

# **Are Corporates Renouncing Shareholder Capitalism and Moving Towards Stakeholder Capitalism?**

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## **Abstract**

For more than four decades, corporates were operating using the principle of “Maximizing Shareholder Value”. With this principle, their focus was on profits and share prices, regardless of the consequences to other stakeholders like community, customers, labor force, suppliers and others. The free-market ideology of “Shareholder Primacy” was a key driver in Indian markets. In this paper, the researchers explore if Indian corporates are replacing “Shareholder Capitalism” with “Stakeholder Capitalism” and are striking the balance between stakeholders in allocating the profits and capital of an organization towards the society. The researchers revisit the time-tested popular narratives of capitalism and the predominant stakeholder in these narratives. In order to promote responsible and sustainable businesses for current and future generations, the researchers believe that the fine balance among stakeholders is the true constant and this balance can be achieved through communication and the principle of stakeholder communication can be meaningful principle of stakeholder capitalism. The researchers through a systematic review of literature and elucidation of major narratives, map the stakeholders of Indian corporates using annual reports and to confirm the resurgence of Stakeholder Capitalism.

## **Keywords**

Stakeholder Capitalism, Stakeholder, Capitalism, Communication and Value creation

## **1. Introduction**

The meaning of the term stakeholder differs on its usage context. It can be considered as an equivalent to a citizen, anyone contributing to the public welfare. In a limited sense it points to someone who participates in something. In business context, it usually refers to a person or groups of people having a direct or indirect effect on an ongoing concern and individuals who act in consulting capacity or directly in decision-making capacity as part of management of the organization. According to Rhenman (1964) and Priya et al., (2019), a stakeholder is engaged in a reciprocal symbiotic relationship with an organization, where the stakeholders rely on the organization to achieve their goals and the organization relies on the stakeholder to ensure its sustainability. Freeman and Reed (1983) posited that stakeholders' opinions and interests in the business activities of an organization are legitimate and must be acknowledged.

It was at Stanford Research Institute, now SRI International, where the term 'Stakeholder' was introduced and was used to represent “individuals which can affect or be affected as a result of organization attaining their objectives” (Freeman, 1984. Prasad et.al, 2019, Ram and Arun 2019). Conversely, individuals who cannot influence or be affected by an organization are not considered stakeholders. In some cases, an organization can affect individuals, but these individuals have no influence on the organization, they are also considered as stakeholders. Academicians at Wharton such as Ackoff, Trist, Emshoff, Mitroff and Mason, and Perlmutter opined on how business could be interpreted in

the context of stakeholders. Shareholders, employees, customers, suppliers, lenders, and society were considered as stakeholders and balancing the influence of these stakeholders to satisfy the goals of an organization forms the crux of stakeholder theory. Originally, stakeholder theory was directed towards value creation and business (Freeman, 1984). Understanding the relationships between these stakeholders and ranking them on the basis of their influence on an organization forms the broader explanation of stakeholder theory. Although the emphasis on stakeholders was more prominent in private sector and organization with a substantial impact on the environment, it is now an integral part of business.

The term 'Capitalism' describes a set of economic systems that rely on private ownership of the means of production and the ensuing sales of goods for profit (Freeman, 2007). Free competition and industrialization are the key characteristics of capitalist systems, leading to accumulation of resources that in turn leads to increased production and sales. 'Capital' is the term used to describe these resources.

Thomas Hobbes (1588–1679), the first great capitalist philosopher put the individual at the center of political theory at a time when there was no effective government. He stated that in the absence of a robust government “the wickedness of bad men also compels good men to have recourse, for their own protection, to the virtues of war, which are violence and fraud”. As a result, everyone wages a battle with everyone else even for a miniscule advantage and Hobbes labeled this as “state of nature”. Adam Smith (Adam Smith, *The Wealth of Nations*) contended that the factors involved in the origin of capitalism revolved around economic prosperity of society at large and also translates to modernization of civilization.

Stakeholder Capitalism, a neologism coined by Edward Freeman is a version of capitalism based on free will and guided by practical experience and observation rather than theory or thoughts. He posits that capitalism is not always about profits, self-interest, competition, and free markets, but also on freedom, rights, value and communication of virtues. The primary focus is on interrelationships between stakeholders working together to achieve a common goal, creating value in a manner that one's right does not outclass another's. Cooperation between stakeholders is voluntary and are established with formal written contracts or informal contracts based on trust and understanding. When these obligations and responsibilities are upheld, the cycle continues and thus sustainable relations are formed. Although stakeholders intend only their own gain, an invisible hand as postulated by Adam Smith promotes a beneficial outcome which was no part of his intention.

Although Capitalism and Markets systems have led to Industrial revolution, an argument could be made that class divide between the rich and poor was an unintended consequence relevant to this day. Moreover, the long-term effects on environment, developing of society as a whole has suffered as a result of inequity. Freeman identifies five narratives of capitalism which prevailed in the world for a reasonable amount of time due to economic conditions in its time.

### **1.1 Labor capitalism**

Karl Marx (1867) was the earliest proponent of class relations that that eventually gave way to a capitalist economy. Marx essentially reproduces Smith's theory in *The German Ideology*, *The Poverty of Philosophy* and *The Communist Manifesto*, in which division of labor leads to development of productive forces driven and market formation. Marx has emphasized that society is basically divided into capitalist and labor classes and the premise of capitalism is labor and capital, are at crossroads due to fixed resources of productive assets. The opposing nature of capitalist and the laborer leads to a permanently anxious labor class and eventually labor class is entitled to take over the capital resources by aggression. Although Capitalists sector is not larger than the labor sector, it is the dominant actor. Figure 1 illustrates the stakeholders' relations in Labor capitalism.

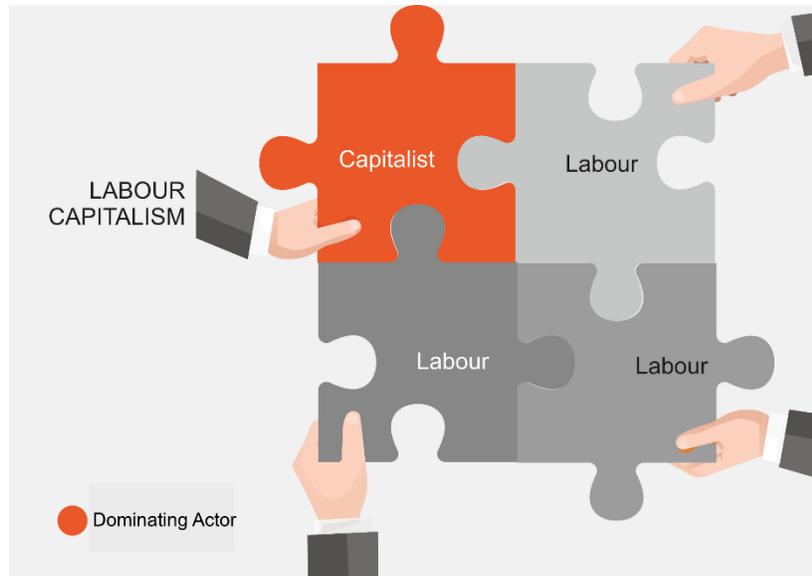


Figure 1: Stakeholders in Labour Capitalism (Pillai, 2020)

### 1.2 Government capitalism

Keynes (1971) hypothesized that building a better society was beyond the reach of individuals. He emphasized that government with its powers would be able to bring about the necessary changes and therefore government is the most powerful stakeholder superseding all other stakeholders and the ensuing capitalism to be managed by the government. Welfare state is a variation of government capitalism. Figure 2 illustrates that government is the dominant stakeholder and engages with consumers, investors and labor forces, a characteristic feature of government capitalism.

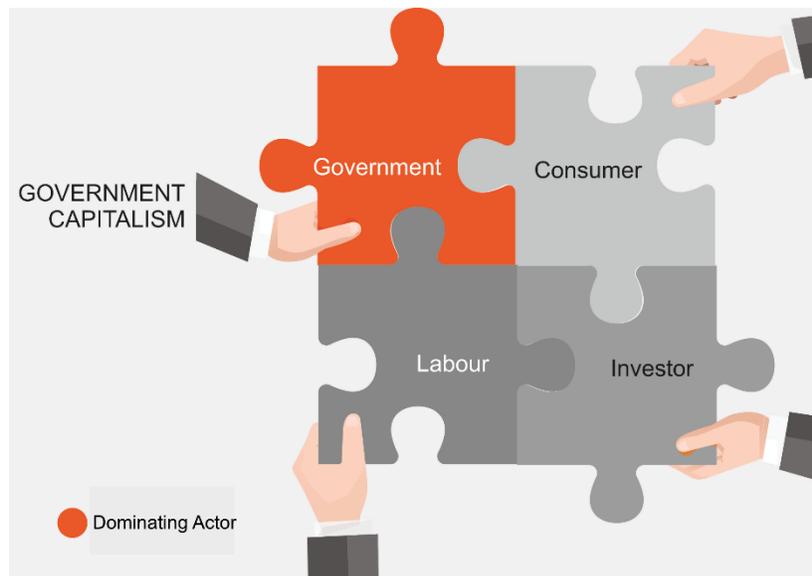


Figure 1: Stakeholders in Government Capitalism (Pillai, 2020)

### 1.3 Investor capitalism

Milton Friedman (1962) and Vinay and Babu (2018) advocated economic freedom for shareholders along with a limited role of government and that increasing investor wealth or value is the function of capitalist system. According

to Friedman, as illustrated in Figure 3, shareholders who are better off have higher investing power and bring about better outcomes of all stakeholders involved. He also argues that social responsibility is an obstacle to the investor's concerns by limiting the ability to create wealth. Welfare of customers, community, or charity is seen as antagonistic to the primary goal of increasing shareholder value.

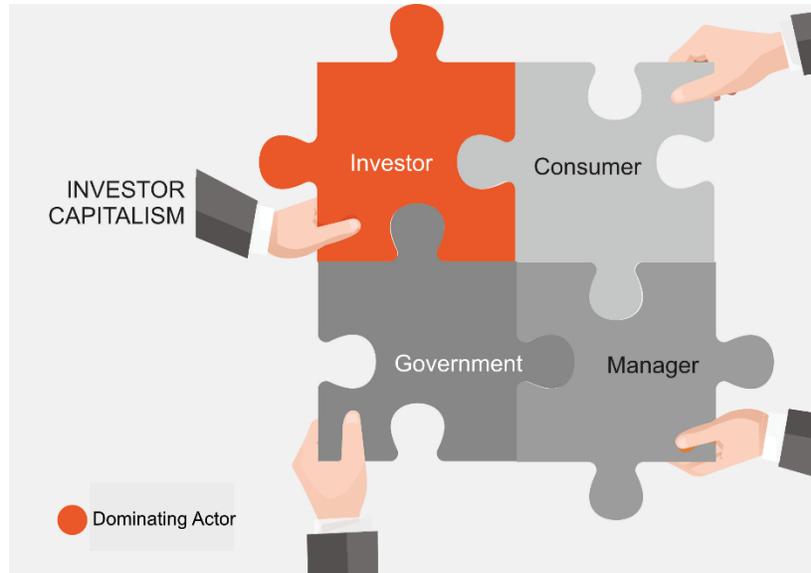


Figure 3: Stakeholders in Investor Capitalism (Pillai, 2020)

#### 1.4 Managerial capitalism

Ballantine, Berle and Means (1932) posited that traditional economic theory does not completely consider ownership and managers of the organization as stakeholders. They argue that responsibility and control to be in the hands of the management rather than investor (or stockholder) to ensure a neutral organization, making them the dominant stakeholder. Figure 4 illustrates the stakeholders' relations in Managerial Capitalism.

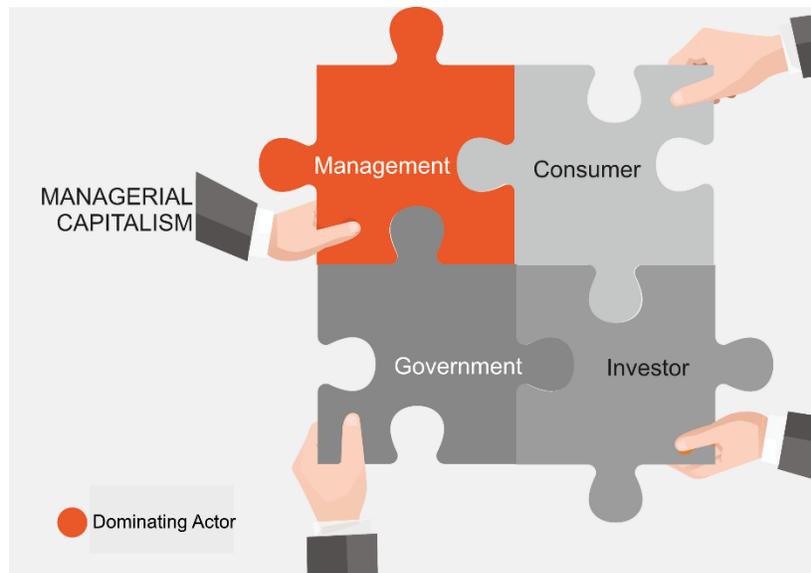


Figure 4: Stakeholders in Managerial Capitalism (Pillai, 2020)

## **Entrepreneurial capitalism**

Within the capitalist system, entrepreneur is the key player (Schumpeter (1942), Kirzner (1979), and Baumol (1990) Anjana et al., (2018). They posit that an entrepreneur disrupts the existing market to create a newer one and the interests of entrepreneur take precedence over the interests of other stakeholders. Figure 5 illustrates the stakeholders' relations in Entrepreneurial Capitalism.

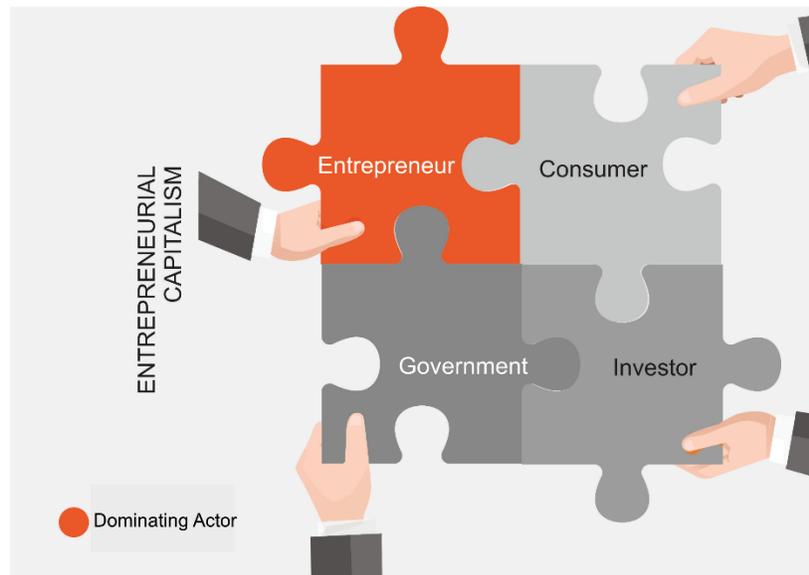


Figure 5: Stakeholders in Entrepreneurial Capitalism (Pillai, 2020)

## **2. Discussion**

Freeman posits that the assumptions about markets are similar in all of the five narratives. Self-interest that is unrelated to other market participants or unheeded, dissociation of morality from prosperity and zero-sum game of resources are the three assumptions which results in four problems with these models of capitalism.

Fostering competition, a prerequisite to capitalism, when other individuals are seen as a threat instead of partnering with them for value creation, resulting in the problem of competition. Capitalists, particularly in entrepreneurial ventures resolve competitor demands and threats and encourage collaborating relationships in order to create sustainable organizations. Value-creation as an outcome is seen, when mutually beneficial trade occurs rather than with dominance. Separating capitalism from ethics by developing another set of norms, rules, and morals for business and not integrating moral aspects, like agreements, trust, honesty, which are essential for a sustainable organization is described as Separation Fallacy by Freeman (1994). The ensuing complications are labeled as the problems of business ethics. Each group, either labor, government, investors, or managers assumes that their rights overshadows the rights of others and the rest of the organization should cater to the needs of the major group, that will eventually result into conflicts. This is labeled as the problem of the dominating actor. Keeping long term aspects of business, competition, ethics, and dominating actors depend on government to resolve these problems through mandates on business, organizations, and individuals. A paradoxical situation in liberal democracy arises when the government resort to redistributing resources, it ends up with the problem of a dominating actor and a vicious cycle ensues.

Freeman proposes that Stakeholder Capitalism can resolve these problems through the principles of Stakeholder Cooperation, Stakeholder Engagement, Stakeholder Responsibility, Complexity, Continuous Creation and Emergent Competition. Stakeholder Cooperation helps in creating value, exchanged, sold, and sustainable since stakeholders love to mutually their conflicts and also achieve their objectives by through agreements. By meeting the needs of multiple stakeholders, the business succeeds through stakeholder engagement. Stakeholder Responsibility relies on

the stakeholders honoring their clauses of their agreements and accepting responsibility for their their actions. Value creation is possible because humans are capable of imbibing different values and at different points and not naïve. This principle of complexity enables the trading and sustaining the value created. Business should promote cooperation with stakeholders and encourage creation of new sources of value through morality, agreements, trust, honesty, and care, which augurs a sustainable organization through continuous creation. By accepting that in every interaction a win-win solution is not available, participating stakeholders should strive to seek the win-win solution, a situation of emergent competition occurs.

### **3. Conclusion**

Following the Great Recession in 2008, a renewed interest in stakeholder capitalism was inevitable. Although socialism shaped the principal economic and social structure of India for nearly four decades after gaining independence, India moved towards a more market-based economy towards the end of twentieth century. Changes in organization staffing policies, creation of a lean workforce, spurt in entrepreneurial ventures are some of the factors causing realignment of stakeholders' segments. Changes in consumption behavior, advances in technology has forced industrial sector to introspect who are their stakeholders. Freeman concedes that the six principles may not always be successful, as exceptions to the rules that there will always exist a small group which will pursue only their self-interest even at their expense. Growing exposure of frauds have revived the interest and need of stakeholder capitalism, especially creation of new sources of value through morals, relationships, teams, trust, honesty, and care which are essential for a sustainable organization. We offer the inclusion of seventh principle through Stakeholder Capitalism "The principle of stakeholder communication". It draws attention to consistent and periodic disclosure of the current state of meeting the needs of multiple stakeholders such as customers, suppliers, communities, employees, and financiers. Transparency and communicating regularly to stakeholders can make the difference and offer the necessary checks and balances required to exercise prudent choices. We believe that we can do a better job in the course of making use of capital and ensuring stakeholder balance using the principle of stakeholder communication along with the other six principles.

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