

## Stakeholder management and CSR: questions and answers

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Published online: 19 January 2013  
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**Alexander Moutchnik (AM):** Dear Mr. Freeman, at the 5th International Conference on Corporate Social Responsibility—The Future of CSR—organized by Professor Joachim Schwalbach that has taken place in October 2012 in Berlin<sup>1</sup> you have talked about “The role of CSR in the New Narrative of Business”. Do you think that we are now witnessing the watershed between the “old” and the “new” fundamentals of business?

<sup>1</sup> <http://www.csr-hu-berlin.org/>.

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**Edward Freeman (EF):** Yes. There is no doubt that the story of business needs to change. The changes have been going on for over 30 years, as technology has driven globalization, a much different operating environment for business, and a publicness to everything that a business does. The old story of business as just about profits and the money and shareholders, just doesn’t work anymore, if it ever did. The Global Financial Crisis of 2008 brought this point home, but the changes have been going on for some time.

The new narrative says that successful businesses are about more than money. They are driven by purpose. They create value for customers, suppliers, employees, communities, as well as the people with the money, financiers. It says that capitalism is a system of social cooperation, that it is how we create value for each other and trade. And, it says that people are complex creatures, not the simple self-interested maximizers of the old story.

**AM:** In your seminal book “Stakeholder Theory: The State of the Art”<sup>2</sup> you summarize your first landmark book on the topic “Strategic Management: A Stakeholder Approach”<sup>3</sup> in the following logical schemata: “(1) No matter what you stand for, no matter what your ultimate purpose may be, you must take into account the effects of your actions on others, as well as their potential effects on you. (2) Doing so means that you have to understand stakeholder behaviors, values and backgrounds or contexts, including the societal context. To be successful over time it will be better to have a clear answer to the question, “what do we stand for?” (3) There are a few well-defined ways to think about stakeholder management,

<sup>2</sup> Freeman et al. 2010: Stakeholder Theory. The State of the Art, Cambridge Univ. Press, Cambridge.

<sup>3</sup> Freeman 1984: Strategic Management: A Stakeholder Approach. Boston: Pitman.

or focal points, that can serve as answers to the question, “what do we stand for?” or enterprise strategy. (4) We need to understand how stakeholders relationships work at three levels of analysis: the rational, or “organization as a whole”; the process, or standard operating procedures; and the transactional, or day-to-day bargaining. (5) We can apply these ideas to think through new structures, processes, and business functions, and we can especially rethink how the strategic planning process works to take stakeholders into account. (6) Stakeholder interests need to be balanced over time”.<sup>4</sup> Thereupon you write, that “the idea of ‘corporate social responsibility’ is probably superfluous. Since stakeholders are defined widely and their concerns are integrated into the business processes, there is simply no need for a separate CSR-Approach”.<sup>5</sup> How can you explain the uselessness of a separate CSR-Approach?

**EF:** CSR is built on false conceptual distinctions such as (1) facts and values; (2) business and ethics; (3) social and economic; (4) business and social; and others. It is almost an apology for business being about the money and self interest, so that some “social” compensation is necessary. If you change the underlying narrative of business to see it as “creating value for all stakeholders”, then CSR just isn’t necessary. This is a subtle but important point: As long as we continue to talk about CSR as separate from “the business” then we are implicitly approving of the old narrative of business.

Another way to say this is that CSR needs to be built into the business it shouldn’t be seen as something separate from the business model. The intuitions behind CSR are good. People who advocate CSR intend that ethical and social concerns are as important as profits. And they are correct. It’s just that these concerns should not be separate from the business model.

**AM:** In your book “Stakeholder Theory: The State of the Art” you quote Professor John Kay as saying that “stakeholders are about the business, and business is about the stakeholders”.<sup>6</sup> Why is this aphoristic statement so important to you, and what role does the concept of “values” play in the relationship between stakeholders and business and respectively between business and stakeholders as well?

**EF:** Every business has always created value and sometimes destroyed value for its stakeholders. How could it do

anything else? There have always been customers and suppliers and employees and communities and people with the money. More recently we’ve begun to be conscious of the effects of business on the stakeholders and so we’ve had the development of what I call stakeholder theory. There is an idea that stakeholder theory is about CSR or civil society or the nontraditional business stakeholders. Many times people have begun to talk to me about stakeholder theory and I realize that they don’t see customers or employees or suppliers as primary stakeholders. They are more interested in NGOs or government or interest groups or critics. I see this as leaving out the very core of the value creation process. It’s not that NGOs or government or interest groups are not important because they influence the value creation process. But thinking about business without thinking about customers, suppliers, employees, communities, and financiers, well, it just isn’t business. So John Kay’s aphorism “stakeholders are about the business and business is about the stakeholders” is a nice way of remembering that stakeholder theory is a theory about how to run a great business and that business is really about how you create value for stakeholders.

Another way to say this is that stakeholder theory changes the unit of analysis of business. Business isn’t just about transactions. It’s about relationships with customers, suppliers, employees, communities, and financiers. And it is about how these relationships are dependent on each other. Stakeholder theory is about how we cooperate together to create value and trade with each other. It’s a new story about business.

**AM:** What is the contribution of Hilary Putnam with his “Fact-Value Dichotomy”<sup>7</sup> to the stakeholder approach?

**EF:** Hilary Putnam is a pragmatist philosopher in a long line of pragmatists from Charles Pierce, William James, John Dewey and Richard Rorty. His book *The Collapse of the Fact-Value Dichotomy* shows how facts and values are entangled with each other.<sup>8</sup> Much of management theory makes a sharp distinction between facts and values and pretends that facts have nothing to do with values. For instance a simple example is the use of the word cruel. When I call someone cruel I’ve done something that’s factual if in fact that person has undertaken cruel acts. When I call someone cruel I’ve also made a value judgment about their character. Cruelty is not a good thing. Putnam’s book should be required reading for everyone who teaches in a business school.

<sup>4</sup> Freeman et al. 2010: 60.

<sup>5</sup> Freeman et al. 2010: 60.

<sup>6</sup> Freeman et al. 2010: 60.

<sup>7</sup> Putnam und Walsh 2012: The end of value-free economics, Abingdon, Oxon; New York: Routledge.

<sup>8</sup> Putnam 2012: The Collapse of the Fact-Value Dichotomy and Other Essays, Cambridge, Mass.: Harvard Univ. Press.

**AM: What exactly do you mean when you speak about the emerging of a “New Story”, which will introduce the “New Normal” way of doing business?**

**EF:** The new story goes something like this:

Firstly, business is primarily about purpose... money and profits follow. Secondly, any business creates (or sometimes destroys) value for shareholders, as well as customers, employees, suppliers and communities. Building and leading a business involves getting these interests going in the same direction. Thirdly, capitalism works because we are complex creatures with many needs and wants, and we can cooperate to create value for each other. Sometimes we act for selfish reasons and sometimes for “other-regarding” interests. Incentives are important, but so are values. Fourthly, most people tell the truth and keep their promises, and act responsibly most of the time. And, we need to expect that behavior. Fifthly, business and capitalism are the greatest systems of social cooperation and value creation ever created. Competition is important in a free society, since it ensures options. But, the engine of capitalism is value creation.

**AM: In order to make the use of the term “CSR” as “Corporate Social Responsibility” more precise and correct, you propose together with S. Ramakrishna Velamuri and Brian Moriarty<sup>9</sup> to remove the letter “S” from the acronym as any responsibility of business, by definition, has a societal orientation. Moreover, you point out that the letter “C” meaning “Corporate” refers only to large business units and not to small or medium-sized businesses, public organizations and institutions of any kind and affiliation. Hence you propose to replace “Corporate Responsibility” with “Company Responsibility”. In order to preserve the well-established acronym CSR, you finally introduce its new interpretation in the meaning of “Company’s Stakeholder Responsibility”. Why is the discussion about different meanings of the “CSR”-semantics so important? And what is the consequence of the prevailing lack of a general consensus between practitioners and academics in this field?**

**EF:** Semantics is important. Semantics is about meaning. To say we have a semantic problem is to say we don’t know what we’re talking about. Stakeholder responsibility and social responsibility refer to different things. They referred to different ideas about business. So it’s very important to be clear about what CSR really stands for. We’ve made a proposal that CSR should stand for company stakeholder

responsibility to signify that responsibility for stakeholders is something every company has, not just large corporations. And we want to signify that the stakeholder approach to understanding business is what should be the core idea here.

**AM: In a very small number of sustainability reports—if any—there is an analysis of “economic” and “social” aspects of certain “environmental” measures or of “environmental” consequences of certain “economic” or “social” decisions. Do you think that despite the vast experience on sustainable corporate management and sustainability reporting, there is still a big lack of knowledge of the proper interconnection between “economic”, “social” and “environmental” perspectives?**

**EF:** The economic and social distinction is a distinction that really is not very useful. If I hire you I have done something that has economic effects. If I hire you I’ve also done something that has social effects. And if I hire you it will also have an environmental footprint. If I sell you a product the same thing happens. If our transactions all have economic and social and environmental effects—which one is it? Into what bucket should I put which transactions? If every transaction is always economic and social and environmental then there’s no distinction worth making.

**AM: Do you see any obstacles in the way of the adoption of the “New Narrative” of business?**

**EF:** Often executives are their own worst enemies. They adopt the idea that the purpose of business is to make as much money as possible even when they know that if they act this way they won’t be very successful. The old story is deep in our culture. It will take a generation to get the new story adopted. But there are lots of signs of progress. What we need to do is to pay more careful attention to real businesses and what they’re actually doing in creating value for stakeholders. We need not to get distracted by the latest set of principles for social responsibility or the latest cooperative multi government level agreement. Whatever those things are and whatever good they might do they often simply reaffirm the old story that business is morally questionable and always just about the money.

I think there are five real challenges to changing the underlying story, the narrative of business.

The first challenge, the stakeholder accounting challenge, is to think through what accounts would we look at if we were thinking about how to create value for stakeholders and not just value for investors. We need nothing less than an overhaul of our basic system of accounting. We need to think through what accounting for stakeholders would look

<sup>9</sup> Freeman et al. 2006: Company Stakeholder Responsibility: A New Approach to CSR, Business Roundtable Institute for Corporate Ethics, 2006, 6. <http://www.corporate-ethics.org/pdf/csr.pdf>.

like. And, there's a lot of work that's being done in this area by people and companies around the world.

The second challenge I call the total performance challenge. Do profits measure the total performance of the business? I don't think they do. Profits are important but oftentimes, mistakes in managing stakeholder relationships don't show up in profits until it's too late. Profits are based on accounting for investors in their measures that often leave out value that's created for other stakeholders. In addition profits don't adequately capture the interdependence of customers, suppliers, employees, communities and people with money. We need new ways to measure this interdependence.

The third challenge I call the behavioral stakeholder challenge. We need an understanding of how real stakeholders work. Too much of our business theory is based on the economic fiction of many buyers and sellers in markets where they are narrowly self-interested. We need to build on work in behavioral economics as well as psychology and other fields to get realistic ideas about how stakeholders actually behave.

The fourth challenge the public-policy challenge, asks what public policies are relevant if stakeholder theory captures the essence of how business really works. How can public policy encourage value creation for stakeholders? How can public policy encourage entrepreneurs to start new businesses that are both profitable and address some of the challenges of our society? Most current public policy starts from the old story and talks about how to constrain the greed of current businesses. That view is just inappropriate for the 21st-century.

The final challenge, the ethical theory challenge, is perhaps the most far-reaching. It challenges us to do no less than reinvent ethics. Human beings have been value creators and traders since the beginning of organized society. Business is understood as value creation and trade is as old as human society. Yet, if you examine almost any book on ethics and certainly any book on political philosophy you'll find not much attention paid to the idea of business. We need to put business into the core of our ideas about ethics. Ethics is about how we live together. It's about how we cooperate together so that all of us can flourish. Business needs to be a central part of this discipline. The first question of political philosophy has always been: how is the state justified? Perhaps we need to think about the first question as how is value creation and trade sustainable over time rather than how is the state justified. Then the question of the role of the state becomes: how does it help promote value creation and trade? Note that this only makes sense if our idea of business is an idea built on creating value for stakeholders.

**AM: What role does the dialogue with stakeholders in the “new narrative” of business play? What are the prerequisites and the challenges of the corporate culture, decision making, business intelligence and strategy-based dialogue principles?**

**EF:** The only way that businesses can be successful in creating value for stakeholders is to actually have engagement with all stakeholders. This engagement has to go beyond just talking. It has to go towards intermeshing of stakeholders in what the company does. There is much progress on this front. Supply chain management to put customers, suppliers and employees in the same room to design better supply chain practices is a good example. Some companies engaged communities and customers and employees in designing a company strategy for building better communities. And some companies are engaging customers and employees and suppliers in dialogue about product and business process design. One company I spoke with recently has even engaged stakeholders in designing the process by which they want to be engaged. This process is currently being co-created by the company and its stakeholders.

**AM: What is the influence of social media on the communication between companies and their stakeholders? Does social media ease such dialogues or is it the opposite—does it make them almost impossible, drawing the focus to numerous and mostly anonymous “friends”, “fans” and “followers” instead of common and rather well-known stakeholder groups?**

**EF:** My take on social media is that it's speeding up this process of stakeholder engagement. It allows for the participation of a much broader array of stakeholders. We need to understand that critics are the source of value creation. Behind every critic is usually a new business idea. Now every company can't take advantage of all of these ideas but seeing critics as sources of value creation is very different than seeing them as annoying insects to be swatted. The friction that comes from critics can be used in a positive way to create new products and services. Notice that this is only true if the companies built around the purpose. Critics are then saying you need to change to really live your purpose better.

I really think that we can be the generation that makes business better. To do this we have to adopt a new story about business that raises the bar for everyone. I think this is easy to do when you pay attention to how great businesses actually work. For the most part they're driven by purpose and profit follows. They create value for customers, suppliers, employees, community, and financiers. Yes, they sometimes make mistakes but for the most part they put business

and ethics together. It's time that we realize this and get on with the business of creating a new narrative about business.

**AM: Thank you very much for your answers.**

## Literature

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