizations to engage stakeholders to set out performance evaluation criteria in the QP3 elements (people, processes, product). SEAAR is the methodology setting out people-centred principles and process standards through which an organization engages its stakeholders to determine product and service excellence” (Accountability Institute 2004). Two principles can therefore be identified for SEAAR: comprehensiveness and reciprocity. In what follows, these two principles will be explained and it will be shown that they follow from the application of the three contributions of stakeholder theory to the CR debate.

The principle of comprehensiveness stems from both the adoption of the organic model of the corporation and the extension of corporate responsibility. First, as the organic view of the corporation entails, SEAAR must be comprehensive in its scope—i.e., it must address corporate performance as more than simply economic performance but as socially and ethically acceptable value creation. The evolution of auditing practice suggests that the auditing community adjusted its practices according to changing conceptual schemes. It suggests that auditors recognized that business, society and ethics

are not distinct realms but are in fact different points of view of the same universe.

Social and ethical audits of corporations became relevant once it was generally accepted that business could not be understood outside of its social context and that it was not immune from ethics. In fact, for SEAAR to have any relevance, corporations must be conceived through the organic model described in the second chapter.

Stakeholder theorists maintain that stakeholder theory provides the best conceptual framework for developing SEAAR instruments that will give accurate accounts of CR. For instance, in “A Stakeholder Framework for Analysing and Evaluating Corporate Social Performance” (1995), Clarkson argues that “corporate social performance can be analyzed and evaluated more effectively by using a framework based on the management of a corporation’s relationships with its stakeholders than by using models and methodologies based on concepts concerning corporate social responsibilities and responsiveness” (Clarkson 1995: p. 92). This is because by focusing on relationships, the dichotomies between ethics and business, and between society and business, are broken down. Because many of the relationships of the corporation involve parties outside the purely business-based context, the social and ethical context must be considered. In other words, if the focus is on relationship, one must adopt an organic model of the corporation. In describing SEAAR, Zadek also recognises the organic model of the corporation as he argues that SEAAR seeks to integrate business within the broader realm of the social and ethical (Zadek 1998: p. 1421). He maintains that SEAAR “provides one of the few practical mechanisms for companies to integrate new patterns of civil accountability and governance with a business success model focused on deepening stakeholder relationships around core non-financial as well as financial values and

interests.” Zadek also holds that while the magnitude of the effects of some organisations—due to their scope of operation—may be astounding, SEAAR must attempt to cover the effects of *all* of the organisation’s activities, not just the economic effects (Zadek 1998: p. 1421).

As Zadek holds, many variations exist as to approaches to SEAAR, but comprehensiveness may never be compromised (Zadek 1998: p. 1436). As stated above, this implies addressing the social and ethical beyond economics, but it also implies accounting to all relevant parties. The second meaning of the principle of comprehensiveness relates to the parties involved in the reporting process and to whom the corporation reports. Historically, the fiduciary duty of organisations—i.e., organisation’s duty to provide owners or investors with a fair return—has almost always been reflected in organisational reporting. However, this is only reporting on the corporation’s responsibility to one group of stakeholders. The evolution of SEAAR also stems from the extension of the concept of responsibility stakeholder theory contributed to the CR debate. The fact that SEAAR lists stockholders as one group of stakeholder among many indicates that it conceives of CR as extending beyond duties owed to stockholders. Corporations cannot be selective in their stakeholder engagement. John Pearce of the Social Audit Network states that “social auditing involves gathering the perspectives of *all* stakeholder groups in an organisation . . . and attempting to reflect the differences and agreements in their views about the company’s performance. The aim is to gather the views of *each* stakeholder group separately on what they consider to be the significant indicators of whether the company is achieving its stated objectives” (Social Audit Network 2004).

As has been demonstrated in the last chapter, stakeholder theory extends CR beyond traditional limits. This contribution points to the fact that corporations are responsible for the negative effects their actions may have on individuals or groups—regardless of whether these effects are direct or indirect, or are of economic importance. For this reason, stakeholder theorists argue that corporations must be accountable to all stakeholders. Because it is in large part a means to accountability, theorists have therefore viewed SEAAR as a normal extension or operationalisation of stakeholder theory. The recognition of the extension of CR in SEAAR is evident from the fact that SEAAR instruments generally report on the use of the precautionary principle (OECD 2001; AA1000 2000). The precautionary principle can be defined as the recognition that “the absence of full certainty shall not be used as a reason to postpone decisions where there is a threat of harm” (Privy Council Office 2004). This is therefore a clear indication that SEAAR uses a conception of CR that extends beyond knowledge and expertise.

As Swift and Dando (2002) maintain, accountability to stakeholders “essentially concerns the provision of information from one party to another, where the one who is accountable explains or justifies actions to the one to whom the account is owed” (Swift and Dando 2002: p. 98). Similarly, Zadek writes that “reporting is a way in which stakeholders can see if the company ‘listened’ to their concerns, and over time whether they have responded in practical terms” (Zadek 1998: p. 1428). And this is regardless of the power stakeholders have or the urgency of their claims. Whoever has a legitimate claim should be considered in the SEAAR process. In fact, Hummels holds the organizational debate should be organized in a way that the powerless are able to voice their concerns and be heard (Hummels 1998: p. 1410). Finally, Gray argues that “[t]he

social account may serve a number of purposes but discharge of the organisation's accountability to its stakeholders must be clearly dominant of those reasons and the basis upon which the social account is judged" (Gray 2000: p. 250).

So far, SEAAR has been presented mainly as a retrospective analysis of corporate conduct. In fact, SEAAR is generally used in this way. Corporations recognise the increasing demand and expectations of disclosure and transparency and respond by publishing their social and ethical accounts. They will monitor how their accounts are received through media and will adjust for future reporting exercises. Good-intentioned corporations will do this by addressing some of the concerns raised through the media by changing corporate practices. However, according to stakeholder theorists, this is insufficient and does not consist in responsible corporate conduct. The problem is that the media will generally cover mainstream issues—i.e., issues affecting a good proportion of the white, middle-income population. The concerns of lower-income groups, isolated groups and individuals do not often reach the media. As a consequence, corporations do not often hear the concerns of these stakeholders and cannot adjust corporate behaviour in response to them. The discursive approach to ethics stakeholder theorists advocate would enable SEAAR frameworks to overcome this deficiency.

SEAAR must be seen as an ongoing process of discourse. The second principle of SEAAR, reciprocity, states that both the corporation and stakeholders must be involved. SEAAR cannot simply be an exercise of disclosure. The communication must be two-way. It must become an approach used to operationalise the notion of the ongoing stakeholder debate. According to Hummels, SEAAR provides the possibility of a systematic and ongoing discussion about moral meaning (Hummels 1998: p. 1415).

Zadek, the founder of AA1000, attempts to bring SEAAR in this direction. He holds that inclusive stakeholder consultation as a core element of the corporate audit allows for various values and opinions to shape the assessment rather than the assessment being based on a single or prevalent economic standpoint (Zadek 1998: p. 1425). He argues that SEAAR “is an integral element of the process of communication between the company and key stakeholders” (Zadek 1998: p. 1428). Pruzan and Thyssen also hold that the ethical accounting statement “is based upon the shared values which the stakeholders have defined in a conversation process” (Pruzan and Thyssen 1994: p. 24). Clearly implied in this view is the fact that SEAAR must go beyond disclosure. It is more than the one-way communication corporations have historically practiced. Hummels holds that debates “should be held in the organization as well as in society concerning the purpose, objectives, means, processes and outcomes of organizational behavior” (Hummels 1998: p. 1405). He goes so far as writing that the role of the manager is to organize these debates and ensure they are open (Hummels 1998: p. 1407).

Stakeholder theorists advocate the use of SEAAR as an essential tool of their discursive ethics approach. However, the business community generally argues against the inclusive discursive approach to SEAAR on the basis of its impracticality. They argue that it is virtually impossible to consult *all* stakeholders in the course of a SEAAR exercise. This is a legitimate concern but it does not immediately refute the discursive approach to ethics advocated by stakeholder theorists. Stakeholder theorists have developed different schemes for identifying stakeholders and their salience (see Mitchell et al. 1997; Brenner 1993; Clarkson 1995). By recognising the impossibility of corporations discussing corporate conduct and issues with *all* stakeholders affected,

stakeholder theorists must now attempt to develop schemes for establishing ethically appropriate samples of individuals and groups to represent the full range of stakeholders with whom the corporation will discuss in the course of its SEAAR exercise. This sample of stakeholders must be involved in developing the SEAAR framework but it must also be consulted on the results of the SEAAR exercise. The post hoc discussion is essential as it is through this discussion that consensus on how the corporation can improve its conduct in terms of CR can be reached. However, the legitimacy of the process will depend on whether the full range of stakeholder interests are duly represented and discussed.

- Conclusion -

During the last three decades of the 20th Century, with increasing attention to corporate power and the consequences of failures in CR, business ethicists developed a more comprehensive approach to corporate conduct. Stakeholder theory, this novel approach, is based on a more accurate description of the nature of corporations and the extension of the concept of CR. Fundamentally normative, the theory emerged in large part because managers saw it as a means for developing more balanced and more robust strategies that reflect the evolution of the organisation. The theory holds that corporations are responsible for the consequences of their actions. Any individual or group affected by the corporation—everyone who has a *stake* in the operations of the corporation—is recognised as a stakeholder, to whom the corporation owes responsibilities.

Based on the literature reviewed, it has been shown that through increased descriptive accuracy and normative adequacy, stakeholder theory makes three major contributions to CR: (1) the implicit adoption of the organic model of the corporation; (2)

the extension of the concept of responsibility; and, (3) the use of a discursive approach to ethics.

In chapter 2, it was argued that two dogmas of CR—i.e., the business and society dichotomy and the separation thesis—have made it very difficult conceptually to develop more accurate theories of CR. Theories or models of the corporation are used to describe the nature, function and structure of corporations and therefore have a profound affect on how properties of the corporations, such as its responsibilities, how it ought to conduct business, what guiding principles it ought to use, are defined. Models of the corporation also stress various internal and external groups of persons toward whom the corporation is alleged to have responsibilities. The five main models of the corporation were identified and it was demonstrated that between the (1) private property model, (2) private contract model, (3) social contract model, (4) machine model, and (5) organic model, only the last model eliminates the two pervasive theses. It does so by recognizing that the corporation is a part inextricably linked to a greater whole or system—i.e., society. Through this model it is made apparent that corporations operate within a network of relationships that extend beyond the purely economic. The organic conception of the organisation implicit in stakeholder theory enabled the theory to reframe the relationship between business and society in a fundamental way by explicitly recognising the corporation's embeddedness in society. Also, the relational and systems approach of the organic model implies that because corporations' acts can have positive or negative consequences on others, they are subject to ethical valuation. It was argued that, viewed through the organic model, stakeholder theory is therefore the only descriptively accurate and normatively adequate theory of the corporation. The

avoidance of the two dichotomies by recognizing the organic nature of corporations is a novel and important contribution to the CR debate.

In the first part of chapter 3, the concept of "stakeholder" was defined and analysed. A review of the stakeholder theory literature revealed a plethora of definitions. However, it was argued that the most useful and normatively accurate stakeholder definitions were based on the concept of risk—i.e., stakeholders are those individuals or groups who risk being harmed in some way by the actions of a particular corporation. It has been shown that through the introduction of this concept, stakeholder theory extends CR beyond traditional limits. However, many theorists still contend that corporations have responsibilities to stockholders only, a view they defend through the performance argument, loyalty argument, lack-of-expertise argument, and concern-for-corporate-power argument. It was then shown how stakeholder theory responds to and refutes these arguments and demonstrates that, in fact, CR extends beyond economic performance, the owners of the corporation, expertise, the law and government regulations.

In the last chapter, a third contribution stakeholder theory makes to the CR debate was presented. It was demonstrated that stakeholder theory makes an important contribution of a procedural nature by providing a foundation for identifying what exactly are the responsibilities of corporations. It was explained that stakeholder theory provides a discursive approach to CR that enables it to overcome shortcomings traditional CR approaches faced.

Throughout this thesis, the results of a review of the CR and stakeholder theory literature have been presented. Diverse streams of argument within the CR literature were brought together, which enabled the presentation of stakeholder theory as a key

element of a shifting CR debate. An examination of the literature on the nature of corporations, the scope of CR, and discourse ethics enabled the identification of founding elements of stakeholder theory that often remain implicit.

The description, provided in this thesis, of the three contributions stakeholder theory brings to the CR debate is set at the theoretical rather than practical level. The purpose has been to show how stakeholder theory influenced the theory and conceptualisation of CR. Except for the final part of chapter 4 dealing with SEAAR, no attempt was made to verify if, in practice, these theoretical contributions have influenced corporate conduct. In the last chapter, it was briefly explored whether the most obvious operationalisation of stakeholder theory—i.e., SEAAR—is in fact consistent with the basic tenets of stakeholder theory. Two principles were identified for SEAAR: comprehensiveness and reciprocity. It was shown that these two principles follow from the application of the three contributions of stakeholder theory to the CR debate.

This thesis was not meant as a thorough analysis but rather as a preliminary exploration for future work. Important questions as to the link between SEAAR and stakeholder theory remain to be answered. While the general ethical thrust of stakeholder theory appeals to many ethicists and CR theorists, its applicability remains on shaky grounds. In particular, SEAAR frameworks, an attempt at applying stakeholder theory in practice, seem to lack consistency and a rigorous moral logic. Hence, the field of CR would benefit from in-depth work on testing the validity and moral logic of SEAAR frameworks through the lens of stakeholder theory.

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