Understanding Stakeholder Value

The Evolution of Value Series - Part 3, by Wayne Visser

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Northampton, MA | September 27, 2021 08:17 AM Eastern Daylight Time

The dominance of shareholder value grew through the 1970s and into the 'greed is good' Wall Street boom-and-bust 1980s, with deregulation ushering in a new era of creative financial products like derivatives. This in turn fuelled the growth of the casino economy – which economist John Maynard Keynes had warned about decades previously, saying:

"Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done."[i]

It was in reaction to the prevailing shareholder value logic – and especially the idea that companies have a legal, fiduciary duty to place their needs above all others – that the concept of stakeholder value emerged. Although the idea wasn't new, American professor, R Edward Freeman is credited with introducing stakeholder theory in 1984.[ii] He argued that companies should be accountable to a broader set of stakeholders – literally, all those who have a stake in the business; in other words, interested and affected parties.

The argument against a stakeholder-driven approach, advanced by neoliberal economists, avaricious shareholders and many incumbent business leaders, was and continues to be that, since everyone is a stakeholder, the concept is rather meaningless. And more to the point, that by trying to satisfy a diverse set of competing interests, business will take its eye off the making-money ball. This objection is, frankly, ridiculous. Every business leader knows that he or she needs to be profitable.

Profits – including returns to shareholders for stock listed companies – are like oxygen. Business needs profits to survive. But breathing is not the purpose of a business. Nor does breathing accomplish anything on its own. Profits are a means to an end, and the end, companies' reason for being, is adding value to society through the provision of goods and services. And that is of course impossible in the absence of healthy relationships with suppliers, customers, government, communities, media, investors and others – good stakeholder relations, in other words.

The shareholder primacy lobby began to be questioned when the social responsibility and corporate governance movements took off in the 1980s and 1990s. One breakthrough moment was the inclusion of stakeholder value in the 1994 King Code on Corporate Governance in South Africa. Another was the creation of the stakeholder salience method by academics Ronald K. Mitchell, Bradley R. Agle and Donna J. Wood, to help companies prioritise stakeholder groups. I still use their power, legitimacy and urgency test for helping companies to achieve stakeholder focus.[iii]

The 2000s was the decade of accountability, as stakeholder engagement and non-financial reporting gained traction following the launch of the AA1000 standards and the Global Reporting Initiative's Sustainability Reporting Guidelines, both in 1999. Since these standards were modelled on financial accounting, auditing and reporting, the principle of materiality, or significance, was adopted. But how should a company determine if one sustainability issue or another is more or less material? The answer is to ask stakeholders – and so stakeholder materiality assessment was born. Today, you will often see an illustrative matrix in corporate sustainability reports, plotting the importance of different issues to stakeholders in relation to their impact on the company.

It is worth noting that in 2019 and 2020 a set of symbolic victories for stakeholder value over shareholder value were achieved. Specifically, three things happened to demonstrate that stakeholder primacy has finally been recognised as the preferred business philosophy, twenty-five years after Freeman introduced it as a theory.

It began (ironically, some might say) with the investment management firm Blackrock, which is the biggest investor in the world, with $8.7 trillion in assets under management by the end of 2020. Back in January 2019, their CEO Larry Fink wrote a public Letter to CEOs of the companies in which Blackrock invests on behalf of their clients. The letter, which mentioned stakeholders six times and created ripples of interest in media and boardrooms around the world, was entitled "Profit & Purpose" and included the following statement:

"Purpose is not a mere tagline or marketing campaign; it is a company's fundamental reason for being – what it does every day to create value for its stakeholders. Purpose is not the sole pursuit of profits but the animating force for achieving them. Profits are in no way inconsistent with purpose – in fact, profits and purpose are inextricably linked. Profits are essential if a company is to effectively serve all of its stakeholders over time – not only shareholders, but also employees, customers, and communities."

Next, in August 2019, the Business Roundtable, which is an association of chief executive officers of America's leading companies, announced "the release of a new Statement on the Purpose of a Corporation signed by 181 CEOs who commit to lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and

shareholders." Those CEOs included the leaders of many of the world's largest corporations, including Amazon, Apple, BP, Coca-Cola, Dow, Dell, DuPont, Deloitte, EY, Ford, General Motors, Google, Goldman Sachs, IBM, HP, Intel, Johnson & Johnson, KPMG, McKinsey, Mastercard, Microsoft, Moody's, Morgan Stanley, Nasdaq, Pepsi, Pfizer, Phillips, PwC, Oracle, SAP, Proctor & Gamble, Salesforce, Siemens, 3M, Walmart, Xerox and many others.

In announcing the change, the Business Roundtable makes the end of shareholder primacy crystal clear, saying: "Each version of the document issued since 1997 has endorsed principles of shareholder primacy – that corporations exist principally to serve shareholders. With today's announcement, the new Statement supersedes previous statements and outlines a modern standard for corporate responsibility." The statement itself goes on to say that "we share a fundamental commitment to all of our stakeholders" including delivering value to customers, investing in employees, dealing fairly and ethically with suppliers, supporting communities and generating long-term value for shareholders.

Finally, in January 2020, the World Economic Forum (WEF) went on to issue its Davos Manifesto 2020, subtitled "The Universal Purpose of a Company in the Fourth Industrial Revolution". The Manifesto repeated the same message as the Business Roundtable Statement, beginning with the statement that, "The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities and society at large." In September of the same year, WEF issued a set of Stakeholder Capitalism Metrics, collaboratively developed and supported by 120 of the world's largest companies.

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[i] Keynes, J.M. (1936). *The general theory of employment, interest and money*. London: Macmillan.

[ii] Freeman, R.E. (1984). *Strategic management: a stakeholder approach*. Boston: Pitman.

[iii] Mitchell, R.K., Agle, B.R. & Wood, D.J. (1997). Toward a theory of stakeholder identification and salience: Defining the principle of who and what really counts. *The Academy of Management Review,* 22(4), 853–886.

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