Business Ethics

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Lecture - 07
Stakeholder Theory of the Firm

Welcome back. So, now, we will be discussing the stakeholder theory of the firm. In a earlier discussions we discussed about corporate social responsibility, corporate social responsiveness and corporate social performance and we discussed like, all this things are first we need to consider beyond this things of course, these responsibilities, responsiveness or performances are for whom and whenever we are talking of for whom there comes the relevant of stakeholder theory of the firm.

So, if you recollect like in today's discussion we started with the share holders responsibility or limited responsibility towards the firm and when you are talking of corporation we talked of like corporation as a legitimate entity, we talked of the artificial existence of the organization and we talked of like the share holders, the responsibility of the fiduciary responsibility of the managers and the directors of the firm towards the share holders money. And when we introduce the concept of corporate model responsibility and social responsibility we discussed about the shifting of the perspective from the share holder orientation to the stakeholder orientation.

So, before we move on to the discussion of the stake holder theory of the firm in details we have to understand whom do we define as, who are the stakeholders of the particular firm.

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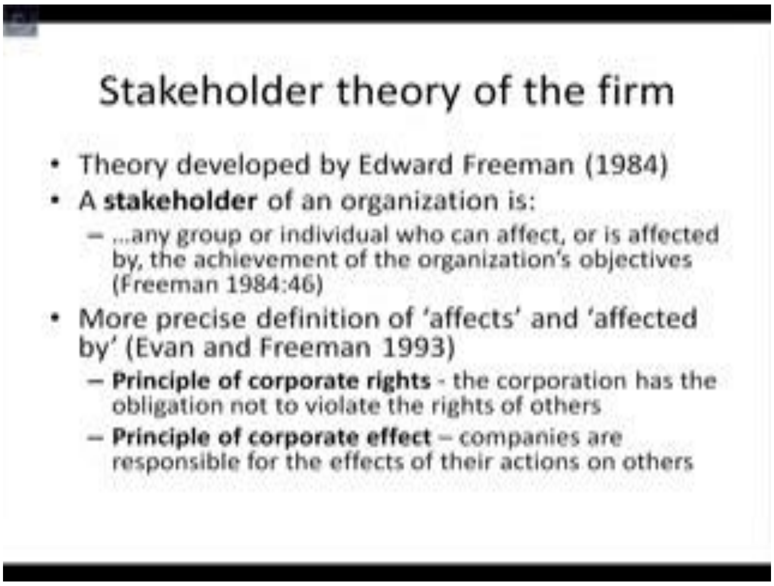

So, this is the theory of the firm which is developed by Edward Freeman and the definition of a stakeholder of a organization is any group or individual who can affect or is affected by the achievement of the organizations objectives. So, we can see it is two way relationship. So, whenever we recognize a body a party as a stakeholder that can where individual or a group. So, the stakeholders can affect or get affected by the achievements of the organization objectives.

So, organization in order to reach it objectives, it may affect the stake holders or we may get affected by the stake holders. So, it is in both way. More precisely to define this who gets affected and how they gets affected is the definition can be looked into two things which is called the principle of corporate rights. So, the corporation has the obligation not to violate the right of others and the principle of corporate effect that companies are responsible for the effects of their actions on others. So, if you notice this two definitions very carefully it talks of like we cannot the corporation cannot violet certain rights which others injure for the sake of reaching its own objectives. So, this is principle of corporate rights. So, corporation has the obligation not to violate the rights of others.

Second is companies are responsible for the affects of their actions on others. So, whenever certain consequences are there then based on the services or the products the deliverables which the objectives that is organization as set for itself when it gives rise to certain consequences either the things that you produce or deliver or the way that you do the things if it needs to any consequences then the corporates are responsible for it. Based on these the two points of emphasis where we are talking of the stakeholders are getting affected by or it can affect also the performance of organization we can extend or elaborate the definition of stake holders by incorporating it, within it these definition of enjoying the rights or rights not getting violated by the corporation and we can define it in a broader way by stating that.

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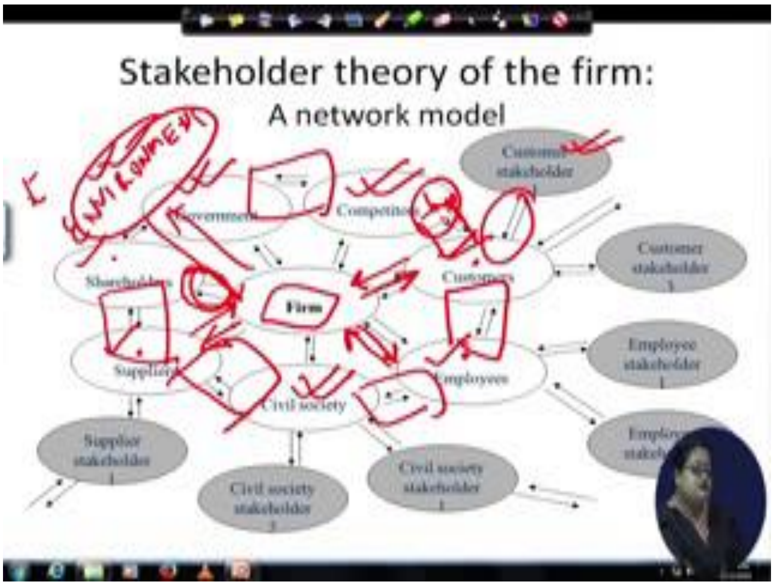

Stakeholders are individuals or groups who is I gets either harmed or benefited by the firm stakeholders are individuals who either gets benefited or harmed by the firm or whose rights can be violated or respected by the corporation. To repeat stakeholder is a group of individual or stakeholder is a individual or group who is either harmed by or who gets benefited from the corporation and whose rights can be violated or be respected by the corporation.

So, by in these definition we incorporate this concept of rights being enjoyed or violated and they are called stakeholders getting affected by or affected by the organizations and its deliverables and how you does it things to, how it process that is followed in its business. Next question comes after we have defined who is a stakeholder, next question comes whom do we recognize as our stakeholders. In this again we have different views of recognizing whom do we consider as our stakeholders. Let us focus into this model. In this if we are looking into the traditional way which we call to be the tradition model of doing a business, the two way arrow as shown is existing only between the firm and the share holders.

In the traditional model the other important contributors to the business like the suppliers, the employees and the customers, they have only one way arrow with the other one way relationship with the organization. Means if you are concentrating on the diagrams you can understand initially in the traditional model the four important actors who have been given prominence as important contributors to the firm are share holders, suppliers, customers and employees.

Out of this four entities who are connected with business and helping the business to reach it objectives, the firm has recognized through its fiduciary responsibility for the share holders money and only there is a only with the share holders there is a two way relationship, but with the suppliers the employees, the customers this is taken to be one way relationship only where they are only suppliers are providing goods to the firm, raw materials to the firm, employees are providing their services to the organization, customers are buy the product from the organization of the services from the organization.

But the firms responsibility back to the customers employees or the suppliers have not been recognized in the traditional model of doing a business where we talk of this model as the share holder orientation of doing a business.

Second with the emergence or the stakeholder theory of the firm which is the second generation model there we find like this both way relationship has been established not only with the share holders, but also with suppliers, employees and customers. Recognizing that suppliers have important stake in the firm’s business because they contributing positively by giving in course materials etcetera and it compared with the share holders the other three do not have a, like share holders invest based on the prices of share and the game that will be getting out of the dividends and other things. But suppliers and employees and customers do not have such a mental set when they are giving their services or buying from the organizational, giving their raw material supply, their raw materials.

So, as compared two share holders may be they have long perspective in mind as compared to share holders who are investing based on different judgments which are self enhancing for the share holders themselves in terms of the; they comparing the share prices and the relative gains that they will be getting. So, it becomes legitimate to say that suppliers, employee and customers do have a legitimate stake in the firm because they are contributing positively towards the performance of the firm and it is not only the share holders. So, the initial stake holder theory of the firm realized this two way relationship with the suppliers, employees and the customers.

Next when this and these are taken to be the primary stakeholders. Share holders suppliers, employees and customers are taken to be the primary stakeholders of the organization because the organization can visualize a direct connect between what they are contributing to the firm's performance and objectives. But also there are certain stakeholders like government the other competitors the civil society at large who the firm may not visualize interpret to be contributing directly to the firms objective are performance, but they do definitely have and influential effect on how the firm is performing in terms of facilitating or enduring the performance of the organization. So, these are also realized government, competitors, civil society, we can also had here environment, may have an effect on how the organization is performing in terms of either facilitating it or the enduring it. So, this also have been recognized has stake holders.

So, this is an extend model of the stakeholders where you are trying to cover all the entities that were directly or indirectly connected it a business and either be affect or get affected by the way that you are doing in your business. In this particular network model that we are discussing over here what we find, what is written in gray color over here, in the network model we recognize the stakeholders of the direct stakeholders who are connected to us as also our stakeholders first. So, you see like the customers stakeholders are also getting recognized as the stakeholder of this particular firm, number 1, and we understand the interconnectivity between the different stakeholders.

So, here what you find the competitors and governments are getting connected the suppliers and the shareholders are getting connected, suppliers and civil society are getting connected, civil society employees are getting connected, employees and customers are getting connected.

So, this is a network or your competitors and customers are very important to your customers and competitors are getting connected and that is how this wave is becoming more complex day by day. So, it is not only your immediate direct stakeholders, but some indirect stakeholders are, so where you see competitors also are your stakeholders is very important because you recognize their contributions in influencing your business or you see how you can influence their business, the government, the civil society, the society at large and the environment and you see like the interconnectivity between these stakeholders and also the stakeholders to that stakeholder is also part of your it becomes the part of your stakeholder. And this defines the extended responsibility of the firm to not only your direct stakeholders, but to the stakeholder of the stakeholder and it also gives an idea to the firm like.

So, this chain talks of your extended responsibility not only to the immediate stakeholder, but the stakeholder of the stakeholder also and it also this network gives an idea to the firm about if my business is affecting one of the stake holders, if my business is affecting one of the stake holders in certain way because any one of the stake holders in certain way because all the stakeholders are connected to each other it may send repulse across and that may have a major impact on how I do my business.

So, this impact can be both positive if I am acting, if I am doing my business in a socially responsible way. So, this impact this repulse will be a positive repulse which will spread across the stakeholders and develop positive reputation for the organization, but if I am doing my business in a social irresponsible way and if that irresponsiveness is towards any of the stakeholders it may send repulse all across and may have a detrimental effect for the business at large. And this network model helps us to understand the complexity of the relationship and it spreads over of a caution of we how in what way we should be responsive towards the expectations of the stakeholders and how to take care of those expectations.

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So, next what we move on to like how the stakeholder theory is getting practiced in international context. So, we see like when you talking of German supervisory board it already includes employee representatives of the Keiretsu system in Japan where we talking of network of banks manufactures suppliers and service providers. So, this is recognized about the network relationship present for the stakeholders and how this can be, relationship can be maintained properly with all the stakeholders is discussed in this type of system.

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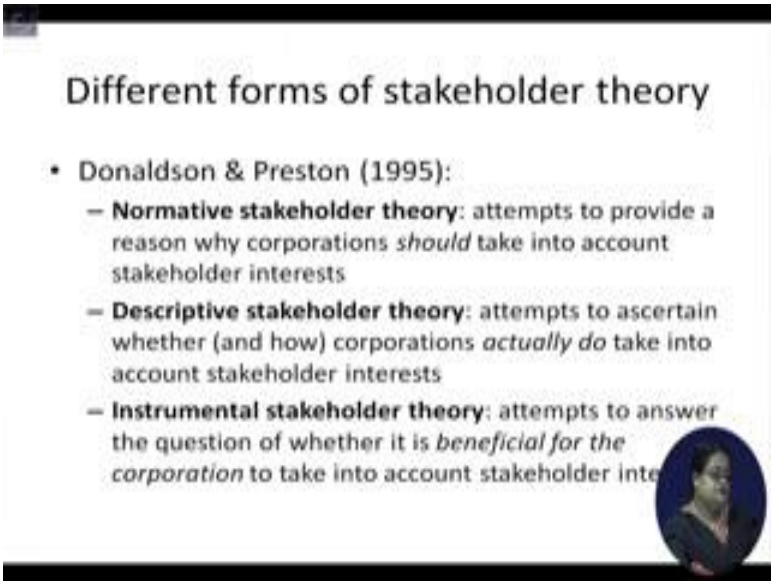

We have like different forms of stakeholder theory and these forms of stakeholder theory can be classified under three different headings when, so this three forms are normative stakeholder theory, descriptive stakeholder theory and instrumental stakeholder theory. Normative stakeholder theory tries to discuss why a corporate should take care of the stake holders or why it should take into account their views of the different stakeholders. This why part, normative part, we have answered just now in the previous slide where we are focusing on the network model of the stakeholders and we came to understand that if we are because the stakeholders, all the stakeholders are related to each other, all the different stakeholders are related to each other and the stakeholder is of stakeholder are also remotely connected to us the firm and then we have a mutual responsibility and a holistic responsibility to all the stakeholders and we have extended responsibility of the stakeholders of the stakeholders also.

So, if we are doing something positive for the stakeholders any of the stakeholders then it helps in creating positive impact, a positive result throughout and that helps in the enlighten self of like self interest of the organization positive and why we should not doing any harm again is, if we are doing any harm to one of the stakeholders it has a multiplicative effects on the all the other stakeholders and what we may see like is I have done this much of harm to may be to one is actually not that is small harm, but it is a multiplicative affect which is spread across all the different stake holders and the damage could be a major damage both from the moral perspective and from the business interest perspective also.

So, when you are talking of normative holder theory we have focusing on the why the stakeholders should be taken care of from a moral perspective and we want to focus on this thing like because the all the stakeholders are contributing in a positive way towards the performance of the firm. Obviously, they have developed a certain stake on the organization, expectations from the organizations and it is a part of moral irresponsibility of organizations and to see that they are not violating any of their rights and or not harming them and otherwise providing benefits to them or respective their rights of the stakeholders who are contributing positively either directly or remotely to the performance and growth of the organization that is the normative stakeholder theory. Where we talk of descriptive stakeholder theory it talks of attempts to ascertain whether and how actually they take it into account stakeholder interests.

So, what you find is a difference between of normative theory and descriptive theory; Normative theory talks of the ideal condition which talks of corporate, and why corporate should take into the account the stakeholders interest. When it comes to the practice of taking take care of the interests of the stakeholders the organization may need to device certain mechanisms how to take care of the; how to take care of the needs of the stakeholders. It may so happen there are 2 3 4 5 different stakeholders expressing their demand to be satisfied expectations at the same point of time to the organization, but the organization do not have the resources to answer to all the demands of all the stakeholders at a same point of point.

So, it may be so required that the there are a prioritization of the stakeholders and the prioritization of the demands of a specific stakeholder may required to be done. So, that the firm can (Refer Time: 31:10) on some of their stakeholders whose needs a met and some needs of the stake holders are met; however, that they want to prioritize it. So, when you are discussing it about the descriptive stakeholder theory here we are focusing on whether and how corporations actually to take into account the stakeholder interest and here of course, one important point is that of prioritization and in the subsequent models we will try to discuss about this how this prioritization of stakeholders interest are done by the organization.

Third stakeholder theory that we are focusing on is the instrumental stakeholder theory and here we will try to focus on the question whether it is beneficial for the corporation to take into account the stakeholders interest. So, here what will be focusing on is the benefits, mutual benefits that is derived and when you are talked of enlightened self interest of the business when you introduce the concept of corporate social responsibility. So, that is the benefit that the organization derives from taking care of the stake holders and the needs of the stake holders and this is called the instrumental stake holder theory.

In the subsequent discussions we will be like when we talk of employees and ethics and consumers and ethics, suppliers and ethics, environment and ethics, these are specific stakeholders and how they are specific needs are taking care of by the organizations will be discussed in details in the subsequent discussions. And how it will comes beneficial for the organization for their stakeholders also and how actually this needs an taken care of, what are the specific guiding theories which helps to with respect to each of the stakeholders which helps the organization to answer to these stakeholders stake and interest in a proper way will be discussed in the subsequent modules.

Next we will move on to the accountability of the organization when we talk of corporate accountability and the firm as a political actor.

Thank you.